2017 CPD Webinar Programme

Charities Update

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1 Introduction

1.1 The charity sector under pressure

The charity sector could be said to be under more pressure than ever before. Recent issues have included:

(a) Commercial agreements which are not necessarily in the best interests of beneficiaries,
(b) Alleged financial mismanagement;
(c) Undue pressure on vulnerable donors;
(d) Excessive remuneration for chief executives;
(e) The blurring of charitable objectives and political lobbying;
(f) Concerns about charities and terrorist financing;
(g) Changes in the relationship between the public and private sector;
(h) The financial climate!

There is more cynicism among donors, and increased scrutiny in the media, Parliament, and of course, from the Charity Commission.

In July 2016, Charity News reported that public trust and confidence had fallen from 6.7 in 2014 to 5.7 out of 10 for this year.

1.2 Issues concerning the Charity Commission

1.2.1 Introduction

A review of CC news and the CC website indicates that the are a number of core issues, where the CC has concerns about the extent to which trustees understand their responsibilities, and whether trustees are compliant.

The implications for the auditor or independent examiner of these issues may be

(a) direct, for example there may be a requirement for disclosure within the accounts, and where omission of such information would be a qualification issue, or
(b) indirect where there is an issue for disclosure in the trustees' report.

In all cases a good auditor or independent examiner will be concerned to see that trustees are alert to the guidance, and give assistance and advice, subject of course to ethical requirements.

1.2.2 Public benefit and charitable objectives

The requirement to act in accordance with the charity's objectives and in so doing provide public benefit continues to be at the forefront of the CC work. This is considered further in chapter 2 below.

Some of the other guidance referred to in CC News over the last 12 months goes back to the basic concept of complying with charitable activities and providing public benefit. For example:

(a) Funding non-charitable organisations;
(b) Fee-charging educational charities;
(c) Business rate relief.

1.2.3 Effective trustee management

Given the recent charity "scandals" concerning Big Kids etc., the Charity Commission issued a press release entitled "trustees must engage with finance guidance says charity regulator. Sarah Atkinson, Director of Policy and Communication, outlined three sets of updated guidance:

(a) Managing charity's finances: planning, managing difficulties and insolvency (CC12);
(b) Charity reserves: building resilience (CC19); and
(c) Charity governance, finance and resilience: 15 questions trustees should ask.

Appendix 1 is a Word version of the 15 questions which you can use as a checklist for clients. Note that some of these questions give the accountant / auditor an opportunity to provide advice and possibly additional services. Care should be taken that you do not breach the Ethical Standards for Auditors in providing such advice or services. If you want an electronic copy please e-mail telfordtraining@gmail.com

1.2.4 Counter-terrorism legislation.

The CC is alert to the nature of fund-raising and areas where charities operate that are susceptible to contact with exposure to terrorist activities, including terrorist finance. The whistle blowing duties are wider than general money laundering reporting as they extend to employees as well as trustees. Auditors and independent examiners should also be alert to this, given their own whistle-blowing responsibilities.

1.2.5 Fraud

CC News regularly features references to updated guidance for trustees in areas such as mandate fraud, cyber-fraud, running a fraud awareness week in October 2016 and launching a new website www.charitiesagainstfraud.org.uk

Auditors and independent examiners should consider cross referring their fraud risk assessment to this guidance in assessing trustees' attitude to fraud prevention.

1.2.6 Financial difficulties

CC News in October 2016 highlighted the need to take early steps to manage financial difficulties. This is an issue with potential direct impact on the accounts and should be considered as part of the going concern review. CC are working with sector bodies and other experts to update guidance for trustees and staff. Keep your eyes out for such guidance, highlight it to trustees and monitor compliance.

1.2.7 Level of reserves

Linked to the above, is the adequacy of reserves and again CC have updated their guidance. Given the lick with the requirement to include reserves in the trustees' report, this should be high on the trustees' agenda.

1.2.8 Social investment

The Charities Act 2016 also introduced a new statutory power for charities to make social investments. These are considered further below.

1.2.9 Gift aid and trading subsidiaries

ICAEW identified that earlier CC guidance that payments made under gift aid were not distributions was incorrect, and therefore certain payment which had been made in excess of distributable reserves were unlawful.

There is updated guidance effective from 1 April 2015 and trustees, and directors of the trading subsidiaries, need to decide whether to take action if previous payments have been over the limit.

2 Charity fundraising

2.1 Introduction

An updated version of CC 20 Charity fundraising – a guide to trustee duties has been issued, following the implementation of the Charities (Protection and Social Investment) Act 2016 (Charities Act 2016).

This imposes duties on trustees to take responsibility for the charity's fundraising, under 6 principles:

(a) Planning effectively;
(b) Supervising your fundraisers;
(c) Protecting your charity's reputation, money and other assets;
(d) Identifying and ensuring compliance with the laws or regulations that apply specifically to your charity's fundraising;
(e) Identifying and following any recognised standards that apply to your charity's fundraising;
(f) Being open and accountable.

2.2 Reporting requirements

Larger charities will be required to disclose a statement for each of the following for accounting periods beginning on or after 1 November 2016:

(a) The fundraising approach taken by the charity, by anyone acting on its behalf, and whether a professional fundraiser or commercial participator carried out any fundraising activities;
(b) Details of any fundraising standards or scheme for fundraising regulation that the charity has voluntarily subscribed to;
(c) Details of any fundraising standards or scheme for fundraising regulation that any person acting on behalf of the charity has voluntarily subscribed to;
(d) Details of any failure by the charity, or by any person acting on its behalf, to comply with fundraising standards or scheme for fundraising regulation that the charity or the person acting on its behalf has voluntarily subscribed to;
(e) Whether the charity monitored the fundraising activities of any person acting on its behalf and, if so, how it did so;
(f) The number of complaints received by the charity, or by a person acting on its behalf for the purposes of fundraising, about fundraising activity;
(g) What the charity has done to protect vulnerable people and other members of the public from behaviour which:
    (i) Is an unreasonable intrusion on a person's privacy;
    (ii) Is unreasonably persistent; and
    (iii) Places undue pressure on a person to give money or other property.

2.3 Smaller charities

Although there is no obligation for smaller charities to make the above disclosures, it is a general principle within the SORP that the trustees of "smaller charities are encouraged to include some or all of the additional information required of larger charities if the charity trustees consider such additional information relevant to their charity's stakeholders." Given the current public concern about fundraising, the trustees of small charity's may decide that it is relevant to a small charity's stakeholders.

3 Reporting matters of material significance to the Charity Commission

3.1 Introduction

The Charity Commission is currently analysing responses to a consultation aimed at updating and clarifying the reporting of matters of material significance to the charity regulators. This guidance will apply to the Charity Commission in England and Wales, OSCR and the newly created charity regulator in Northern Ireland.

3.2 Statutory background

3.2.1 Duty to blow the whistle

The duty to report arises where the auditor or independent examiner, in the course of their work, identifies a matter, which relates to the activities or affairs of the charity or of any connected institution or body, and which they have reasonable cause to believe is likely to be of material significance for the purposes of the exercise by the regulator of its functions.

Auditors and independent examiners are only required to communicate matters described as being of material significance in the context of the regulator's functions.

Determining whether a matter is reportable involves consideration both of whether the auditor has a 'reasonable cause to believe' and that the matter in question 'is, or is likely to be of material significance' to the regulator. The regulations do not require auditors or independent examiners to perform any additional audit work as a result of the statutory duty nor are they required specifically to seek out breaches of the requirements applicable to a particular charity. However, in circumstances where they identify that a reportable matter may exist, they carry out such extra work, as considered necessary, to determine whether the facts and circumstances give them 'reasonable cause to believe' that the matter does in fact exist. It should be noted that the work done does not need to prove that the reportable matter exists.

3.3 Material significance

There is no change in the definition of 'Material significance' which is defined as follows:

"The term **material significance** requires interpretation in the context of the specific legislation applicable to the regulated entity. A matter or group of matters is normally of material significance to a regulator's function when, due either to its nature or its potential financial impact, it is likely of itself to require investigation by the regulator."

The determination of whether a matter is, or is likely to be, of material significance to the regulator inevitably requires auditors to exercise their judgement. In forming such judgements, they need to consider not simply the facts of the matter but also their implications. In addition, it is possible that a matter, which is not materially significant in isolation, may become so when other possible breaches are considered.

3.4 Proposed changes to the guidance

The changes are summarised in the following table:

	Current list	**Proposed amendments, additions and deletions**	**Comments**
1.	Matters suggesting dishonesty or fraud involving a **significant** loss of, or a **major** risk to, charitable funds or assets	Matters suggesting dishonesty or fraud involving a **material** loss of, or a **material** risk to, charitable funds or assets	'Significant' is changed to 'material' to align with the terminology in the SORP
2.	Failure(s) of internal controls, including failure(s) in charity governance, that resulted in a **significant** loss or misappropriation of charitable funds, or which leads to **significant** charitable funds being put at major risk	Failure(s) of internal controls, including failure(s) in charity governance, that resulted in a **material** loss or misappropriation of charitable funds, or which leads to **material** charitable funds being put at major risk	To align terminology to that used in the SORP
3.	Matters leading to the knowledge or suspicion that the charity or charitable funds have been used for money laundering or such funds are the proceeds of serious organised crime or that the charity is a conduit for criminal activity	**During the audit/independent examination** knowledge or suspicion that the charity or charitable funds **or the charity's bank accounts** have been used for money laundering or such funds are the proceeds of serious organised crime or that the charity is a conduit for criminal activity	Adding in section about bank account as there have been instances of charities allowing others to use their bank account to move money.
4.	Matters leading to the **belief** or suspicion that the charity, its trustees, employees or assets, have been involved in or used to support terrorism or proscribed organisations in the UK or outside the UK;	Matters leading to the **knowledge** or suspicion that the charity, its trustees, employees or assets, have been involved in or used to support terrorism or proscribed organisations in the UK or outside the UK, with the exception of matters related to a qualifying offence as defined by Section 3(7) of the Northern Ireland (Sentences) Act 1998	Small update to change the word 'belief' to 'knowledge'. Update to include specific references in respect of Northern Ireland. This change is intended to negate the need to report qualifying offences that occurred prior to 1998 in relation to the Northern Ireland conflict
5.	Evidence suggesting that in the way the charity carries out its work relating to the care and welfare of beneficiaries, the charity's	During the audit/independent examination evidence suggesting that in the way the charity carries out its	Amended to clarify that the evidence would be obtained during the audit/independent examination.

	beneficiaries have been or were put at significance risk of abuse or mistreatment	work relating to the care and welfare of beneficiaries, the charity's beneficiaries have been or were put at significance risk of abuse or mistreatment	
6.	**<u>Significant</u>** or recurring breach(es) of either a legislative requirement or of the charity's trusts	**<u>Single</u>** or recurring breach(es) of either a legislative requirement or of the charity's trusts **<u>leading to material charitable funds being misapplied</u>**	Text amended to clarify that it is material breaches which must be reported, and this may be in the form of a single or recurring breach.
7.	A deliberate or significant breach of an order or direction made by a charity regulator under statutory powers including suspending a charity trustee, prohibiting a particular transaction or activity or granting consent on particular terms involving significant charitable assets or liabilities	**<u>During the audit/independent examination evidence suggesting</u>** a deliberate or significant breach of an order or direction made by a charity regulator under statutory powers including suspending a charity trustee, prohibiting a particular transaction or activity or granting consent on particular terms involving significant charitable assets or liabilities	Amended to clarify that the evidence would be obtained during the audit/independent examination.
8.	Any notification or matter reported to the trustees on resigning as independent examiner or matter that the examiner is aware of on resignation or ceasing to act that falls within the categories of the previously reportable matters, or for examiners the notification on ceasing to hold office or resigning from office, of those matters reported to trustees.		It is suggested that this matter is removed as it was misinterpreted leading to auditors and independent examiners simply notifying the Regulator when they had ceased to hold office due to a change in appointment.
9.		**<u>On making a modified opinion, emphasis of matter, or issuing of a qualified independent examiner's report identifying matters of concern to which attention is drawn, notification of the nature of the modification / qualification / emphasis of matter or concern with supporting reasons including notification of the action taken, if any, by the trustees subsequent to the audit opinion / examiner's report.</u>**	This is introduced to ensure that issues identified during the audit / examiner's report are separately highlighted to the Regulators so that timely regulatory action can be taken if appropriate. This ensures that Regulators can respond to these issues as soon as notification is received and also that Auditors / Examiners are fully aware that this is a separate duty.
10.		**<u>Evidence that, without</u>**	Auditors normally, and

		reasonable cause, trustees have not taken action on matters identified by the auditor / examiner in their scrutiny of accounts for a previous year.	examiners can choose to issue management letters. These can highlight areas of weakness in financial controls or governance. The issuing of a management letter of itself is not reportable but if the trustees fail to act upon the recommendations this may be more significant.
11.		**During the audit / independent examination evidence that conflicts of interest have not been managed by the trustees in accordance with guidance issued by the charity regulator and / or related party transactions have not been fully disclosed in all the respects required by the applicable SORP.**	Unauthorised private benefit or incomplete disclosure of related party transactions damages public trust and confidence and leaves charity assets open to the risk of misappropriation.

3.5 The right to report

A separate statutory right (as opposed to a duty) to report to the appropriate regulator also exists and may be used by auditors / examiners. Auditors / examiners become aware of circumstances which in their opinion does not give rise to a duty to report to the regulator but which should nonetheless be brought to their attention. Such matters should be considered in conjunction with ISA 250 'Consideration of law and regulations', and where any report is made auditors / examiners rely on the protection afforded by general law.

4 Directions and guidance for independent examiners

4.1 Overview

An updated CC 32 being Directions and guidance for independent examiners is due for issue. This updated guidance will:

(a) include revisions in the Directions, and the guidance on applying those directions, and therefore, the work which needs to be carried out.
   (i) New direction 2 – Check for any conflict of interest that prevents you as an examiner form carrying out your independent examination;
   (ii) New direction 7 – If during the independent examination, the examiner identifies a conflict of interest was present and / or related party transactions took place, the examiner must check if these were properly authorised and were fully disclosed;
   (iii) New direction 9 – Check that the charity's financial sustainability and the trustees' assessment of going concern.
   (iv) The proposed guidance now generally refers to 'should' and therefore the directions are now expected practice, rather than being recommended best practice.

(b) In addition to changes in the Directions there will be changes in eligibility to carry out an independent examination where income if greater than £250,000.

(c) It will also be possible for an independent examination to be carried out on consolidated accounts.

(d) Finally, there is a proposal for a revised independent examiner's report (see Appendix 2).

5 Reporting and public benefit

5.1 SORP requirements

The SORP requires all charities to:

(a) Explain the main activities undertaken to further the charity's purposes for the public benefit; and
(b) Include in their report, a statement confirming whether the trustees have had regard to the Charity Commission's guidance on public benefit. *(FRS 102 SORP 1.18, FRSSE SORP 1.19)*

5.2 Charity Commission Guidance

The Charity Commission issued guidance for trustees entitled "How to write charitable purposes.

This guidance suggested that trustees should make the following clear:

(a) What outcome the charity is set up to achieve;
(b) How it will achieve these outcomes;
(c) Who will benefit from these outcomes; and
(d) Where the benefits extend to.

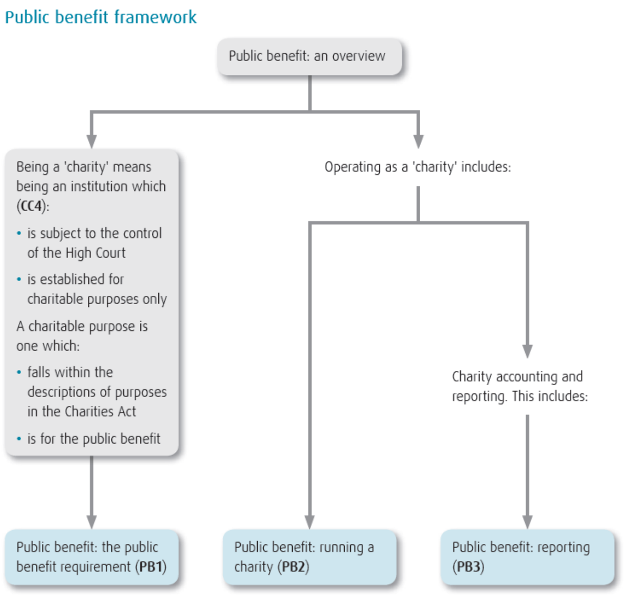
The guidance gives clear recommendations on the use of words, the need for clarity, precision and completeness.

5.3 The public benefit framework

For many years the prevention of poverty, the advancement of education and the advancement of religion were deemed to be in the public interest. The Charities Act 2006 required the Charity Commission to introduce guidance on providing public benefit.

The Commission initially set out two key principles of public benefit and, within each principle, there are some important factors that must be considered in all cases. This has now been superseded by the following framework.

There are 3 relevant documents on the CC website as follows which form a public benefit framework as follows:



There are two aspects of public benefit:

(a) the 'benefit aspect'
(b) the 'public aspect'

A charity must satisfy both, although there are different rules if the purpose is to relieve or prevent poverty. These tests will be applied to each charitable purpose.

To satisfy the benefit aspect a purpose must be beneficial and any detriment or harm that results from the purpose must not outweigh the benefit.

5.4 Some cases

5.4.1 U Turn UK CIC (formerly Uturn UK Ltd) and the Charity Commission

The First Tier Tribunal reported on 27th February 2012 in relation to an appeal by Uturn UK CIC against a refusal by the charity commission to register the company. The case is interesting as it relates to a decision by the Commission that there was insufficient evidence to support the view that the proposed object which concerned the promotion of "street associations" was an exclusively charitable nature.

The Tribunal supported the Commission.

5.4.2 Preston Down

This Exclusive Brethren meeting hall was originally refused registration as charity on the grounds that it failed to meet the public benefit test. Compare this with the original decision in the church of Scientology where the CC considered that Scientology was not a religion. The CC has now agreed to accept an application after a change in the trusts by a deed of variation. The latest from the CC is that they still have concerns and are now reviewing nearly 100 similar Exclusive Brethren meeting halls.

5.4.3 Cambridgeshire Target Shooting Association

On 2 February 2015, the Charity Commission refused to register the CTSA on the grounds that it "is not established for exclusively charitable purposes for the public benefit".

The Commission published a very detailed analysis of the reasons behind the rejection which trustees and other might find illuminating and helpful in framing their own charitable objects and making the link with public benefit!

5.4.4 Living out

A very recent case involved a Christian charity working with homosexuals which was initially refused registration because the CC was unable to conclude whether its activities were in the public interest, notwithstanding that the wider promotion of the Christian religion was. After an appeal, the objectives were restructured and the CC has now approved the registration. This case demonstrates the need to write charitable objectives carefully, and the degree of detailed scrutiny to which they are subjected.

5.4.5 The Countryside Alliance

The Charity Commission has recently turned down an application from the Countryside Alliance for registration as a charity, on the grounds that it was unable to determine whether its activities are for charitable purposes. The report makes interesting reading into the rationale and approach adopted by the Commission.

6 New UK GAAP, charities and SORPS

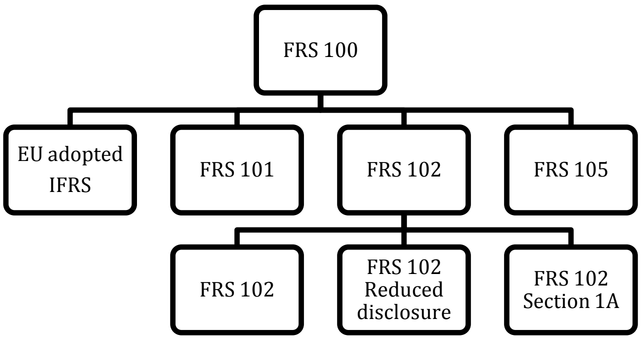
6.1 Introduction

There are no changes if a charity is preparing receipts and payments accounts.

6.2 Accounting standards and SORP

6.2.1 Accounting standards

The revised structure of accounting standards under new UK GAAP is as follows:



A charity cannot comply with IFRS (and therefore cannot comply with FRS 101). It cannot qualify as a micro-entity and therefore cannot comply with FRS 105. A charity which does not qualify as small is required to comply with FRS 102 for periods commencing on or after 1 January 2015. It must therefore comply with FRS 102 SORP from that date.

6.3 Small charities

As noted above a charity can qualify as small under the revised regulations. However, it cannot use abridged accounts and in practice is not able to comply with FRS 102 S1A and must comply with the additional requirements imposed by the SORP.

6.4 SORPs

6.4.1 Two SORPs

Initially the Charity Commission issued two SORPs, one based on FRS 102 and one based on FRSSE.

6.4.2 SORP Update Bulletin 1

SORP Update Bulleting 1 announced that FRSSE SORP is to be withdrawn and all charities will be required to comply with the FRS 102 SORP which has been amended to reflect this fact.

6.5 FRS 102 SORP

Many charities adopted the FRS 102 SORP for periods commencing on or after 1 January 2015 and have, therefore, already made the transition to new UK GAAP. They should have few problems preparing their accounts this year.

It is important to note that, in practice, a small charity may not apply FRS 102 Section 1A. This is because the SORP adds back most of the disclosures which the small company regulations and FRS 102 remove. For example, the regulations remove the requirement for disclosure of directors' emoluments and staff costs. The SORP includes detailed requirements for both, and applies the requirement in FRS102 for disclosure of key management remuneration.

6.6 FRSSE SORP

Those small companies who previously retained FRSSE and adopted FRSSE SORP will need to transition to the FRS 102 SORP. This will include a requirement to prepare an FRS 102 style cash flow statement if the charity qualifies as a larger charity. Given that the definition of a larger charity is one with income greater than £500,000 this will apply to many small charities. As the audit exemption limit has increased to income greater than £1 million, many unaudited charities are required to prepare a cash flow statement, which may pose some issues for some independent examiners!

The Charity Commission issued a very useful helpsheet, outlining the key differences between FRSSE SORP and FRS 102 SORP.

In accordance with the general requirements of FRS 102 and the SORPS, an explanation of transition is required.

6.7 Impact of change in definition of small company limits and audit appointment

6.7.1 The small company size criteria

The recent revisions to company size limits apply to charities. Therefore, the increase in the turnover limit from £6.5 m to £10.2 and balance sheet from £3.26 m to £5.1 mean that there is a tranche of charities which did not qualify as small which can do in future.

However, the restriction on adding disclosures does not apply to not-for profit entities and therefore charities may not, in practice, follow FRS 102 Section 1A. Nor can they produce abridged accounts. Finally, a charity is not permitted to be a micro-entity. These changes are effective for periods commencing on or after 1 January 2016 but may be early adopted for periods commencing on or after 1 January 2015. Note that this only applies to financial reporting and not to audit.

6.7.2 Audit and group accounts limits

A charitable company has to consider two tests for audit – those relating to companies, and these, of course are going up, and those for all charities, including unincorporated ones. This increased for periods ending on or after 31 March 2015 from income > £500,000 to income > £1,000,000. The other situation in which an audit is required did not change i.e. income > £250,000 and gross assets > £3,260,000.

At the same time the income requirement below which group accounts are not required was changed to £1,000,000.

Illustration 1

A charitable company has income of £8 million and gross assets of £4 million. It has a 30 September year end and the directors / trustees have asked for your advice on the options available for the 30 September 2016 year-end.

Comments on illustration 1

Year ended 30 September 2015

The charity is medium sized and requires an audit under the Companies Act 2006. It also requires an audit under the Charities Act but it is not required to have two!

Year ended 30 September 2016

Unless the charity early adopts the revised regulations, it remains medium sized and is therefore required to adopt FRS 102 in full and is subject to audit under CA 2006. It can however choose to early adopt the regulations and qualify as small.

Under the revised regulations, it considers whether it qualifies as small this year under the revised size criteria, and whether it would have qualified as small last year had the revised size criteria been operative. The charity would have qualified on that basis and can therefore qualify for year ended 30 September 2016.

If it chooses to early adopt the size criteria, it must early adopt the whole of the regulations and must also adopt FRS 102. It cannot use FRSSE 2015.

It is however still required to have an audit under CA 2006.

Year ended 31 September 2017

The charity now qualifies as small and is audit exempt under the Companies Act but not the Charities Act.

Where a charity previously required an audit under CA 2006 but no longer does so but still needs one under the Charities Act will need to discuss with the trustees whether to retain the Companies Act audit requirement (the exemption is of course voluntary) or move to a Charities Act audit.

Item	***Audit under Charities Act 2011***	***Audit under Companies Act 2006***
Addressees of audit report	*Trustees*	*Members*
Signing of audit report	*The audit report is signed in the name of the firm*	*The audit report is signed in the name of the audit partner or*

		responsible individual i.e. Senior Statutory Auditor
Review of directors' / trustees' report	*The auditor is required to read the report and consider whether the report is inconsistent with the financial statements under ISA 720A. An express opinion is not required.*	*The guidance for the auditor is in ISA 720B. An express opinion is required.*
Statement on balance sheet	*The statement on the balance sheet would include the audit exemption statement required under Companies Act 2006*	*The audit exemption statement would not be included.*
Criminal liability for reckless audit reporting	*There are no similar provisions under Charities legislation*	*The auditor under the Companies Act is potentially liable under criminal law if he knowingly or recklessly causes a report to be made which is misleading, false or deceptive.*
Successor auditors	*There are no similar provisions under Charities legislation*	*The auditor under the Companies Act has a duty to make audit files available to his successor auditor*
Limitation on liability	*There are no similar provisions under Charities legislation*	*Companies Act permits the auditor to limit liability*

6.8 Larger charities

Previously a larger charity was defined as "a term used in the SORP to identify those charities subject to audit under charity law in their jurisdictions."

Following the increase in the audit limit to £1,000,000 that link has now been broken and under SORP Update Bulletin 1 the definition remains at an income level of £500,000. The importance of this definition is that a larger charity has to comply with additional requirements, primarily disclosure matters, which do not apply to a small charity.

In particular, a large charity needs a cash flow statement. Under FRS 102 Section 1A, an entity meeting the small company size criteria would not be required to prepare a cash flow statement.

6.9 Public benefit entities and FRS 102

6.9.1 Introduction

A public benefit entity is defined as:

"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."

6.9.2 PBE Requirements of the standard

Paragraphs in FRS 102 prefixed by 'PBE' apply solely to public benefit entities. These paragraphs are not applicable (whether directly or by analogy) to entities that are not PBEs.

Most are in Section 34 *Specialised activities* but a small number, and certain other specific references to PBEs, appear elsewhere.

Other than the specific paragraphs referred to above, all other requirements of FRS 102 are applicable to PBEs.

6.9.3 Statement of compliance

The financial statements of a PBE that applies 'PBE' paragraphs include an explicit statement that the entity is a public benefit entity.

6.10 Charitable groups

6.10.1 General

Many charities operate within a group context. Where a subsidiary, associate or joint venture is a charity, all the directly charity related issues identified in these notes apply, unless otherwise stated.

Where the subsidiary is not a charity, for example a trading subsidiary established to generate funds for the charity via gift aid, there will be additional options as the trading subsidiaries will be able to adopt FRS 102 reduced disclosure or FRS 102 Section 1A. A micro-entity which is a subsidiary of a charity, but is not itself a charity, can use FRS 105, provided that it is not included in group accounts.

6.11 SORP update bulletin 1

6.11.1 Introduction

The key changes have already been dealt with i.e. the revision to the definition of larger charities and the withdrawal of the FRSSE SORP.

6.11.2 Other changes

Other changes have been made to bring the SORP into line with the amendments made to FRS 102 and for clarification.

6.11.3 Stock of goods donated for distribution to beneficiaries

An amendment to 6.12 replaces the words “adjusted for any loss of service potential” to “adjusted to reflect the lower of deemed cost, adjusted for any loss of service potential and replacement cost, where replacement cost is the economic cost incurred if the charity was to replace the service potential of the donated goods at its own expense in the most economic manner.

6.11.4 Goodwill and intangible assets

The SORP is amended in line with the general amendment to FRS 102 requiring that if, in exceptional circumstances, the useful life cannot be measured reliably, and it may not exceed ten years. Initially the maximum useful life was five years.

Amendments to this effect have been made to module 10 and 24.

6.11.5 Impairment of assets

As with 6.11.4 above a further amendment is required because of a specific amendment to FRS 102. SORP 10.23 has been amended to state that “An impairment loss recognised for goodwill must not be reversed in a subsequent accounting period.”

6.11.6 Cash flow statements

The original version of the SORP required all charities following it to prepare a cash flow statement. FRS 102 Section 1A permits an entity which meets the small company size criteria not to prepare a cash flow statement. The revised SORP requires a cash flow statement for all charities which meet the large charity definition i.e. those with income greater than £500,000.

6.11.7 Merger accounting

Module 27 has been amended to reflect the change in company law which precludes the use of merger accounting in situations where a UK registered company enters a business combination with a third party. SORP 27.4 brings in a bullet point to emphasise that the use of merger accounting must be permitted by the statutory framework. The other paragraphs are similar to those previously in FRS 6 and now within FRS 102 S 34.

A new paragraph 27.4A has been added emphasising that companies cannot use merger accounting and that unincorporated charities may only do so if permitted by legislation and if they meet the criteria in the SORP.

Interestingly, the SORP anticipates that companies may seek to invoke the true and fair override and refers them to Appendix IV of FRS 102 – Note on legal requirements.

6.11.8 Related parties

An additional category of related parties is introduced in line with the amended definition in FRS 102 – an entity from whom the reporting charity receives key management personnel services, or to whom the reporting charity provides such services.

6.12 Unincorporated charities and transition

Strictly, an unincorporated charity may not adopt the FRS 102 SORP as the Accounts and Report Regulations have not been updated to remove the requirement to comply with SORP 2005. However, the use of a true and fair override is permitted.

7 The SORPs

7.1 Structure of the SORP

One of the key changes that users will notice is the split of the material into modules, some of which are core and therefore are applicable to all charities, and others of which are dependent on the individual charity, and in particular its activities. The SORP microsite allows users to effectively 'tailor' their own SORP as appropriate. This is seen to be a key advantage of the new modular approach as it is based on a 'think small first' approach which gives simplification of the requirements but there are additional layers for the larger complex charities. This should allow the SORP to be simpler to use.

The SORP is structured as follows:

Core modules	
1.	Trustees' annual report
2.	Fund accounting
3.	Accounting standards, policies, concepts and principles, including the adjustment of estimates and errors
4.	Statement of financial activities
5.	Recognition of income, including legacies, grants and contract income
6.	Donated goods, facilities and services, including volunteers
7.	Recognition of expenditure
8.	Allocating costs by activity in the statement of financial activities
9.	Disclosure of staff remuneration, related party and other transactions
10.	Balance sheet
11.	Accounting for financial assets and financial liabilities
12.	Impairment of assets
13.	Events after the end of the accounting period
14.	Statement of cash flows[1]
Section 1: Special transactions relating to charity operations	
15.	Charities established under company law
16.	Presentation and disclosure of grant making activities
17.	Retirement and post-employment benefits
Section 2: Accounting for special types of assets held	
18.	Heritage assets
19.	Accounting for funds received as agent or as custodian trustee
Section3: Accounting for investments	
20.	Total return (investments)
21.	Accounting for social investments
22.	Accounting for charities pooling funds for investments
Section 4: Accounting for branches, charity groups and combinations	
23.	Overview of charity combinations
24.	Accounting for groups and the preparation of consolidated accounts
25.	Branches, linked or connected charities and joint arrangements
26.	Charities as subsidiaries

[1] In FRS 102 initially there was no automatic exemption from the requirement for a small entity to produce a cash flow statement. This has been changed in the July 2015 amendments and therefore section 7 will not apply as core in small charities.

27.	Charity mergers
28.	Accounting for associates
29.	Accounting for joint ventures
Appendices	
1.	Glossary of terms
2.	The Charity (SORP) Committee
3.	Thresholds for the UK and Republic of Ireland

7.2 The use of 'must', 'should' and 'may'

For the first time the FRS 102 SORP uses specific terms to identify those requirements that must be followed in order to comply with the FRS 102 SORP from those recommendations that should be followed as best practice and the options or illustrations that may be adopted by a charity when preparing its accounts.

7.3 References in the notes

In the notes which follow, references are to the FRS 102 SORP and have the same application under FRSSE SORP unless specifically stated.

8 Trustees' annual report

8.1 Introduction

All charities are required to prepare a trustees' report, although a company charity which is required under company law to prepare a directors' report may include the information to be included within the trustees' report within the directors' report and does not need a separate document.

The FRS 102 SORP retains the current focus of the annual report on providing information relevant to a charity's stakeholders and the charity telling its own story in a balanced manner. All charities reporting under the FRS 102 SORP must provide a baseline level of information but more is required of larger charities.

SORP 2005 made reference to reporting fulfilling the trustees' duty of stewardship and FRS 102 SORP takes this further with a statement that the responsibility for preparing the report rests with a charity's trustees who must approve it.

The FRS 102 SORP, in common with the 2005 SORP, defines larger charities as those charities which are required to have an audit under charity law. In those jurisdictions where there is no charity law audit requirement, larger charities are defined by reference to their gross income. The FRS 102 SORP sets out any additional information or disclosures that must be provided by larger charities.

8.2 Applicability of guidance

In practice charities will fall into one of the following categories:

(a) Small company charities as defined by Companies Act 2006 – these charities will require a directors' report. As noted above they also need a trustees report which can be included within the directors' report;
(b) Company charities which do not qualify as small under the Companies Act which are required to include a strategic report, in addition to the directors' report required by small companies;
(c) Unincorporated charities, including Charitable Incorporated Organisations, which need a trustees' report

Module 1 of the SORP differentiates between information required by all charities (1.14 – 1.33) and information required by larger charities (1.35 – 1.53). For this purpose, small charities are defined as "*those not subject to statutory audit.*" Note that this is not the same as small as defined by Companies Act 2006!!

8.3 Contents of trustees' report

8.3.1 Introduction

The SORP confirms that the purpose of the trustees' report is to ensure that the charity is publicly accountable for the stewardship and management of the funds it holds on trust.

All charities, including small charities, must include the information in 6.3.2 below. Larger charities are required to include the additional information in 6.3.4. Trustees of smaller charities may decide to include some or all of that information, and all charities are permitted to include additional information if considered relevant to the information needs of the primary users of their report.

8.3.2 Requirements for all charities

The key areas are:

(a) Objectives and Activities;
(b) Achievements and Performance;
(c) Financial Review;
(d) Structure, Governance and Management;
(e) Reference and administrative details;
(f) Exemptions from disclosure;
(g) Funds held as custodian trustee.

8.3.3 Additional content for larger charities

In addition to more detailed disclosures under the above headings, the SORP requires disclosure of future plans.

8.3.4 Statement of charity's policies

Within the financial review section of the report, the SORP requires the charity to disclose its policies, in particular in relation to:

(a) Reserves (stating the level of reserves and why they are held);
(b) Whether there are uncertainties about the ability to continue as a going concern;
(c) Any fund or subsidiary undertaking hat is materially in deficit, explaining the circumstances which gave rise to the deficit and the steps being taken to eliminate the deficit.

The latter two points sometimes will not be applicable. All charities should have a policy on reserves. Guidance and examples of the wordings are available in CC19 and OG43, both of which are available from the charity commission website.

8.4 Limited company charities and the strategic report

8.4.1 Introduction

SORP Information Sheet 5 gave guidance on compliance with The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 which are effective for periods commencing on or after 1 October 2013. This has been carried forward in the FRS 102 SORP.

8.4.2 Applicability

The regulations apply to large and medium-sized company charities only.

8.4.3 Content

The effect of the regulations is to split the previous content of the directors' report into two. The first section the strategic report includes information much of which was already included in the Trustees' Annual Report. Therefore, the information sheet requires it to be included within the annual report in a separately delineated section headed Strategic Report.

The objective of the strategic report is to:

(a) Provide context for the related financial statements;
(b) Provide an analysis of the charity's past performance;

Provide insight into the charity's main objectives and strategies, and the principal risks it faces and how they might affect future prospects.

8.4.4 Change to audit requirement for strategic report

Section 496 of the Companies Act 2006 currently requires the following, which is reported as an 'other matter' in the auditor's report:

The auditor must state in his report on the company's annual accounts whether in his opinion the information given in [the strategic report (if any) and] the directors' report for the financial year for which the accounts are prepared is consistent with those accounts.

The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015 (SI 2015/980) replace this requirement with the following:

In his report on the company's annual accounts, the auditor must:

(a) state whether, in his opinion, based on the work undertaken in the course of the audit:
- *(i) the information given in the strategic report (if any) and the directors' report for the financial year for which the accounts are prepared is consistent with those accounts, and*
- *(ii) any such strategic report and the directors' report have been prepared in accordance with applicable legal requirements,*

(b) state whether, in the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, he has identified material misstatements in the strategic report (if any) and the directors' report, and

(c) if applicable, give an indication of the nature of each of the misstatements referred to in paragraph (b).

Where applicable, the regulations also amend the reporting requirements where a separate corporate governance statement is prepared.

The scope of an audit already includes reading all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and identifying any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired in the course of performing the audit. Therefore, it is not expected that (a) (i) or (b)-(c) above will have implications on the work performed by auditors. Whilst (a) (ii) is a new reporting requirement, an auditor will normally have assessed compliance with the applicable legal requirements through the completion of an accounts disclosure checklist.

Therefore, whilst the wording of the report will change in this area for companies, the audit work performed should not. It is expected that the FRC will update its example audit reports to reflect this change in due course.

What is perhaps different is the implication of omissions.

Illustration 2

A charity's trustees have prepared a trustees' report which has omitted certain information required by the SORP. In addition, the report excludes the required disclosures relating to future developments and related risks.

What is the implication for the auditor in the following situations:

(a) The charity is unincorporated?
(b) The charity is a limited company?

Comments on illustration 2

The understatement of the administration and fundraising costs means that the trustees' report is inconsistent with the accounts, If the trustees refuse to amend their report, the auditor will qualify the report. This applies both under company and charity law.

It is in relation to the omission of information that the difference arises. Under charity law, the issue is only one of inconsistency. The omission of information does not result in an inconsistency. There is therefore no obligation or option to qualify the report.

Under the revised company law, the omission of the information means that the report has not been prepared in accordance with the requirements of the Companies Act, and if the trustees refuse to include the information the auditor would need to qualify. It is an interesting question as to whether qualification is required if the information that is omitted is required by the SORP rather than the Companies Act!

8.5 Significant changes from SORP 2005

The significant changes from SORP 2005 that affect all charities are:

(a) The charity must explain any policy it has for holding reserves and state the amounts of those reserves and why they are held. If the trustees have decided that holding reserves is unnecessary, the report must disclose this fact and provide the reasons behind this decision.
(b) The concession allowing the disclosure of the names of trustees to be limited to a maximum of 50 has been dropped and instead all trustees who acted in the year or who are in position at the date the report is signed must be listed. This change was to ensure that details of all trustees are reported.

The significant changes from SORP 2005 that affect larger charities are:

(a) Larger charities must provide an explanation of their social investment policies and explain how any programme related investments contributed to the achievement of its aims and objectives.
(b) Larger charities must explain the financial effect of significant events. This is in addition to reporting the significant charitable activities undertaken (which is carried over from SORP 2005).
(c) The statement concerning risk management made by larger charities is dropped and instead larger charities are required to provide 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 those risks.
(d) Larger charities must disclose their 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.

All charities investing endowment on a total return basis must refer to module 21 for the additional information to be disclosed in their report.

8.6 FRSSE SORP

The requirements of the FRSSE SORP and FRS 102 SORP are identical. Both SORPs require more information to be provided by larger charities. Larger charities are those that are subject to statutory audit under charity law.

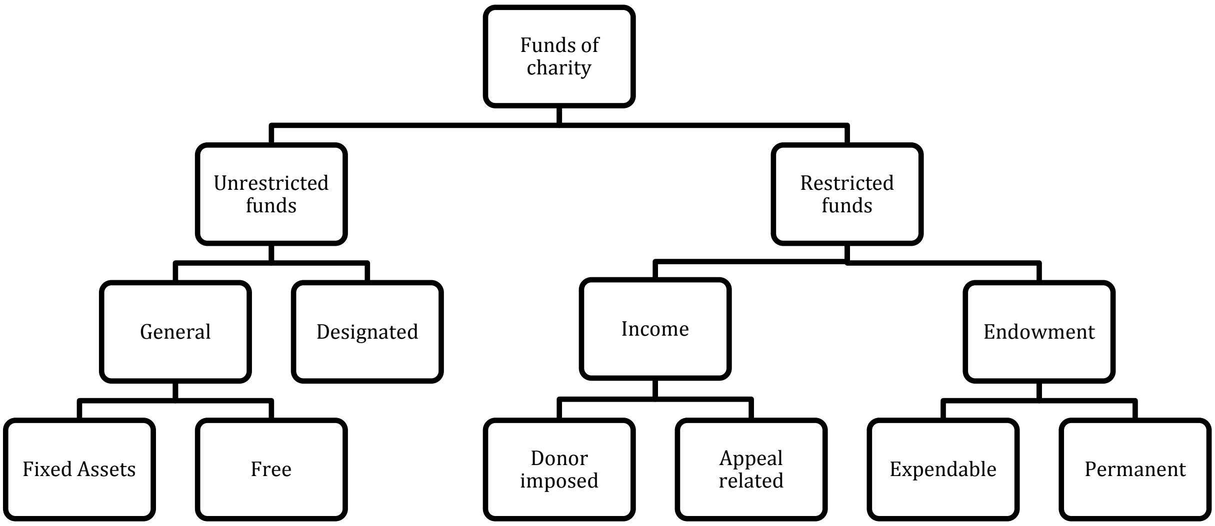
9 Fund accounting (Module 2)

9.1 Introduction

Since neither FRS 102 nor FRSSE deal with fund accounting, it is dealt in full in the SORP. The FRS 102 SORP does not change the basic accounting requirements, which require a columnar presentation of the movements in funds within the Statement of Financial Activities (SoFA).

The charity must observe the basic rules of fund accounting in preparing the accounts. In particular, the accounts should be prepared in columnar form differentiating between restricted and unrestricted funds, and grouping similar types of fund together if appropriate.

The following figure illustrates the classes of charitable funds:



The main purpose of the accounts is to give an overall view of the total incoming resources during the year and how they have been expended, with a balance sheet to show the overall financial position at the year-end. There are additional requirements for charities that have to account for more than one fund under their control. The accounts should provide a summary of the main funds, differentiating in particular between the unrestricted income funds, restricted income funds and endowment funds. The columnar format of the Statement of Financial Activities is designed to achieve this. Depending on the materiality of each, the notes to the accounts should group the restricted funds under one or more heads.

9.2 SORP Helpsheet 2 What's changed

The classification of the funds of a charity is unchanged. However, the FRS 102 SORP requires that the transfer line in the SoFA nets to nil and so one sided funds transfers are prohibited. This approach rules out one sided transfers as a mechanism for dealing with the acquisition of, or transfer of, trusts to or from another charity. The accounting treatment for such 'transfers' is to recognise a gain (or loss) equal to the value of the net assets (or net liabilities) acquired (acquisition accounting) or to adopt merger accounting where the relevant criteria are met.

The reference to loans from one fund to another fund of the same charity is dropped (SORP 2005, paragraph 350) as such amounts, if not temporary, are in substance transfers between funds and can only be made where the purposes of the trusts are sufficiently similar to allow such payments.

9.3 Transfers between funds

SORP 2015 confirms that the total value of transfers in the SoFA must always net to nil, and may be made for the following reasons:

(a) To transfer assets from unrestricted funds to finance a deficit on a restricted fund;
(b) To transfer the value of fixed assets from restricted funds to unrestricted funds when the asset has been purchased out of restricted fund donations but is held for a general and not a restricted purpose;
(c) Where restricted funds have ben lawfully released and transferred to unrestricted funds;
(d) Where the trustees have exercised a power to declare a special trust over a gift initially recognised as unrestricted; or
(e) Where charity law permits the proceeds of restricted funds to be spent for an alternative purpose (such as the cy pres procedures in England and Wales) for example the alternative use of the proceeds of a failed appeal, or the alternative use of excess of funds raised from an appeal.

SORP requires that the notes to the accounts must disclose:

(a) a summary of the assets and liabilities of each category of fund of the charity, if not provided by presenting this information in a columnar balance sheet;
(b) details of the purposes and trust law restrictions imposed on each material individual fund;

(c) details of the movements on material individual funds in the reporting period, reconciling the opening and closing fund balance (small funds with similar purposes may be aggregated);
(d) details of the reasons for any material transfers between different classes of funds;
(e) where endowment has been converted to income, details of the amount(s) converted and the legal power for its conversion;
(f) where the trustees have a power to invest permanent endowment on a total return basis, the details of the movements in the value of unapplied total return for the reporting period (refer to the SORP module 'Total return (investments)'); and
(g) details of the planned use of any material designated funds, explaining the purpose of the designation.

9.4 FRSSE SORP

The approach taken to this topic is the same in identifying and disclosing unrestricted, restricted and endowment funds. Both SORPs require the transfer between funds line to net to nil and consequently one-sided transfers are not permitted.

10 Accounting standards, policies, concepts and principles, including the adjustment of estimates and errors (Module 3)

10.1 Charities SORP (FRS 102)

Chapter 3 deals with accounting policies, estimates and errors and should not provide any major issues. The following disclosure points may need to be addressed:

(a) Basis of preparation note should include reference to SORP, FRS 102 and whether accounts prepared in accordance with applicable charity and / or company law in the jurisdiction of registration;
(b) Going concern disclosures. As well as including disclosures where there are material uncertainties related to events or conditions that cast significant doubt on the charity's ability to continue as a going concern, the SORP confirms that where there are no material uncertainties, this should also be stated;
(c) Charities must also state:
    (i) That the charity is a public benefit entity
    (ii) The judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the accounts;
    (iii) The key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next reporting period; and
    (iv) In respect of those assets and liabilities where there is a significant risk of material adjustment within the next reporting period, the notes must include details of their nature and their carrying amount as at the end of the reporting period.

There are no major changes in the application of accounting policies specific to charities but see later notes on correction of errors.

10.2 SORP helpsheet 2 – What's changed

The FRS 102 SORP sets out accounting policies which are consistent with FRS 102. The time-frame for considering going concern under FRS 102 is at least 12 months from the date the accounts are approved.

SORP 2005 attempted to list the most common accounting policies and discussed a number of them in detail. This list was set out in the SORP 2005 paragraphs 356 to 370 but the FRS 102 SORP does not take this approach. Instead, module 3 considers the selection of accounting policies and what constitutes compliance with the SORP at a principles level. The FRS 102 SORP then considers accounting policies in the context of the particular issues addressed within each module.

Neither FRS 102 nor the FRS 102 SORP will result in a wholesale change to the accounting policies as set out in SORP 2005. However, there are a number of significant changes that may affect particular charities.

10.3 FRSSE SORP

The terminology and definitions used differ significantly between the FRSSE (old GAAP) and FRS 102 (new GAAP) SORPs.

The most significant differences in definition are:

(a) Whilst both SORPs require trustees assess going concern, the FRS 102 SORP specifies that their review covers at least 12 months from the date the accounts are approved.
(b) The FRSSE SORP makes special mention of prudence and accruals which is not specifically referred to in FRS 102.
(c) The FRS 102 SORP refers to alternative measures to fair value.
(d) The FRSSE takes a different approach to determining accounting policies than FRS 102 with users of the FRSSE 'having regard' to FRS 102 as 'current practice'.
(e) FRS 102 requires more disclosures than the FRSSE and this is reflected in the disclosure requirements of the FRS 102 SORP.

11 The SoFA (Module 4)

11.1 Introduction

The SoFA has been simplified compared to the 2005 SORP as the SORP feedback indicated that some of the headings were unattractive and clunky. The SORP committee sought to produce a SoFA that did not require major reanalysis. The secretary to the SORP committee described the changes as ones of style not substance.

There was some pressure from FRC to move to a single column SoFA with more of the analysis relegated to the notes. However, this was overcome and a columnar SoFA is retained.

A bigger practical issue is the requirement in FRS 102 for comparative figures for all amounts in the SoFA. This must therefore include comparatives for all the rows and columns in the SoFA. The SORP permits a single comparative figure on the face of the SoFA as under SORP 2005, and permits comparative information for the separate classes of funds, if any, held by the charity to be presented either on the face of the SoFA or prominently in the notes to the accounts.

The revised SoFA outline is shown below. In addition to the rows and columns in the illustration the SORP confirms the following:

(a) The formats must be used consistently and the comparative figures required are total column only;
(b) May vary order in which a charity presents headings and may insert additional subtotals;
(c) May add additional columns but must make clear the class of fund to which the column relates;
(d) Material exceptional items are required by FRSSE whereas FRS 102 requires disclosure of the nature and amount of any material items of income or expenditure were this is relevant to an understanding of the charity's financial performance. This can be in the notes or as additional lines within the relevant activity heading.
(e) Any material loss through fraud or financial crime must be disclosed;
(f) The SORP confirms that charities are unlikely to have extraordinary items (as they don't really exist) or discontinued operations (as a discontinued operation represents the complete discontinuation or disposal of business activity or charitable activity). If it does have the former they should be shown after net incoming resources expended and, if the latter, the SoFA needs to distinguish between continuing and discontinued operations.
(g) Charities below the audit threshold are not required to report on an activity basis but may instead adopt an alternative basis. For example, it could be based on the nature of income and expenditure, such as salary related costs, property related costs, interest expenses, transport costs and grants made.

The basic structure of the SoFA, with its columnar presentation distinguishing the classes of fund held: unrestricted income, restricted income and endowment, is retained.

However, the number of headings within the SoFA has been reduced and a 'plain English' style adopted to describe the nature of the income or expenditure included within each heading of the SoFA. In accordance with FRS 102, a new requirement is made that comparatives are provided for all columns in the SoFA either by way of adding additional columns or by providing this information in the notes to the accounts. Some of the line headings in the SoFA have been changed.

A single column SoFA for all funds is permitted where only one class of funds is material, otherwise unrestricted and restricted funds and endowment must be shown separately.

The treatment of gains and losses on investment assets has changed. SORP 2005 presented both realised and unrealised investment gains and losses as an item within 'other gains and losses' after striking a total for 'net incoming/outgoing resources'. FRS 102 requires that changes in the value of financial instruments (which includes investments) measured at fair value are taken through profit and loss (FRS 102, paragraph 12.8). In order to comply with this requirement, gains and losses on investments are now shown in the SoFA before striking a total for 'net income/ expenditure'.

An extract from the SORP 2005 is compared with the FRS 102 SORP in the table below:

2005 SORP (SoFA extract)	**FRS 102 SORP (SoFA extract)**
Voluntary income	Donations and legacies
Activities for generating funds	Other trading activities
Investment income	*Income from* Investments
Incoming resources from charitable activities	*Income from* Charitable activities
Other incoming resources	Other *income*
Total incoming resources	Total income and endowments
Costs of generating voluntary income	***Expenditure on* Raising funds**
Fundraising trading: cost of goods sold and other costs	
Investment management costs	
Resources expended on Charitable activities	***Expenditure on* Charitable activities**
Governance costs	
Other resources expended	Other *expenditure*
	Net gains/(losses) on investments
Net incoming/outgoing resources before transfers	Net income/(expenditure)
Gross transfers between funds	Transfers between funds
Gains on revaluation of fixed assets for charity's own use	Gains/(losses) on revaluation of fixed assets
Gains/losses on investment assets	
Actuarial gains/losses on defined benefit pension schemes	Actuarial gains/(losses) on defined benefit pension schemes
	Other gains/(losses)
Net movement in funds	Net movement in funds

Income:

The main heading 'incoming resources' is renamed 'income and endowments from'.

'Voluntary income' is renamed income from 'donations and legacies'.

'Incoming resources from charitable activities' is renamed income from 'charitable activities'.

'Activities for generating funds' is renamed income from 'other trading activities'.

'Investment' income and 'other' income line headings remain unchanged from SORP 2005.

Expenditure:

The main heading 'resources expended' is renamed 'expenditure on'.

'Costs of generating voluntary income', 'fundraising trading: cost of goods sold and other costs' and 'investment management costs' are all combined in a new heading expenditure on 'raising funds'.

'Charitable activities' is retained is retained as expenditure on 'charitable activities'.

The heading of 'governance costs' is dropped altogether with these costs being included in expenditure on 'charitable activities'. For those charities reporting on an activity basis, governance costs are a separate component of support costs.

'Other resources expended' is renamed 'other' expenditure. Discontinued operations must now be shown by way of a separate column to reflect the requirements of FRS 102. Similarly, extraordinary items must be shown separately. The 'other gains and losses' heading is for those gains and losses under FRS 102 that fall outside of any other heading.

The FRS 102 SORP clarifies that:

(a) The conversion of endowment to income may be shown either under other income or by way of the transfer line.
(b) The transfers between funds line must always net to nil.
(c) Internally generated databases cannot be capitalised.

11.2 FRSSE SORP

The basic structure of the SoFA, with its columnar presentation distinguishing the classes of fund held: unrestricted income, restricted income and endowment and the line headings used to describe income and expenditure are the same. Both SORPs, in compliance with the applicable accounting standard, require comparatives for each column in the SoFA, which can be disclosed by way of additional columns or in the notes to the accounts.

However, there are a number of key differences:

(a) Gains and losses on investment assets count towards net income/expenditure in the FRS 102 SORP but are excluded from net income/expenditure in the FRSSE SORP.
(b) An additional category of 'other gains and losses' is present in the FRS 102 SORP only.
(c) The FRSSE requires the separate disclosure of 'exceptional items' which are exceptional by virtue of size or incidence whereas the FRS 102 requires the separate disclosure of 'material items'. FRS 102 has an additional category of 'extraordinary items' which fall outside of ordinary activities and are of an abnormal nature and unlikely to recur; these must be disclosed separately in the SoFA after striking the total for net income/expenditure.
(d) The FRSSE requires the costs of 'a fundamental reorganisation or restructuring that has a material effect on the nature or focus' of a charity to be disclosed whereas FRS 102 requires the separate disclosure of discontinued operations which must be done by way of additional columns in the SoFA.
(e) The FRSSE SORP permits charities with an existing accounting policy of capitalising the data capture costs of internally generated databases to continue this accepted practice but this is accounting treatment is prohibited by FRS 102 and so is not an option under the FRS 102 SORP.

12 Income recognition (Module 5)

12.1 Non-exchange transactions (FRS 102 Section 34.64 -34.74)

12.1.1 Introduction

A non-exchange transaction is "a transaction whereby an entity receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange."

The accounting may therefore be required by the donor or recipient.

12.1.2 Applicability

This section does not apply to government grants which are covered by Section 24. Non-exchange transactions include but are not limited to, donations (of cash goods or services) and legacies.

12.1.3 Recognition and measurement

An entity shall recognise receipts of resources from non-exchange transactions as follows:

(a) Transactions that do not impose specified future performance-related conditions on the recipient are recognised in income when the resources are received or receivable.

(b) Transactions that do impose specified future performance-related conditions on the recipient are recognised in income only when the performance-related conditions are met.
(c) Where resources are received before the revenue recognition criteria are satisfied, a liability is recognised.

The existence of a restriction does not prohibit a resource from being recognised in income when receivable.

An entity must take into consideration whether the resource can be measured reliably and whether the benefits of recognising the resource outweigh the costs. Therefore, where it is not practicable to estimate the value of the resource with sufficient reliability**,** the income shall be included in the financial period when the resource is sold.

An entity shall recognise a liability for any resource that has previously been received and recognised in income when, as a result of a subsequent failure to meet restrictions or performance-related conditions attached to it, repayment becomes probable**.**

Donations of services that can be reasonably quantified will usually result in the recognition of income and an expense**.** An asset will be recognised only when those services are used for the production of an asset and the services received will be capitalised as part of the cost of that asset.

An entity shall measure incoming resources from non-exchange transactions as follows:

(a) Donated services and facilities that would otherwise have been purchased, shall be measured at the value to the entity.
(b) All other incoming resources from non-exchange transactions shall be measured at the **fair value** of the resources received or receivable.

12.1.4 Disclosure

An entity shall disclose the following:

(a) the nature and amounts of resources receivable from non-exchange transactions recognised in the financial statements**;**
(b) any unfulfilled conditions or other contingencies attaching to resources from non-exchange transactions that have not been recognised in income; and
(c) an indication of other forms of resources from non-exchange transactions from which the entity has benefited.

12.2 SORP FRS 102 Income recognition – other areas

12.2.1 Income recognition

Within SORP 2005, the 3 tests for income recognition are entitlement, certainty and measurement. The middle one is changed, in line with the general provisions in FRS 102 Section 23 to “probable”. This could mean that a charity will be recognising income earlier than under SORP 2005.

12.2.2 Income from grants

The SORP in effect rejects the option in FRS 102 that there is an accounting policy in relation to grants by requiring the recognition of grants to be related to performance conditions only. Where there are no conditions the grant should be recognised on receipt, or when it is probable that it will be. Where there is a condition that allows a donor to recover any unexpended grant, the condition does not prevent the grant being recognised, but it does require the charity to assess whether a provision is required for the repayment. Again such a provision would be required when the repayment becomes probable.

Illustration 3

Charity C intends to raise funds to purchase a fixed asset which has a ten-year life and it expects to fund the appeal partly via an appeal and partly by obtaining a grant.

How should it be dealt with under the Charities SORP?

Comments on illustration 3

FRS 102 permits an entity an accounting policy choice for government grants (FRS 102 Section 24). The two policies are the performance model and the accruals model.

The Charities SORP requires charities to adopt the performance model and prohibits the use of the accruals model. This is to retain the requirements of the current SORP, which would change if the accruals model were permitted.

Under SORP 2005 the treatment is the same and the funds are recognised in the SoFA on receipt, provided that any conditions attached either to the appeal or to the grant have been complied with. The acquired asset is then capitalised and amortised over its useful life.

If the accruals model were permitted, there would be a difference in the treatment of funds raised by the appeal and those raised via the grant. Funds raised by an appeal would be recognised on receipt, but those raised by grant would only be recognised over the life of the asset.

Given this lack of consistency the SORP committee have decided to require the use of the performance model.

12.2.3 Income from legacies

Again, the general principle is that a legacy is recognised when it is probable that it will be received. This will usually be when the executors have established that there are sufficient assets to pay the legacy, and any conditions attached are either within the control of the charity, or have been met.

Where a legacy is received, or notified as receivable after the balance sheet date but before the approval of the accounts it should be treated as an adjusting event and included in the financial statements if it is clear that it was agreed by the executors before the balance sheet date.

The legacy should not be recognised if conditions have not been met, for example if the charity is the residual legatee and there is a life tenant. Additionally, if the distribution of the estate is to be deferred for more than 12 months from the balance sheet date, it should be discounted at the interest rate that the charity anticipates it would earn on a comparable amount over a similar time frame using the effective interest method in FRS 102 section 11 and the unwinding of the discount rate recorded as an adjustment to legacy income and not as interest receivable. Finally, a legacy debtor should be impaired if it becomes doubtful that it will be received. Again the SORP requires this as an adjustment to legacy income, and not as an expense.

The recognition of legacies is an area where there are differences in practice and it is understood that late changes will allow charities with experience in the area to recognise legacies on a portfolio basis i.e. the use of a mathematical model or formula

12.3 Helpsheet 2 – What's changed

As a consequence of FRS 102, the FRS 102 SORP changes one of the three criteria for income recognition. It requires that income should be recognised when its receipt is 'probable' whereas the equivalent criterion under SORP 2005 was 'virtually certain' Otherwise the two other recognition criteria of entitlement and measurement remain unchanged from SORP 2005.

The FRS 102 SORP also:

(a) Provides that in certain circumstances income from contracts can be classified as restricted income rather than unrestricted income.
(b) Prohibits the adoption of the 'accrual model' for the recognition of income from government grants (this option is not available under SORP 2005 in any case).
(c) Provides more guidance than SORP 2005 on how time related conditions may prevent income recognition.
(d) Provides more guidance on recognising income from legacies including the use of a portfolio approach for immaterial legacies and provides a three-point test as to when receipt of a legacy is 'normally probable'.
(e) Requires extended credit terms be reflected in the calculation of the present value of income receivable (in line with FRS 102) for exchange transactions.
(f) Incorporates specific guidance on income from insurance claims reflecting the FRS 102 requirement that receipt must be virtually certain.

12.4 FRSSE SORP

Both SORPs take the same approach to the criteria for income recognition with the definition of entitlement, measurement and probable (receipt is more likely than not) essentially the same.

The disclosure of certain details of government grants and deferred income is required by FRS 102 and the FRS 102 SORP. The disclosure of deferred income is good practice and is a 'should' in the FRSSE SORP.

13 Income from donated goods, facilities and services (Module 6)

13.1 Introduction

A separate module now deals with this area (Module 6).

Donated goods must be recognised at their fair value unless it is impractical to do so, in which case they should be recognised when sold. Where the assets are to be distributed to beneficiaries the fair value is assessed at the date they are received, not when distributed, although the fair value should be reduced for any loss of service potential in the intervening period.

Similarly, the SORP requires the recognition as income of donated facilities and services which the charity would otherwise have purchased, when received if the value of the gift can be measured reliably. This value is the amount that the charity would pay in the open market for an alternative item that would provide a benefit to the charity equivalent to the donated item. The value to the charity can be lower than the price the charity would pay for that item, but cannot exceed it. For example, a charity may be given use of a property rent free where the market rent for that particular property is much higher than an alternative that the charity would have rented. The value to the charity is the rent it would have paid out for the smaller or otherwise cheaper property.

FRS 102 precludes the valuation of voluntary assistance and this is confirmed in the SORP, although narrative disclosures (with amounts if considered relevant) are permitted.

Finally, the SORP confirms that where practicable donated goods given for resale should be recognised on receipt where practicable, but allows for example the receipt of low-value items and others where there is no detailed stock control, to be included on receipt.

There are disclosures in relation to accounting policy, amounts recognised in the financial statements, distinguishing between classes of items together with details of any donated services received but not valued, for example the contribution of unpaid volunteers.

Illustration 4

A charity needs to rent office space as it has outgrown the treasurer's bedroom. It has been offered m space by a local supporter who has upmarket office space spare. The rental would be £10,000 p.a.

The charity would rent somewhere cheaper at £3,000 p.a. How should this be accounted for?

Comments on illustration 4

The value to the charity is £3,000 p.a. This should be recorded as donations and costs.

13.2 SORP Helpsheet 2 – What's changed

Whilst SORP 2005 required that the income from the receipt of donated goods for sale was recognised once sold, and goods for distribution, on distribution, FRS 102 requires recognition at the point of receipt at fair value. This requirement is only relaxed if either it is not practical and/or the costs of recognition on receipt outweigh the benefit to users of the accounts and the charity of this information.

If it is impractical to measure the fair value of goods donated for resale or distribution, the donated goods must then be recognised as income when they are sold or distributed. Other gifts of donated services and facilities are recognise at the value to the charity but whereas SORP 2005 refers to 'utility', the FRS 102 SORP refers to the 'benefit' to the charity, though the result is likely to be comparable.

The FRS 102 SORP provides guidance on how to apply an estimation technique for donated items for sale under the UK retail gift aid scheme.

13.3 FRSSE SORP

Both SORPs take the same approach to the criteria for income recognition with the definition of entitlement, measurement and probable (receipt is more likely than not) essentially the same. Except for donated tangible fixed assets, both SORPs adopt the same approach to the recognition and measurement of donated goods, facilities and services. Neither SORP permits the valuation of 'general volunteers'.

However, the FRSSE requires donated tangible fixed assets to be recognised at their current value whereas FRS 102 requires recognition at their fair value. Where reference is made to a market price to determine an asset's replacement cost or its fair value, the result will be the same. Also if cost to the donor is used as a measure the result will also be the same.

14 Recognition of expenditure including grant making and funding (Module 7)

14.1 FRS 102

FRS 102 has little to say about recognising expenditure above and beyond the normal recognition criteria and some indication as to when expenditure can be included within the cost of an asset and when it should be included in profit and loss.

14.2 Recognition of expenditure – general rules

The three tests for recognition of expenditure are obligation, probable and measurement. The general requirement is to recognise the expenditure and related liability at the best estimate of the amount required to settle the obligation at the reporting date. There is an exception in the case of certain financial instruments, see below. As with FRS 102 generally, liabilities to be settled after more than one year should be discounted. The unwinding of the discount rate should be a financing cost – allocated to the appropriate expenditure heading.

It is important to recognise that a charity may create a constructive obligation to make a grant or provide services to beneficiaries such that they have to include a provision at the yearend for grants not made or services not provided. The SORP discusses this in some detail and emphasises that:

(a) Such commitments must be specific, communicated directly to the beneficiary or grant recipient and there is an established pattern of practice that indicates that the charity will meet its commitment;
(b) The existence of conditions must be considered to identify whether they limit the recognition of such commitments.

The section on expenditure brings in the requirements of section 28 FRS 102 to recognise employment benefits based on services and therefore matters such as holiday pay accruals, the cost of termination and providing post-employment benefits must be recognised as services are rendered.

Whilst considering pension costs it is important to bear in mind the upcoming need for charities to automatically enrol their workers.

There is one final area within FRS 102 which may give rise to problems and that is the requirement within multi-employer schemes for deficits to be recognised when there is an agreement to fund them, even if the amounts are not yet payable.

Illustration 5

A charity has agreed to fund Professor Hufflepuff's research for a cure into motor neurone disease for the next five years.

How should this be accounted for on the following alternative assumptions:

(a) The charity has agreed £100,000 a year with no conditions
(b) The charity has agreed full funding with no conditions
(c) The charity has the right not to continue with the funding if the research does not proceed satisfactorily or in the light of alternative projects becoming available

Comments on illustration 5

In situation (a) the charity is committed to making 5 payments of £100,000 and should provide in full at the present value of the commitments.

In situation (b) the conditions for making a provision are not met as it is not possible to make a reliable estimate of the commitment.

There is a condition attached to future payment and there is therefore no requirement to accounts for future years until the conditions have been met in situation (c).

14.3 SORP Helpsheet 2 – What's changed

The FRS 102 SORP requires the discounting of liabilities and provisions for the time value of money where settlement is delayed for more than 12 months and the effect is material. This treatment was referred to in SORP 2005 in connection with grant commitments (paragraph 323) but is now more extensively applied to be consistent with FRS 102.

The FRS 102 SORP provides guidance on accounting for onerous contracts and employee benefits. In line with FRS 102, the FRS 102 SORP requires the accrual of a liability for paid annual leave and sick leave, if material.

14.4 FRSSE SORP

Both SORPs require the discounting of liabilities and provisions for the time value of money where settlement is delayed for more than 12 months but the suggested discount rates differ with the FRSSE making reference to government bonds and FRS 102 to a market rate of interest or the opportunity cost of investment income forgone, as applicable.

The FRS 102 SORP includes a section on the treatment of employee benefits which is not found in the FRSSE. The accrual of paid annual leave (holiday pay) and paid sick leave, where material, is required by FRS 102 but is not required by the FRSSE.

FRS 102 requires more extensive disclosures than the FRSSE regarding the uncertainties relating to commitments and any reimbursements.

15 Funding commitments (FRS 102 34.57 – 34.63)

15.1 Introduction

In the context of a grant-making entity, this section of FRS 102 is important. It is built on in SORP section 16.

An entity that commits to provide resources to other entities shall apply the requirements of paragraphs 34.58 to 34.63 and the accompanying guidance at Appendix A to this section, except for commitments to make a loan to which entities shall apply Section 11 *Basic Financial Instruments* or Section 12 *Other Financial Instrument Issues,* as applicable.

When applying these paragraphs, the requirements of Section 2 *Concepts and Pervasive Principles* and Section 21 *Provisions and Contingencies* shall also be taken into consideration.

15.2 Recognition

An entity shall recognise a liability and, usually, a corresponding expense**,** when it has made a commitment that it will provide resources to another party, if, and only if:

(a) the definition and recognition criteria for a liability have been satisfied;
(b) the obligation (which may be a constructive obligation**)** is such that the entity cannot realistically withdraw from it; and
(c) the entitlement of the other party to the resources does not depend on the satisfaction of performance-related conditions**.**

Commitments that are performance-related will be recognised when those performance-related conditions are met.

15.3 Measurement

An entity shall measure any recognised liability at the present value of the resources committed.

15.4 Disclosure

An entity that has made a commitment shall disclose the following:

(a) the commitment made;
(b) the time-frame of that commitment;
(c) any performance-related conditions attached to that commitment; and
(d) details of how that commitment will be funded.

The above disclosures may be made in aggregate, providing that such aggregation does not obscure significant information. However, separate disclosure shall be made for recognised and unrecognised commitments.

15.5 Guidance

The following is an integral part of the standard.

“Entities often make commitments to provide cash or other resources to other entities. In such a case, it is necessary to determine whether the commitment should be recognised as a liability. The definition of a liability requires that there be a present obligation, and not merely an expectation of a future outflow.

A general statement that the entity intends to provide resources to certain classes of potential beneficiaries in accordance with its objectives does not in itself give rise to a liability, as the entity may amend or withdraw its policy, and potential beneficiaries do not have the ability to insist on their fulfilment. Similarly, 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.

A liability is recognised only for a commitment that gives the recipient a valid expectation that payment will be made and from which the grantor cannot realistically withdraw. One of the implications of this is that a liability only exists where the commitment has been communicated to the recipient.

Commitments are not recognised if they are subject to performance-related conditions. In such a case, the entity is required to fulfil its commitment only when the performance-related conditions are met and no liability exists until that time.

A commitment may contain conditions that are not performance-related conditions. For example, a requirement to provide an annual financial report to the grantor may serve mainly as an administrative tool because failure to comply would not release the grantor from its commitment. This may be distinguished from a requirement to submit a detailed report for review and consideration by the grantor of how funds will be utilised in order to secure payment. A mere restriction on the specific purpose for which funds are to be used does not in itself constitute a performance-related condition.

For funding commitments that are not recognised, it is important that full and informative disclosures are made of their existence and of the sources of funding for these unrecognised commitments.

16 Allocating costs by activity in the SoFA (Module 8)

16.1 Introduction

This module requires larger charities above the statutory audit threshold to report on an activity basis, and since this is not dealt with in FRS 102 itself it is addressed in module 8.

The SoFA must distinguish between expenditure on charitable activities which contribute to furthering the charity’s aims and purposes, and those undertaken to provide funds. Further analysis of significant activities must be provided either on the face of the SoFA or in the notes.

The module gives further guidance on allocating costs and dealing with support costs.

16.2 SORP Helpsheet 2 – What’s changed

The approach to allocating support costs is unchanged from SORP 2005 but support costs now include governance costs as a separate component.

16.3 FRSSE SORP

The approach taken to this topic is the same in both SORPs

17 Disclosure of trustee and staff remuneration, related party and other transactions (Module 9)

17.1 Introduction

This section deals with the detailed disclosures required in relation to:

(a) Trustees' remuneration and benefits;
(b) Trustees' expenses;
(c) Transactions with related parties that require disclosure;
(d) Transactions with related parties that do not require disclosure;
(e) Disclosure of related party transactions;
(f) Disclosure of audit, independent examination and other financial service fees;
(g) Disclosure of ex-gratia payment
(h) Disclosure of staff costs and employee benefits; and
(i) Remuneration and benefits received by key management personnel.

17.2 SORP Helpsheet 2 – What's changed

The significant changes in the FRS 102 SORP are:

(a) The disclosures required for trustees equally apply to de-facto trustees.
(b) Clarification that trustee expenses include costs reimbursed and costs paid direct to third parties.
(c) Whilst the details of individual donations without conditions made by trustees need not be disclosed, the total amount donated must be disclosed (required by FRS 102).
(d) Unless immaterial, the total amount of expenses waived by trustees must be disclosed (required by FRS 102).
(e) Contributions by a charity to a pension fund for the benefit of employees must now be disclosed (required by FRS 102).
(f) Details of redundancy and termination payments for staff must be disclosed (required by FRS 102).
(g) All charities must disclose if the number of staff is paid £60,000 or more in bands of £10,000 from £60,000 upwards.
(h) The total paid to key management personnel must be disclosed (required by FRS 102).
(i) The glossary definition of a related party is now more closely aligned with the definition provided in section 33 of FRS 102 and charity law, particularly section 118 of the Charities Act 2011 (England and Wales) and section 68 of the Charities and Trustee Investment (Scotland) Act 2005.

17.3 FRSSE SORP

Due to FRS 102, the FRS 102 SORP requires a number of additional disclosures:

(a) The disclosure of the aggregate value of unconditional donations made by trustees is required.
(b) The disclosure of a charity's contributions to a pension fund for the benefit of employees.
(c) The terms and conditions of transactions with, and the details of any guarantee given or received from, related parties.
(d) More information on the nature, accounting policy and funding of termination payments.
(e) Disclosure of the total amount of employee benefits received by key management personnel.

18 The balance sheet (Module 10)

18.1 General

The balance sheet presentation under FRS 102 is based on CA 2006 format headings. This gives rise to an interesting problem in relation to terminology. Can an entity use the FRS 102 title e.g. inventories or must it use the CA 2006 heading stocks?

Interestingly the SORP continues to use the old terminology stocks!

18.2 Charities SORP

The balance sheet format remains unchanged. However, there is extra information on certain balance sheet items, in particular on social investments and how to account for them. Areas on heritage assets, total return on investments (if allowed) and the treatment of legacy income are other areas which have been 'beefed up'.

18.3 SORP helpsheet 2 – What's changed

The format of the balance sheet in SORP 2005 was based on the format specified in the Companies Acts modified for fund accounting. There are no substantive changes to the format of the balance sheet in the FRS 102 SORP.

The FRS 102 SORP requires that:

(a) Investment properties are measured initially at cost and subsequently at fair value at the reporting date. SORP 2005 permitted 'any reasonable approach to market valuations' but FRS 102 requires valuations to be made by an independent expert or disclosure that this has not been done.
(b) The class of mixed use investment property is introduced with the property apportioned between its investment use and operational use unless this is impractical in which case it is treated as a tangible fixed asset. SORP 2005 had required such mixed used properties to be classified based on main use of the property (SORP 2005, paragraph 257).
(c) Property which is let or occupied by another group undertaking must now be treated as investment property.
(d) Social investments are shown as a separate class of investment.
(e) Debtors recoverable more than 12 months after the year-end must be discounted to present value, if the effect is material.

18.4 FRSSE SORP

The format of the balance sheet is common to both SORPs. However, there are some differences in terminology. For example, the FRSSE refers to write down of assets whereas FRS 102 refers to impairment and the FRSSE refers to non-financial fixed assets whereas FRS 102 uses the term non-monetary fixed assets.

There are differences of detailed accounting treatments:

(a) The FRSSE does not permit revaluation of intangible fixed assets.
(b) Capitalised goodwill is not to have a life of more than 20 years under the FRSSE 2008 and is now assumed not to exceed 5 years under FRSSE 2015 where the economic life cannot be reliably measured. Following the issue of SORP Update Bulletin 1, the useful life may not exceed 10 years, if it cannot be measured reliably.
(c) Options of including tangible fixed assets and stock at a fixed amount where certain criteria are met are only available under the FRSSE.
(d) FRS 102 does not permit the exclusion from the category of investment property let and occupied by another group undertaking.
(e) Although both SORPs require the initial recognition of unlisted investments at cost, FRS 102 subsequently requires that, where practicable, they be measured at fair value under FRS 102; however, an alternate approach is permitted by the FRSSE.
(f) FRS 102 requires, in the absence of knowledge of any pension scheme liability, that any contractual obligation to make additional payments to a defined benefit pension scheme be recognised.

There are also differences in the approach taken to disclosure:

(a) FRS 102 requires more disclosures to do with intangible fixed assets.
(b) FRS 102 requires more disclosures to do with investments.
(c) FRS 102 requires more disclosures to do with stock.
(d) FRS 102 requires more disclosures to do with liabilities.
(e) Disclosures differ on contingent items with the FRSSE requiring disclosure of amounts to do with capital expenditure and FRS 102 asking for an indication of uncertainties and any reimbursement.

19 Financial assets and financial liabilities (Module 11)

19.1 Introduction

We are unable to provide a full commentary on financial instruments in this course but it is essential on transition to recognise that:

(a) Every entity will have some financial instruments as the definition of a financial instrument is "a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity."

This therefore includes trade debtors and creditors, bank loans and overdraft and shares held in another company, whether as trade investments, subsidiaries or associates or otherwise.

(b) Financial instruments are dealt with in FRS Section 11 (basic financial instruments) or section 12 unless they are covered by an alternative section. For example, leases are dealt with in section 16 and investments in a subsidiary company by section 9.

(c) The treatment of many basic financial instruments will not change, e.g. overdrafts and bank and other loans at market interest rates, trade debtors and creditors which do not include a financing element (generally due within one year);

(d) The treatment of some items currently included within the accounts will change e.g. loans on non-market terms and trade debtors which include a financing element.

(e) Note too that investments in non-convertible preference shares and non-puttable ordinary shares are required to be included at fair value, if fair value can be measured reliably.

This will invariably be the case with listed investments. This is in contrast with the current treatment which will almost certainly be at cost less impairment, although certain specialised entities such as charities and pension schemes may already be required to be include investments at fair value.

It may also be possible to fair value unlisted investments and if it is they should be included at fair value.

(f) Some items which are currently not recognised will require to be included. These include derivative financial instruments.

(g) Measurement of financial instruments will be on one of three bases:

a. Amortised cost – the normal measurement basis for basic financial instruments under Section 11;
b. Fair value – the normal basis for non-basic financial instruments under Section 12
c. Cost less impairment.

(h) It is also important to note that there is a transitional exception which ensures that any financial assets or liabilities which have been derecognised under old UK GAAP but that would not have been derecognised under FRS 102.

19.2 Action required on transition

It is essential that you identify which financial instruments require to be recognised and identify the appropriate measurement basis, and agree with client / auditor the approach to be adopted.

19.3 Charities and financial instruments

The SORP suggests that the following will be the typical financial instruments associated with charities:

Table 7: Common basic financial instruments

Financial instrument	Measurement on initial recognition
Cash	Cash amount received or paid
Debtors – including trade debtors and loans receivable (trade accounts and notes receivable)	Settlement amount after any trade discounts (provided normal credit terms apply) or amount advanced by the charity
Creditors – including trade creditors and loans payable (trade accounts and notes payable)	Settlement amount after any trade discounts (provided normal credit terms apply) or amount advanced to the charity
Overdraft (loan due on demand)	Amount of loan facility drawn down
Qualifying long-term loans (refer to the qualifying debt instrument criteria in FRS 102)	Amount of principal advanced less material arrangement or similar fees
Bank deposit	Cash amount of deposit
Investment in non-puttable (i.e. without an option to sell the equity holding at a later date at an agreed price) ordinary and preference shares or non-convertible preference shares	Transaction value (cost)
Loans advanced by the charity on market terms	Amount of principal advanced

19.4 SORP helpsheet 2 – What's changed

In accordance with FRS 102, the FRS 102 SORP distinguishes between accounting for 'basic' financial assets and financial liabilities and 'other' financial assets and financial liabilities. It identifies which financial instruments are classified as 'basic'.

If a charity holds other, more complex, financial instruments then reference must be made to the relevant sections of FRS 102. SORP 2005 made only limited reference to financial instruments (paragraph 338).

19.5 FRSSE SORP

The FRSSE has a much less detailed approach to financial instruments (financial assets, financial liabilities and equity instruments) than FRS 102 and this is reflected in the disclosures required. The FRS 102 SORP, reflecting the standard, differentiates between basic and other financial instruments. FRS 102 has very detailed and lengthy disclosures regarding financial instruments.

20 Public benefit entity concessionary loans (FRS 102 34.87 – 34.97)

20.1 Introduction

In this section FRS 102 addresses the recognition, measurement and disclosure of public benefit entity concessionary loan arrangements within the financial statements of public benefit entities or entities within a public benefit entity group making or receiving public benefit entity concessionary loans. These paragraphs apply to public benefit entity concessionary loan arrangements only and are not applicable to loans which are at a market rate or to other commercial arrangements.

20.2 Definition

Public benefit entity concessionary loans are loans made or received between a public benefit entity or an entity within the public benefit entity group, and another party at below the prevailing market rate of interest that are not repayable on demand and are for the purposes of furthering the objectives of the public benefit entity or public benefit entity parent**.**

20.3 Accounting treatment

Entities making or receiving public benefit entity concessionary loans shall use either:

(a) the recognition, measurement and disclosure requirements in Section 11 *Basic Financial Instruments* or Section 12 *Other Financial Instruments Issues* (for example, Section 11 requires initial measurement at fair value and subsequent measurement at amortised cost using the effective interest method); or

(b) the accounting treatment set out in paragraphs PBE34.90 to PBE34.97 below.

A public benefit entity or an entity within a public benefit entity group shall apply the same accounting policy to concessionary loans both made and received.

20.4 Initial measurement

A public benefit entity or an entity within a public benefit entity group making or receiving concessionary loans shall initially measure these arrangements at the amount received or paid and recognise them in the statement of financial position.

20.5 Subsequent measurement

In subsequent years, the carrying amount of concessionary loans in the financial statements shall be adjusted to reflect any accrued interest payable or receivable.

To the extent that a loan that has been made is irrecoverable, an impairment loss shall be recognised in income and expenditure.

20.6 Presentation and disclosure

The entity shall present concessionary loans made and concessionary loans received either as a separate line items on the face of the statement of financial position or in the notes to the financial statements.

Concessionary loans shall be presented separately between amounts repayable or receivable within one year and amounts repayable or receivable after more than one year.

The entity shall disclose in the summary of significant accounting policies the measurement basis used for concessionary loans and any other accounting policies which are relevant to the understanding of these transactions within the financial statements.

The entity shall disclose the following:

(a) the terms and conditions of concessionary loan arrangements, for example the interest rate, any security provided and the terms of the repayment; and
(b) the value of concessionary loans which have been committed but not taken up at the year end.

Concessionary loans made or received shall be disclosed separately. However multiple loans made or received may be disclosed in aggregate, providing that such aggregation does not obscure significant information.

<u>Illustration 6</u>

A charity lends £5,000 interest free to Mr & Mrs H Ardup under its charitable objectives for the relief of poverty. The loan is interest free and repayable in full after 3 years

<u>Comments on illustration 6</u>

The charity has an accounting policy choice; it can follow FRS 102 section 11 or section 34

FRS 102 Section 11

Although there is no actual interest payable, FRS 102 requires the present values to be calculated at an effective rate, being the market rate i.e. 10%.

The only cash outflow would be the capital repayment at the end of year 3 of £3,756.67. Cash received is £5,000.00.

How should the difference of £1,243.33 be treated?

The	***Interest calculation***	***Income statement***	***Balance sheet***
Initial			*3,756.57*
Year 1	*£3,756.67 @ 10%*	*375.66*	*375.66*
			4,132.23

Year 2	*£4,132.23*	*413.22*	*413.22*
			4,545.45
Year 3	*£4,545.45 @ 10%*	*454.55*	*454.55*
		1,243.43	*5,000.00*

When cash of £5,000 is paid at the end of year 3, the loan balance is cleared.

Note that the net effect in profit and loss account over the term of the loan, assuming no default, change in interest rates etc. is Nil.

	Debit	***Credit***
Initial receipt of funds		*1,243.33*
Year 1	*375.66*	
Year 2	*413.22*	
Year 3	*454.55*	
Total	*1,243.43*	*1,243.33*

Section 34

The treatment under S 34 is to recognise the loan at its face value, accrue any interest due, deduct any amounts received and write down to reflect any impairment.

Note that this choice also applies to loans ***to*** *the charity.*

21 Impairment of assets (Module 12)

21.1 Introduction

FRS 102 requires an impairment review only when there is an indicator of impairment. Under FRS 11 and 15 there were other situations in which an impairment review was required e.g. an impairment review of goodwill was required in the year of acquisition. An annual impairment review was required or if goodwill was assumed to have an indefinite useful life and was not being amortised or if it was being amortised over more than twenty years.

There should be no charity specific issues.

21.2 SORP Helpsheet 2 – What's changed

The requirements remain unchanged from SORP 2005.

21.3 FRSSE SORP

The FRSSE uses the term write-down whereas FRS 102 uses the term impairment. Both standards require an assessment of the carrying amount against its recoverable amount where circumstances indicate this is necessary. The FRSSE uses net realisable value whereas FRS 102 refers to fair value but both are assessed against an active market.

Where a present value is to be calculated the FRSSE makes reference to relevant UK government bonds whereas FRS 102 refers to a market rate. It is likely that for most charities the discount rate will be higher under FRS 102, when reference is made to the rate at which the charity could borrow, than the FRSSE, resulting in a lower present value when reporting under FRS 102.

22 Events after the reporting period (Module 13)

22.1 Introduction

The requirements of Section 32 are identical to those in the previous FRS 21. Accounts are adjusted for adjusting events and non-adjusting events are notes.

22.2 SORP Helpsheet 2- What's changed

The requirements remain unchanged from SORP 2005

22.3 FRSSE SORP

Aside from a difference in terminology, the treatment of adjusting and non-adjusting events is common to both SORPs.

23 Statement of cash flows (Module 14)

23.1 Scope of FRS 102 Section 7

The first question is whether a cash flow statement is required. The scope of FRS 102 Section 7 is similar to that in FRS 1 in that life assurance companies and retirement benefit plans are not required to prepare a cash flow statements.

The investment fund exemption may be wider under FRS 102 as it applies to all investment funds that meet the following conditions:

(a) Substantially all of the entity's investments are highly liquid;
(b) Substantially all of the entity's investments are carried at market value; and
(c) The entity provides a statement of changes in assets.

23.2 Cash flow statements and small companies

FRED 59 introduces an exemption from the requirement to prepare a cash flow statement analogous to that which was included in FRS 1. This is an important change as before it any small entity which had not followed FRSSE would have been required to include a cash flow statement unless it adopted FRSSE 2015.

23.3 Cash flow statements in group accounts

The big scope change is in relation to members of groups. The exemption in FRS 1 only applied to subsidiaries in which the parent held at least 90% of the voting rights. Under FRS 102 it is all qualifying entities. Therefore, more entities will be exempt from the requirement to produce a cash flow statement.

However, since the exemption from the requirement to produce a cash flow statement is now covered by the provisions of FRS 102 Section 1.8 – 1.12 and not within Section 7 (the cash flow section) the subsidiary needs to advise shareholders that it intends not to produce one.

There does not appear to be a requirement to advise the shareholders annually but good governance would suggest that where a continuing advice is in place, new shareholders are advised, especially any who's holding would give them the ability to require a statement to be prepared.

23.4 Analysis of items within the cash flow statement.

There are significant differences in the basis of the cash flow statement:

(a) FRS 102 deal with cash and cash equivalents whereas FRS 1 dealt with cash
(b) FRS 1 identifies the movement in cash whereas FRS 102 shows the movement, and the closing balance;
(c) There are also potential differences in the treatment of bank overdrafts which were never permitted to be included within cash under FRS 1 but can be under FRS 102 if "*they are repayable on demand and form an integral part of an entity's cash management."* Under such circumstances they can be treated as a component of cash and cash equivalents.
(d) There are only three categories of cash flow under FRS 102, rather than the eight or nine under FRS 1. These are cash flows from operations, from investing activities and from financing activities.
(e) FRS 102 does not have the concept of net debt and there are no reconciliations of net debt such as are required under FRS 1. In fact, the only note required by FRS 102 is the analysis of the closing balance between cash, cash equivalents and overdrafts

23.5 Charities SORP

The following tables present the templates included in the SORP (FRS 102).

Table 8: Statement of cash flows

		Total funds	Prior year funds	Note
		£	£	
	Cash flows from operating activities:			
	Net cash provided by (used in) operating activities	X	(X)	(Table 9)
	Cash flows from investing activities:			
	Dividends, interest and rents from investments	X	X	
	Proceeds from the sale of property, plant and equipment	X	X	
	Purchase of property, plant and equipment	(X)	(X)	
	Proceeds from sale of investments	X	-	
	Purchase of investments	-	(X)	
	Net cash provided by (used in) investing activities	X	X	
	Cash flows from financing activities:			
	Repayments of borrowing	(X)	(X)	
	Cash inflows from new borrowing	X	-	
	Receipt of endowment	X	X	
	Net cash provided by (used in) financing activities	X	X	
	Change in cash and cash equivalents in the reporting period	X	X	
	Cash and cash equivalents at the beginning of the reporting period	X	X	(Table 10)
	Change in cash and cash equivalents due to exchange rate movements	X	(X)	
	Cash and cash equivalents at the end of the reporting period	X	X	(Table 10)

Table 9: Reconciliation of net income/(expenditure) to net cash flow from operating activities

		Current Year	Prior Year
		£	£
	Net income/(expenditure) for the reporting period (as per the statement of financial activities)	**X**	**(X)**
	Adjustments for:		
	Depreciation charges	X	X
	(Gains)/losses on investments	X	(X)
	Dividends, interest and rents from investments	(X)	(X)
	Loss/(profit) on the sale of fixed assets	X	(X)
	(Increase)/decrease in stocks	(X)	X
	(Increase)/decrease in debtors	(X)	X
	Increase/(decrease) in creditors	X	(X)
	Net cash provided by (used in) operating activities	**X**	**(X)**

Table 10: Analysis of cash and cash equivalents

		Current year	Prior year
		£	£
	Cash in hand	X	X
	Notice deposits (less than 3 months)	X	X
	Overdraft facility repayable on demand	(X)	(X)
	Total cash and cash equivalents	**X**	**X**

23.6 SORP helpsheet 2 – What's changed

The statement of cash flows required by FRS 102 is based upon the statement developed by the International Accounting Standards Board and is different to the current format. The FRS 102 SORP continues to allow the choice of either the 'direct' or 'indirect' method.

SORP 2005 did not include a template and aside from giving advice on the treatment of cash flows related to endowments, it simply signposted to the relevant accounting standard - FRS 1. Module 14 includes templates illustrating the indirect method.

The SORP describes each of three mandatory headings: operating activities, investing activities and financing activities. It also gives examples of cash flows that fall within each heading and provides advice on the treatment of cash flows arising from endowments.

Eligible parent charities may opt to report using the disclosure exemptions permitted by section 1 of FRS 102 provided the disclosures required for related parties (see module 9) are made and so a parent does not need to prepare a statement of cash-flows for the parent charity itself.

23.7 FRSSE SORP

The cash-flow statement is optional under the FRSSE and its format is based on old GAAP with three sections: cash generated from operating activities, cash flows from other sources and application of cash.

The FRS 102 SORP based on new GAAP has three sections: cash flows from operating activities, investing activities and financing activities. A cash-flow statement is mandatory when preparing the accounts under FRS 102 and in following the FRS 102 SORP.

24 Charities established under company law (Module 15)

24.1 Introduction

Guidance is given in this module on the preparation of the directors' report and strategic report together with guidance on the summary income and expenditure account. The issues have been covered in the earlier notes.

24.2 SORP helpsheet 2 – What's changed

Reference is made to the requirement for a strategic report as a component of the directors' report but this is only required of UK charitable companies that qualify as medium or large companies. Guidance is added for charitable companies incorporated in the Republic of Ireland.

24.3 FRSSE SORP

This module deals with company law requirements which are common to charitable companies whether the accounts are prepared under the FRSSE or FRS 102. Charitable companies registered in the Republic of Ireland cannot use the FRSSE.

The section referring to the 'strategic report' (UK only) is omitted from the FRSSE SORP as this a requirement of only medium and large companies. Also reference to a 'fair value reserve' is omitted from the FRSSE.

25 Presentation and disclosure of grant-making activities (Module 16)

25.1 Introduction

This is now covered by a separate section within the SORP – section 16. There are unlikely to be any difficulties in meeting these disclosures which are in line with those currently included in the Trust's accounts.

25.2 SORP helpsheet 2 - What's changed

The FRS 102 SORP does not permit details of institutional grants to be made by way of a separate publication rather than in the notes to the accounts but it does permit this information to be provided on a charity's webpage provided certain conditions are met or in the trustees' annual report.

25.3 FRSSE SORP

The approach taken to this topic is the same in both SORPs.

26 Retirement and post-employment benefits (Module 17)

26.1 Introduction

This module follows the revised guidance in FRS 102 under which deficits on defined benefit deficits in multi-employer and group schemes will be recognised earlier than under FRS 17.

Guidance is given on the allocation of deficits and surpluses to funds which must be on a reasonable basis.

Note that one of the implications of auto-enrolment is that more charities will have to have regard to this module!

26.2 SORP Helpsheet 2 – What's changed

The requirements for defined contribution plans are unchanged. For defined benefit plans reference is made to FRS 102. In the case of a charity contributing to a multi-employer defined benefit pension plan where its share of an actuarial deficit cannot be identified these are treated as defined contribution schemes. However, where an agreement is in place to make additional contributions based on current and past service of employees a liability must be recognised for the present value of outstanding additional contributions (as required by FRS 102).

26.3 FRSSE SORP

The underlying methods and principles for the treatment of defined contribution and defined benefit pension schemes are very similar though FRS 102 offers some simplifications to the method of making calculations for defined benefit pension schemes. The FRSSE uses the term 'scheme' whereas FRS 102 makes reference to 'plan'.

In the circumstances where a charity is participating in a multi-employer defined benefit pension scheme and it has been asked to make additional contributions but its share of any actuarial pension liability cannot be identified, the FRSSE SORP permits a charity to continue with its existing accounting policy whereas the FRS 102 SORP requires the present value of any additional repayments due to past service to be recognised as a liability.

Reflecting differences in the underlying standards, the FRSSE SORP and FRS 102 SORP have different disclosures for defined contribution and defined benefit pension schemes. FRS 102 requires more disclosure to a greater level of detail than the FRSSE.

27 Heritage assets (Module 18)

27.1 Introduction

The guidance is similar to that in FRS 30 and in addition to module 18, the charity has to follow the requirements in FRS 102 section 34.

27.2 SORP helpsheet 2 - What's changed

The FRS 102 SORP adopts the definition of heritage assets in FRS 102 and drops the explicit link between the objects of the charity and whether or not an asset qualifies as a heritage asset. Instead the FRS 102 SORP sets out three criteria which have to be met if a charity which does not have preservation or conversation objects wishes to account for tangible fixed assets as heritage assets.

The approach to recognition and measurement in SORP 2005 was at cost or valuation. The FRS 102 SORP requires recognition at historical cost or valuation with initial recognition of donated heritage assets at their fair value where practicable.

27.3 FRSSE SORP

Heritage assets are not considered PBE specific and therefore the FRSSE SORP permits a charity to continue with its existing accounting policies provided those policies reflect accepted practice and relevant disclosures are made. Otherwise the FRSSE SORP requires the charity to follow current practice and so the definitions and accounting policies are as for the FRS 102 SORP.

The disclosures that are mandatory in the FRS 102 SORP are best practice in the FRSSE SORP with the expectation that where a charity has no existing practice that the charity will follow current practice. As a matter of good practice users of the FRSSE SORP should make the same disclosures as required by the FRS 102 SORP.

28 Accounting for funds received as agent or as a custodian trustee (Module 19)

28.1 Introduction

In general, funds received as agents are excluded as assets of the charity as they are not under its control. They are therefore excluded from the SoFA but income received for acting as agents (and expenditure incurred in so acting) is included.

Guidance is given to enable charities to assess whether or not they are receiving funds as agent or principal.

There are some presentational and disclosure requirements.

28.2 SORP helpsheet 2- What's changed

The FRS 102 SORP has new guidance at a principles level which distinguishes the accounting treatments for consortium arrangements.

28.3 FRSSE SORP

The approach taken to this topic is the same in both SORPs.

29 Accounting for investments (Modules 20 – 22), investment policy and reporting

29.1 The SORP

Module 20 explains how to account on the total return basis and module 21 deals with accounting for social investments. Module 22 covers accounting for charities pooling funds for investments.

29.2 SORP helpsheet 2 – What's changed Total return (investments) (Module 20)

The FRS 102 SORP sets out the accounting treatment to be followed by charities that invest permanently endowed funds on a total return basis. SORP 2005 had addressed this issue in less detail.

29.3 FRSSE SORP – Module 20

This module is only applicable to charities established in the jurisdiction of England and Wales. The approach taken to this topic is the same in both SORPs.

29.4 SORP helpsheet 2 – What's changed Social investments (Module 21)

The FRS 102 SORP introduces a new class of investment termed 'social investment'. Social investment covers 'programme related investments' which is used in the same way as SORP 2005 (paragraph 308) to describe investments made primarily to further the charitable aims of the investing charity. Social investment also includes a new sub-class of investment termed 'mixed motive investments' which is an investment made both to generate an investment return and to further the investing charity's purposes.

The FRS 102 SORP provides that charities may use the cost model for concessionary loans. The cost model can also be used for other social investments when a reliable estimate of 'fair value' is not practical. Otherwise social investments are recognised at their fair value. The FRS 102 SORP sets out on what basis social investments are reclassified and the treatment of impairment.

29.5 FRSSE SORP – Module 21

The approach taken to this topic is largely the same in both SORPs. However, there are areas of difference:

(a) the FRSSE term 'written down' is used in place of the FRS 102 term 'impairment'; and
(b) when measuring a social investment made in ordinary or preference shares, the FRSSE requires recognition at cost or market value whereas FRS 102 requires recognition at fair value, an approximation to fair value or if fair value cannot be estimated reliably cost less impairment. (Where shares are traded or there have been recent transactions valuations are likely to be the same under either SORP. Similarly, where a market value/fair value is not available then valuation at cost will yield the same result.)

Otherwise, the approach taken to disclosure is the same in both SORPs.

29.6 SORP helpsheet 2 – What's changed - Accounting for charities pooling investments

The FRS 102 SORP provides new guidance on how charities should report pooling of investments and sets out how charities established as investment funds must account for those funds.

29.7 FRSSE SORP – Module 22

The approach taken to this topic is the same in both SORPs.

30 Charities and group accounts (Modules 23 – 29)

30.1 Introduction

In earlier notes we considered the legal requirements for group accounts. In these 7 modules the SORP provides guidance on the detailed application of FRS 102 in preparing such group accounts.

Charitable groups will be impacted by the general changes introduced in FRS 102 sections 18 and 19 on business combinations, by the changes in joint venture accounting brought about by the differences between FRS 9 and Section 15 FRS 102 and by specific issues addressed in the SORP, although in practice few charities will see significant changes arising.

The 7 modules are:

(a) Module 23 – overview;
(b) Module 24 – accounting for groups and the preparation of consolidated accounts;
(c) Module 25 – branches, linked or connected charities and joint arrangements;
(d) Module 26 – charities as subsidiaries;
(e) Module 27 – charity mergers;
(f) Module 28 – accounting for associates;
(g) Module 29 – accounting for joint ventures.

30.2 Requirement for group accounts

Since the definition of subsidiary and the basis of group accounts, including the exemption from the requirement to produce group accounts is based on Companies Act 2006 there are unlikely to be any significant changes in whether or not group accounts are required.

The big changes arise when group accounts are required.

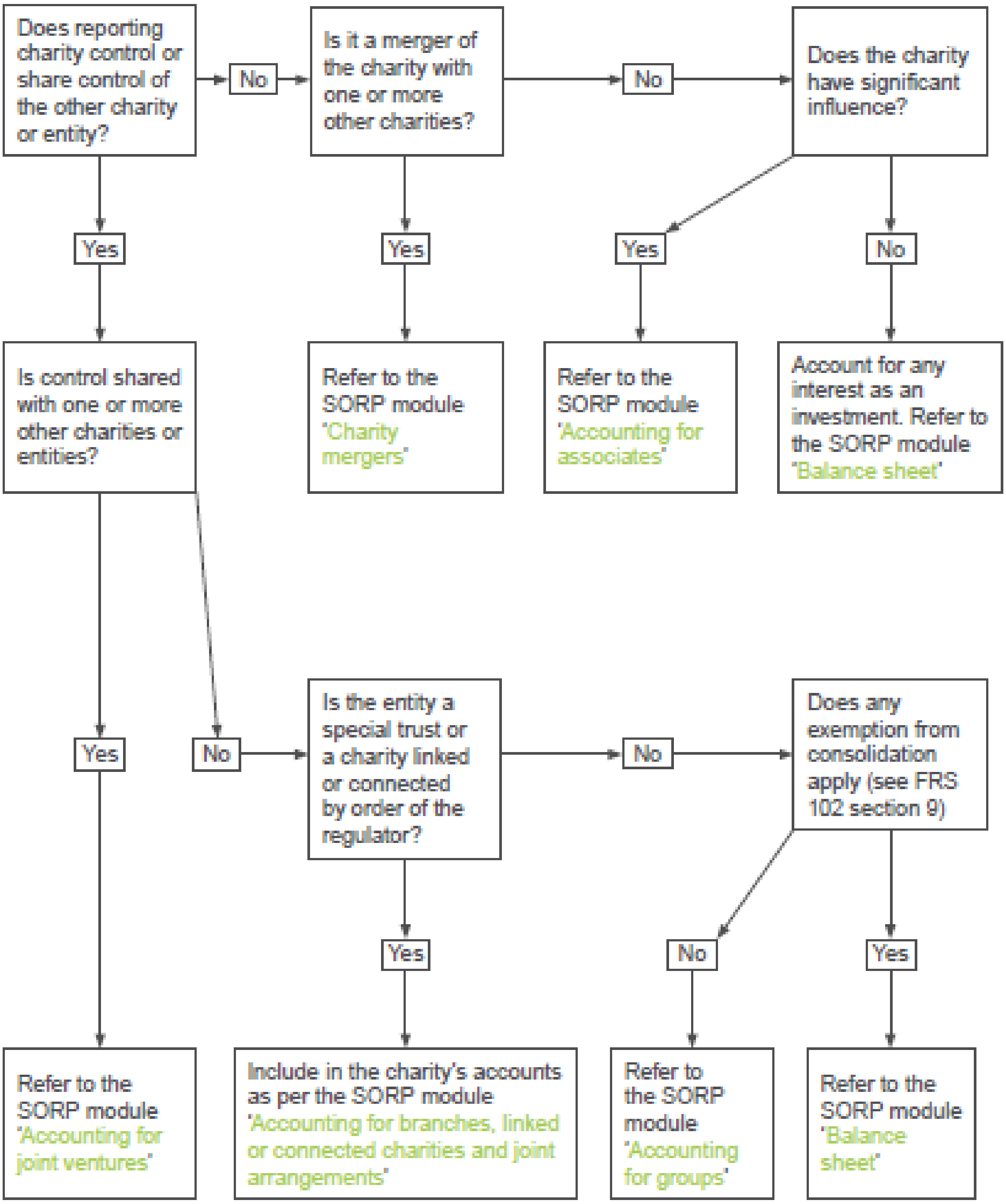
30.3 Business combinations

FRS 102 prohibits the use of merger accounting except in the case of business reconstructions. If merger accounting has been used on previous business combinations, they will need to be restated on the acquisition basis.

30.4 SORP helpsheet 2 – Accounting for branches, charity groups and combinations (Module 23)

The FRS 102 SORP provides a flow chart to assist preparers to identify which modules apply to particular combinations.

Figure 2: Guide to accounting for charity combinations



30.5 FRSSE SORP – Module 23

The approach taken to this topic is the same in both SORPs.

31 Accounting for groups and the preparation of consolidated accounts (Module 24)

31.1 SORP helpsheet 2 - What's changed

The FRS 102 SORP provides new guidance which clarifies the treatment for charity combinations. An interest acquired in a charity is treated as a gain or a loss or, if the applicable criteria are met, as a merger. Treating acquisitions as one sided transfers is not permitted. The SORP requires that negative goodwill on acquiring an interest in a charity is recognised as a gain in the SoFA in the year of acquisition.

Regarding non-charitable acquisitions, FRS 102 presumes that goodwill has a maximum 5-year life. (Note this has now been amended to 10 years see update bulletin below.)

31.2 FRSSE SORP

The preparation of consolidated accounts is not considered PBE specific and therefore the FRSSE SORP permits a charity to continue with its existing accounting policies provided those policies reflect accepted practice. Otherwise charities following the FRSSE should adhere to current practice which is the same as that required of charities following FRS 102.

The disclosures required differ in only the following instances:

(a) Charities following FRS 102 must provide some additional disclosures where a controlling interest is acquired in non-charitable subsidiaries.
(b) Charities following the FRS 102 must also disclose particulars of goodwill and negative goodwill.

32 Branches, linked or connected charities and joint arrangements (Module 25)

32.1 SORP helpsheet 2 – What's changed

The FRS 102 SORP clarifies the definition by specifically excluding incorporated charities from being treated as branches. Incorporated charities, whether or not linked or connected, are accounted for as subsidiaries within the group accounts and not within the charity's own individual accounts as a branch.

32.2 FRSSE SORP

The approach taken to this topic is the same in both SORPs.

33 Charities as subsidiaries (Module 26)

33.1 SORP helpsheet 2 – What's changed

The FRS 102 SORP adds new guidance for those charities which are subsidiaries of another entity.

33.2 FRSSE SORP

The approach taken to this topic is the same in both SORPs.

34 Charity mergers (Module 27)

34.1 SORP helpsheet 2 – What's changed

The FRS 102 SORP sets out the criteria for treating a combination as a merger and the basis upon which charity reconstructions can also be treated as mergers. For example, when a charity changes its constitutional form from unincorporated and incorporates this can be regarded as a reconstruction allowing the adoption of merger accounting.

34.2 FRSSE SORP

The approach taken to this topic is the same in both SORPs.

35 Accounting for associates (Module 28)

35.1 SORP helpsheet 2 – What's changed

The FRS 102 SORP provides that where a charity has an associate interest in another charity the rebuttable presumption, in the absence of information to the contrary, is that the charity's interest is calculated by reference to voting rights.

35.2 FRSSE SORP

The topic of accounting for associates is not considered PBE specific and therefore the FRSSE SORP permits a charity to continue with its existing accounting policies provided those policies reflect accepted practice. Otherwise charities following the FRSSE should adhere to current practice which is the same as that required of charities following FRS 102.

Charities following FRS 102 must provide more disclosures than those following the FRSSE.

36 Accounting for joint ventures (Module 29)

36.1 SORP helpsheet 2 – What's changed

FRS 102 requires the use of the 'equity' method of accounting for joint venture charities and joint venture entities in consolidated (group) accounts. The effect of the equity method of accounting is to show a charity's share of the net income or net expenditure of the joint venture entity as single line in the SoFA with the charity's share of net assets recognised in the balance sheet. This is a change from SORP 2005 that required the gross equity method to be used in the preparation of the consolidated (group) accounts.

36.2 FRSSE SORP

The topic of accounting for joint ventures is not considered PBE specific and therefore the FRSSE SORP permits a charity to continue with its existing accounting policies provided those policies reflect accepted practice. Otherwise charities following the FRSSE should adhere to current practice which is the same as that required of charities following FRS 102.

Charities following FRS 102 must provide more disclosures than those following the FRSSE.

37 Public benefit entity combinations (FRS 102 34.75-34.86)

37.1 Introduction

This section applies only to public benefit entities when it combines with another entity:

(a) At nil or nominal consideration in a combination which is in substance a gift, or
(b) The combination meets the definition and criteria for a merger.

All other combinations are accounted for in accordance with section 19.

37.2 Combinations that are in substance a gift

Section 19 should be followed except that any excess of fair value of assets received over liabilities assumed is recognised as a gain in profit and loss account (and not as negative goodwill). Similarly, where there is an excess fair value of liabilities over assets, this is recognised in profit and loss as a loss and not as goodwill.

37.3 Combinations that meet the definition and criteria for a merger

Merger accounting is permitted.

38 Appendix 1 - Charity governance, finance and resilience: 15 questions trustees should ask

Strategy - a charity's plan of action designed to achieve a long-term overall aim		
1.	**What effect is the current economic climate having on our charity and its activities?**	
1.1.	Are we focusing on the right things, or have we drifted into activities that are over and above our core charitable aims? If we have, should we stop those activities?	
1.2.	How stable and reliable is our funding to support our plans? If we are relying on a single source of income (such as grant funding or investment income), should we look at other sources of funding?	
1.3.	How do we think the political, economic, social and technological environment in which we work is going to change? How can we best reflect this in any forward planning that we do? Does it present us with any immediate opportunities? For example: (a) recruiting volunteers including those with different skills (b) collaborating with others to provide skills, accommodation, equipment or increased buying power (c) re-negotiating contracts (d) bidding for public service delivery contracts	
1.4.	Are there particular risks we should consider? For example: (a) increased (or reduced) demand for services, or changes in the type of services needed (b) reduced income from investments and savings (c) funding uncertainty	
1.5.	Should we think about whether we want to, or are able to, continue operating? Could closing the charity and passing its resources to a similar charity be a better use of scarce funding and resources?	
Financial health		
2.	**Are we financially strong enough to continue to provide services for our beneficiaries?**	
2.1.	Do we have up to date information about our charity's finances, cash flow and debts/obligations? The financial information provided at each trustee meeting should typically include: (a) the latest management accounts (b) a comparison of budget to actual figures (c) an explanation for variances between forecasts and what actually happened (d) details of cash flow and closing bank balances	
2.2.	Do we have access to the right type of financial/professional advice?	
2.3.	Based on the information we have, can we: (a) tell what might happen to our future income? (b) protect (or increase) our current income? (c) continue our programme of activities for the foreseeable future? (d) make our money go further, for example by identifying costs we can cut? (e) fulfil our contractual obligations? (f) meet our financial commitments as they fall due? (g) tell if the charity is facing potential insolvency?	
2.4.	Are we clear about the core activities we want to sustain under	

	any circumstances?	
2.5.	Are we clear about the charity's financial prospects for the longer term?	
2.6.	Are we confident that we will be able to identify and address potential insolvency in good time?	
2.7. `	Have we planned for an orderly wind up of the charity's affairs if the charity is no longer viable?	
3.	**Do we know what impact the social and/or economic climate is having on our donors and support for our charity?**	
3.1.	How secure is our existing funding, for example contracts from other bodies for service delivery, statutory funding or grants, for the foreseeable future?	
3.2.	Is it possible to diversify or broaden our sources of income? For example, there are new opportunities for funding such as organisations, charities and investors that can provide loans and other support to charities as a social investment.	
3.3.	Do we need to rethink our fundraising strategy?	
3.4.	Have we considered other factors that might influence our supporters? Reputational issues and any of a charity's policies can affect the support of its donors, for example the way the charity invests its money or the way it fundraises.	
4.	**What is our policy on reserves?**	
4.1.	What will the consequences be for our charity's beneficiaries (in particular vulnerable beneficiaries) if the charity has no financial reserves to enable it to continue in the event of loss of regular income?	
4.2.	Do we have a clear, published reserves policy that meets the needs of our charity? If not, we need to show why we do, or do not.	
4.3.	Does our policy: (a) fully justify and clearly explain keeping or not keeping reserves? (b) identify and plan for the maintenance of essential services for beneficiaries? (c) reflect the risks of unplanned closure associated with the charity's business model, spending commitments, potential liabilities and financial forecasts? (d) help to address the risks of unplanned closure on their beneficiaries, staff and volunteers?	
4.4.	Do we know what the level of our reserves is now? We need to assess what assets are freely available and not already set aside or designated for particular purposes.	
4.5.	Have we considered: (a) new priorities or needs (for example an increased demand for our services or a change in our activities) which have arisen because of changes in our financial and social environment? (b) the level of reserves needed to meet new priorities and needs, a longer term strategy to replenish reserves, or spending them in their entirety? (c) using reserves to restructure our work?	
5.	**Are we satisfied with our banking arrangements and our current and future investment policy?**	
5.1.	How often do we review our banking arrangements?	
5.2.	Does our bank offer the range of services that we need? For example: (a) online banking with suitable security measures (b) appropriate access to cash on deposit	

	(c) a loan facility	
5.3.	Have we considered the costs and benefits of our current and deposit accounts to ensure competitive interest rates?	
5.4.	Are our deposits protected by the Financial Services Compensation Scheme?	
5.5.	Have we considered the services offered by other banks with a view to switching our provider?	
5.6.	Have we recently reviewed our investment policy to ensure that it is appropriate for current and future needs?	
5.7.	Have we arranged for regular investment policy reviews, taking into account the fact that sudden changes in the economic climate might mean they should take place more regularly?	
5.8.	Have we reviewed the diversity, suitability and risks associated with our spread of investments?	
6.	**Have we reviewed our contractual commitments?**	
6.1.	Do we know what our contractual commitments are - they might include office leases, rental agreements, equipment hire?	
6.2.	Could we collaborate with other organisations to save costs on essential support or back office expenses?	
6.3.	Do we understand the obligations of any existing or new contracts?	
6.4.	Are these obligations manageable for our charity now and for the remainder of the contract?	
6.5.	How do we terminate our contracts in an emergency?	
6.6.	Should we review any contracts we have with fundraisers for value for money and reputational risks?	
6.7.	If we cannot meet the terms of a contract, are we aware of the financial and reputational risks we could face?	
7.	**Have we reviewed any contracts to deliver public services?**	
7.1.	Do we understand the obligations of our existing contracts?	
7.2.	Are these obligations manageable in light of the charity's current and probable future situation?	
7.3.	Can we terminate any contracts we are party to if necessary?	
7.4.	If we cannot meet the terms of a contract are we aware of the financial and reputational risks we could face?	
7.5.	Are we fully aware of the risks and obligations attached to taking on new public service delivery contracts?	
7.6.	Have we explored the different ways in which we can achieve our charity's aims as an alternative to entering into a new contract?	
8.	**If we have a pension scheme, have we reviewed it recently?**	
8.1.	Do we know the risks and liabilities attached to our charity's pension scheme?	
8.2.	What plans do we have to manage those risks and liabilities?	
8.3.	Does our financial reporting make it clear what our pension liabilities are and what we are doing to manage any risk to our charity?	
8.4.	Do we need to take specialist advice?	
9.	**How can we make best use of any permanent endowment investments we hold?**	
9.1.	Do we know whether any of our funds represent permanent endowment and can only be invested to produce income for our charity?	
9.2.	Do we think that the interests of our charity and its beneficiaries would be better served by making use of the greater flexibility to spend permanent endowment offered by the charities act?	
9.3.	Can we take advantage of the power to use a total return approach to investment (this is usually only appropriate for larger	

	permanently endowed charities)?	
Governance		
10.	**Are we an effective trustee body?**	
10.1.	Do we understand: (a) the charity's purposes as set out in its governing document? (b) what our charity will do, and what we want it to achieve? (c) how all of the charity's activities are intended to further or support its purposes? (d) how the charity benefits the public by carrying out its purposes?	
10.2.	Have we read and understood The Essential Trustee (CC3)?	
10.3.	Have we recently reviewed our performance as a trustee body?	
10.4.	Are we using our time together as a Board efficiently and effectively? Have we read the accounts, reports and other background material before the meeting?	
10.5.	Have we recently reviewed the skills, knowledge and experience we have as a trustee body? Have our needs changed?	
10.6.	Are we aware of the importance of effective communication and negotiation with those with an interest in our charity, including our staff?	
10.7.	Do we have sufficient oversight and knowledge of the activities of external people and organisations acting on our behalf?	
10.8.	Do we have the guidance we need to ensure that our decisions are made in the best interests of our charity and its beneficiaries?	
10.9.	Do we know what, if any, conflicts of interests might affect our decision making?	
10.10.	Do we need to monitor the charity's affairs more closely, for example by meeting more frequently?	
10.11.	Do we feel able to take difficult or unpopular decisions if needed, for example about: (a) ending or changing some activities? (b) changing staffing levels? (c) changing staff benefits? (d) merging with another charity? (e) winding up the charity?	
11.	**Do we have adequate safeguards in place to prevent fraud?**	
11.1.	Do we have proper financial controls and procedures in place to prevent fraud?	
11.2.	Do they need reviewing and updating, to take account of any increased risk of fraud as a result of changes in the economic and social environment the charity operates in? An example might be the greater prevalence of computer fraud.	
11.3.	Are there controls and procedures in place to reduce the risk of misuse of personal data?	
Making best use of resources		
12.	**Are we making the best use of the financial benefits we have as a charity?**	
12.1.	Do we understand how to make the most of Gift Aid?	
12.2.	Are we making the most of our potential tax relief as a charity?	
12.3.	Are we aware of any government financial help available for charities? If yes, have we considered whether it is appropriate for our charity, and whether to apply for it?	
12.4.	Have we looked into other types of financial help only available to charities? For example, loans and grants from other organisations and charities.	
12.5.	Do we know where to go for information on how to take advantage	

	of the growing interest in social investment into charities?	
12.6.	Have we considered whether any trading activities should be hived off to a subsidiary trading company in order to avoid tax liabilities?	
13.	**Are we making the best use of our staff and volunteers?**	
13.1.	Are we aware of our obligations as employers and do we know where to go for further information?	
13.2.	Do we have a safeguarding policy?	
13.3.	Do our staff have the right mix of skills and experience that our charity needs to be effective?	
13.4.	Could we introduce more flexible patterns of working in order to focus our resources where most needed?	
13.5.	Do we still need the same type and number of staff? Are there better opportunities to recruit in a more competitive job market?	
13.6.	Are we making the best use of any interest in volunteering for charities?	
13.7.	Are we proactive in attracting potential volunteers and have we reviewed the way we support and use them?	
14.	**Have we considered collaborating with other charities?**	
14.1.	Are there activities that we think could be run more effectively by working with others, such as sharing equipment, sharing staff, running joint training sessions, purchasing or sharing back office services?	
14.2.	Do we know how to identify other charities with similar purposes operating in our area that we could contact to discuss possible collaboration or joint working?	
14.3.	Should we consider the possibility of a formal merger with another charity or charities in the interests of our beneficiaries?	
15.	**Are we making the best use we can of our property?**	
15.1.	Have we thought about how we can use any assets, such as buildings or equipment we own or rent? Could we use them differently, share them with others, re-negotiate terms or sell them?	
15.2.	Have we reviewed the costs and benefits of how we hold property? For example, buying, selling, renting or leasing?	
15.3.	Have we reviewed any insurance policies we hold - can we get a better deal?	
15.4.	What will any change in use of our property mean in terms of insurance?	

39 Appendix 2 – Example independent examiner reports

39.1 Current report (charitable company in England and Wales)

Independent Examiner's Report to the Trustees of XYZ Charity Ltd
I report on the accounts of the company for the year ended (date) which are set out on pages … to …

Respective responsibilities of trustees and examiner
The trustees (who are also the directors of the company for the purposes of company law) are responsible for the preparation of the accounts. The trustees consider that an audit is not required for this year under section 144(2) of the Charities Act 2011 (the 2011 Act) and that an independent examination is needed. [The charity's gross income exceeded £250,000 and I am qualified to undertake the examination by being a qualified member of (named body).]

Having satisfied myself that the charity is not subject to audit under company law and is eligible for independent examination, it is my responsibility to:

- examine the accounts under section 145 of the 2011 Act;
- follow the procedures laid down in the general Directions given by the Charity Commission under section 145(5)(b) of the 2011 Act; and
- state whether particular matters have come to my attention.

Basis of independent examiner's report
My examination was carried out in accordance with the general Directions given by the Charity Commission. An examination includes a review of the accounting records kept by the charity and a comparison of the accounts presented with those records. It also includes consideration of any unusual items or disclosures in the accounts, and seeking explanations from you as trustees concerning any such matters. The procedures undertaken do not provide all the evidence that would be required in an audit and consequently no opinion is given as to whether the accounts present a "true and fair view" and the report is limited to those matters set out in the statement below.

Independent examiner's statement
In connection with my examination, no matter has come to my attention:

1. which gives me reasonable cause to believe that, in any material respect, the requirements:
   - to keep accounting records in accordance with section 386 of the Companies Act 2006; and
   - to prepare accounts which accord with the accounting records, comply with the accounting requirements of section 396 of the Companies Act 2006 and with the methods and principles of the Statement of Recommended Practice: Accounting and Reporting by Charities

   have not been met; or

2. to which, in my opinion, attention should be drawn in order to enable a proper understanding of the accounts to be reached.

Name
Relevant professional qualification or body
Address
Date

39.2 Proposed revised independent examiner's report

Independent examiner's report to the trustees of XYZ Charitable company

I report on the accounts of the company for the year ended 30 April 2017 which are set out on pages xx to xx.

Responsibilities and basis of report

As the charity's trustees (and also as directors of the company for the purposes of company law) you are responsible for the preparation of the accounts in accordance with the requirements of the Companies Act 2006.

Having satisfied myself that the charity is not subject to the requirement for an audit under company law and is eligible for independent examination, I have examined your charity's accounts as required by section 145 of the Charities Act 2011 ('the Act'). In carrying out my examination I have followed the Directions given by the Charity Commission under section 145(5)(b) of the 2011 Act.

My role is to state whether any material matters have come to my attention giving me cause to believe:

1. that accounting records were not kept as required by section 386 of the Companies Act 2006; or
2. that the accounts do not accord with those records; or
3. that the accounts do not comply with the accounting requirements of section 396 of the Companies Act 2006 and the methods and principles of the Charities Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in The United Kingdom and Republic of Ireland; or
4. that there is further information needed for a proper understanding of the accounts.

Independent examiner's statement

Since your charity's gross income exceeded £250,000 your examiner must be a member of a listed body. I conform that I am qualified to undertake the examination because I am a registered member of [named body e.g. ICAEW] which is one of the listed bodies.

I have completed my examination and I have no concerns in respect of any of the matters listed in (1) to (4) above and in connection with following the Directions of the Charity Commission I have found no matters that require drawing to your attention.

Name

Relevant professional qualification stated and name of listed body given

Address

Date