

SORPs 2014

Mission Finance Officers' Forum
February 2014

DON BAWTREE, NATIONAL HEAD OF CHARITIES



THE SORP ED BACKGROUND & HISTORY

The current SORP:

- Accounting and reporting by Charities: SORP 2005 (update 2008)
- Based on existing UK GAAP (law + FRS 1 to 30/FRSSE)
- Intended to interpret the financial reporting framework for application to charities

Why do we need a new SORP?

- UK GAAP as we know it will be replaced for periods commencing on **1 January 2015**
- FRS 100, FRS 101 & FRS 102 replace the existing standards
- Principles loosely based on IFRS but will be UK standards



THE SORP ED OVERVIEW

- Jointly issued by the Charity Commission and OSCR
- At 200 pages is significantly longer than the existing SORP
- Intended as a ‘one-stop-shop’
- Deals with entities still permitted to use FRSSE
- “Small first” approach



THE SORP ED

THE MAIN CHANGES PROPOSED

MODULES

- The SORP is analysed into distinct sections
- Some modules are mandatory whilst others will only be needed if relevant to a charity
- The intention is that each charity will be able to ‘build’ their own SORP
- **Special sections dealing with:**
 - Special transactions (company law, grant making, DB scheme)
 - Special assets (heritage assets)
 - Investments
 - Business combinations and groups

THE SORP ED

THE MAIN CHANGES PROPOSED

PRINCIPLES AND ‘SMALL FIRST’ APPROACH

- The SORP includes clear principles of financial reporting which describes the basis on which the SORP is prepared
- ‘small first’ with ‘additional’ information for large charities

TRUSTEES ANNUAL REPORT

- Increased focus on risk and strategy
- expects charities to provide more specific information on reserves

“MUST”, “SHOULD” & “MAY”

- **MUST** = likely to be necessary to achieve a true and fair view
- **SHOULD** = reflective of best practice
- **MAY** = optional additional information

THE SORP ED

THE MAIN CHANGES PROPOSED

THE STATEMENT OF FINANCIAL ACTIVITIES

- **Simpler presentation, terminology and categories of income and expenditure**
- **Use of the term ‘resources’ largely removed**
- **Income will comprise:**
 - donations
 - income from charitable activities
 - income from other activities
 - investment income
- **Expenditure will normally be activity based, with a focus on the charitable activities discussed in the trustees report**
- **SORP ED does not imply same exemption from preparing separate entity SOFA in group accounts**

THE STATEMENT OF FINANCIAL ACTIVITIES

KEY OBSERVATIONS

Table 2: Statement of financial activities

	Unrestricted funds	Restricted funds	Endowment funds	Total funds	Prior period total funds	Further details
	£	£	£	£	£	
Income and endowments:						
Donations						A1
Earned from charitable activities						A2
Earned from other activities						A3
Investment and other income						A4
Total						
Expenditure:						
Cost of raising funds						B1
Expenditure on charitable activities						B2
Other expenditure						B3
Total						
Net incoming resources (resources expended) before investment gains/(losses)						
Net gains/(losses) on investments						B4
Net incoming resources (resources expended)						
Transfers between funds						C
Other recognised gains/(losses):						
Gains/(losses) on revaluation of fixed assets						D1
Actuarial gains/(losses) on defined benefit pension schemes						D2
Other gains/(losses)						D3
Net movement in funds						
Reconciliation of funds:						E
Total funds brought forward						
Total funds carried forward						

DIFFERENCES

- Simpler terms used throughout
- Less ‘layers’ of disclosure
- Net gains/losses on investments now before “net incoming resources”
- Additional analysis only required where considered necessary for true and fair view
- Governance costs will be allocated and apportioned as a support cost

Sofa	2013	2012
Income:		
Unrestricted income	x	x
Restricted income	x	x
Total	<u>x</u>	<u>x</u>
Cost of raising income	(x)	(x)
Funds available for charitable use	<u>x</u>	<u>x</u>
Charitable expenditure:		
Dogs	x	x
Cats	x	x
Horses	x	x
Total charitable expenditure	<u>x</u>	<u>x</u>
Surplus deficit	<u>x</u>	<u>x</u>
of which unrestricted comprises	x	x
Endowment gains	x	x
Surplus including gains	<u>x</u>	<u>x</u>
Pension adjustment	x	x
Revaluations	x	x
Total movement for year	<u>x</u>	<u>x</u>
Opening funds	x	x
Closing funds	<u>x</u>	<u>x</u>



THE STATEMENT OF FINANCIAL ACTIVITIES

KEY POINTS TO CONSIDER

- Is the retention of a columnar fund-based format appropriate?
- What alternatives should the SORP Working Party consider?
- What do you think of the terminology simplifications?
- Do the proposals require the most appropriate information on the face of the SoFA?

THE SORP ED

THE MAIN CHANGES PROPOSED

INCOME RECOGNITION

- **Income will be recognised when:**
 - The charity has entitlement to the income and
 - The likelihood of receipt is **probable** and
 - The amount can be measured reliably
- **This represents a change from “virtually certain” under the existing SORP**
- **SORP ED provides guidance on:**
 - Understanding the nature of income to understand SoFA allocation
 - Looking to the substance of the transaction
 - Performance conditions vs restrictions
 - The importance of ‘control’ in determining the impact of conditions

INCOME RECOGNITION LEGACIES

- The existing SORP stipulates that sufficient certainty will be achieved “when the charity receives a letter from the personal representatives of the estate advising that payment of the legacy will be made or that property bequeathed will be transferred”
- **The requirements for recognition has changed to:**
 - Evidence of entitlement - when executor has determined that a payment can be made or on notification that payment will be made.
 - Receipt is ‘**probable**’ following probate (sufficient assets, conditions within the control of the charity)
- **The appropriate timing of recognition of legacies will be a hot topic emerging from the SORP ED**



INCOME RECOGNITION

DONATED STOCK

DONATED RETAIL STOCK

- implied that some retail operations could justify bringing in retail stock at the point of donation.
- the assumption is that donated items should be valued, now at fair value, in line with FRS 102.

DONATED STOCK FOR DISTRIBUTION

- Goods given for distribution should continue to be (fair) valued: but adjusted for any loss of service potential.



THE SORP ED

THE MAIN CHANGES PROPOSED

DONATED GOODS AND SERVICES / VOLUNTEERS

- Goods given for distribution to be included on balance sheet pending distribution
- Donated items (other than retail) to be valued at cost to donor, not market value
- Stronger requirement for valuation of donated services and facilities
- Stronger (but ambiguous?) prohibition on valuation of volunteer time



THE SORP ED

THE MAIN CHANGES PROPOSED

EXPENDITURE

- **Allocating costs by activity**
 - full cost
 - no governance category
 - No need for prior year adjustment
- **Onerous contracts**
- **Recognition of funding commitments**
- **Disclosure of grants to institutions**



ACCOUNTING FOR FRAUD

Where a loss due to fraud or theft constitutes an exceptional item it has been:

- Disclosed by way of note
- Where necessary to give a true and fair view identified within the relevant heading in the SOFA

NB: A loss due to theft or fraud is not a charitable application of funds

However in judging whether it should be separately disclosed, the size and nature of the fraud should be considered with reference to FRS3 Reporting Financial Performance.

If the loss constitutes an extraordinary item it has been disclosed separately in the SOFA.



THE SORP ED

THE MAIN CHANGES PROPOSED

STATEMENT OF CASH FLOWS

- **3 standard headings:**
 - Operating cash flows
 - Investing activities
 - Financing activities
- **No net debt note required**
- **No exemption for charitable subsidiaries**

BALANCE SHEET

- **Minimal presentational differences - key differences are in recognition and measurement**

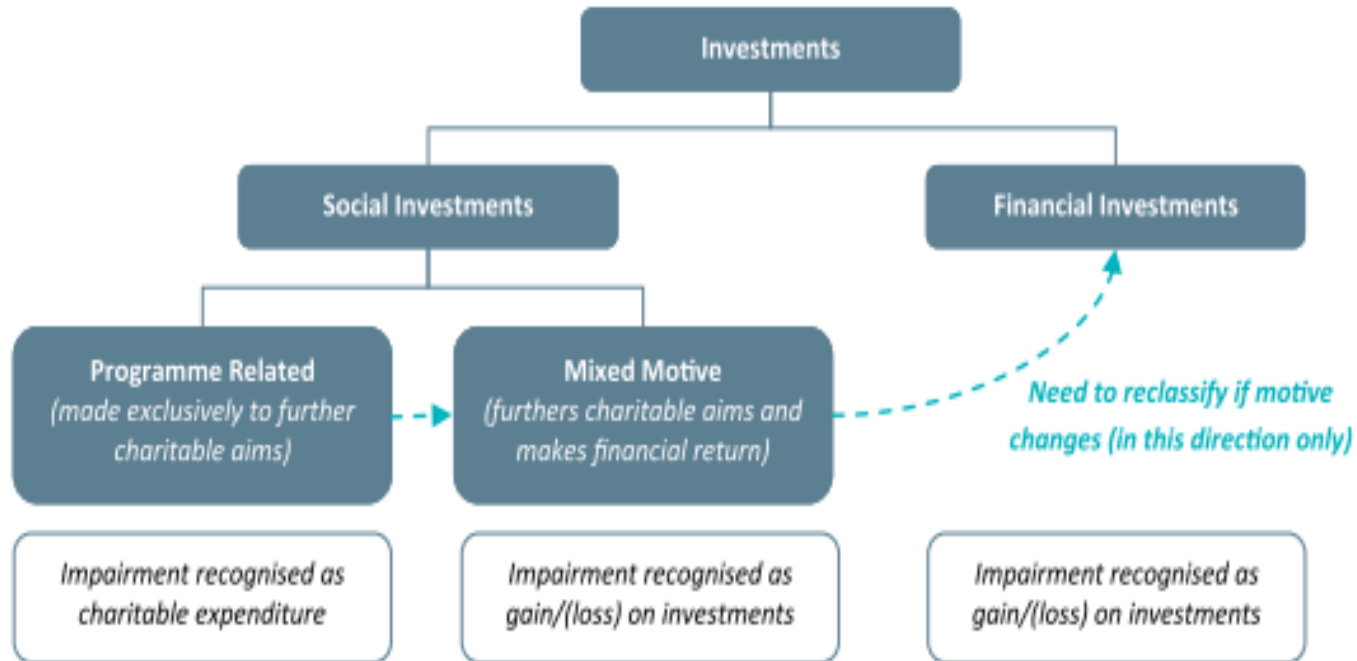


THE SORP ED

THE MAIN CHANGES PROPOSED

INVESTMENTS

- Specific module dedicated to investments
- Extra guidance for:
 - Total return approach to accounting for investments
 - Accounting for social investments (including mixed-motive and programme-related investments)
 - Pooling funds





THE SORP ED

THE MAIN CHANGES PROPOSED

FINANCIAL INSTRUMENTS

- Specific module dedicated to financial instruments
- Principles now applicable to all charities whether reporting under FRS102 or the FRSSE

FINANCIAL INSTRUMENTS

BASIC FINANCIAL INSTRUMENTS

- **Under SORP ED and FRS 102, basic instruments include:**
 - Cash
 - Debt instruments
 - Commitment to receive a loan
 - Investment in ordinary or (non-convertible) preference shares
- **treatment of most basic financial assets and liabilities unlikely to change significantly in practice**
 - Initially, transaction price including finance costs
 - Subsequent measurement at cost or amortised cost less impairment
- **Changes for some charities in accounting treatment of bank loan arrangement fees**



FINANCIAL INSTRUMENTS

COMPLEX FINANCIAL INSTRUMENTS

- “Anything not basic” - FRS 102
- **Examples include** forward exchange contracts, swaps, derivatives
- **Complex financial assets and liabilities to be accounted for at fair value**
- **Focus on identifying financial instruments effectively embedded in other transactions and separately accounting for the financing element of these transactions**



FINANCIAL INSTRUMENTS

CLASSIFICATION AND DISCLOSURE

- Classification of gains or losses on FOREX forward contracts and options in the SOFA will depend on whether hedge accounting principles have been applied from inception
- Detailed disclosure requirements which will require cross-referencing to FRS102 in all but the most straightforward circumstances



THE SORP ED

THE MAIN CHANGES PROPOSED

STOCK

- Where practicality dictates, donated stock for resale will be recognised as income when sold
- Donated goods for distribution recognised on receipt

MULTI- EMPLOYER DEFINED BENEFIT PENSION SCHEMES

- Contractual agreements to restore a pension deficit will be recognised as a liability
- Liability for a group scheme will need to be recognised in (at least) one entity in the group



THE SORP ED

THE MAIN CHANGES PROPOSED

BRANCHES

- ED attempts to draw a distinction between subsidiaries and branches
- Charities operating overseas where locally registered corporate entity has been established would be considered to be subsidiaries

ASSOCIATES AND JOINT VENTURES

- FRS102 extends the equity method of accounting to joint venture entities
- Charitable companies can still choose gross equity method
- Charities preparing accounts under FRSSE (where pre-existing JV) can still choose gross equity method



THE SORP ED

THE MAIN CHANGES PROPOSED

STAFF AND TRUSTEE RENUMERATION

- Inclusion of redundancy costs
- Disclosure requirement for total trustee and senior management emoluments
- No need to disclose pension costs of highest paid employee

RELATED PARTIES

- Extended definition
- New requirement to disclose why the benefits were paid to trustees
- Need to make statement if no related party transactions

THE SORP ED

What happens now? FRS102 transition

TIMING	ACTIONS
Mar-Jul 2013	Release of FRS 102 on 14 March 2013. The SORP Committee released the exposure draft of the new Charities SORP for consultation on 8 July 2013
Summer - Winter 2013	Various seminars on the new SORP exposure draft
Feb-Mar 2014	Audit of financial statements for the years ending 31 December 2013 and 31 March 2014 (still under existing UK GAAP)
Spring - Summer 2014	Finalised SORP expected to have been issued by now Update briefing on new SORP publication and modules as they apply to you and additional training to your finance team as required Audit of transition pro-forma 1 January 2014/1 April 2014 balance sheet (to begin the development of the FRS 102 comparatives for year end 31 December 2014/31 March 2015)
Feb-Mar 2015	Audit of the financial statements for the year ended 31 December 2014/31 March 2015 (under existing UK GAAP) Audit of FRS 102 pro-forma balance sheet and I & E Account at 31 December 2014/31 March 2015 whilst on-site for final audit If more convenient for your finance team you can defer this latter audit of pro-formas to the Spring - Summer 2015 period
Feb-Mar 2016	Audit of first FRS 102 financial statements (31 December 2015/31 March 2016) No surprises due to earlier transition work on 2013 and 2014 accounts
Apr-Dec 2016	Work with finance team to ensure that processes and systems have been updated to embed the changes required as a result of FRS 102
Feb-Mar 2017	Audit of financial statements for year ended 31 December 2016/31 March 2017 under fully embedded systems