Proposed amendments to the Charities SORP (FRS 102) set out in Update Bulletin 2

RESPONSE FROM ICAS TO
THE CHARITIES SORP-MAKING BODY

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Background

ICAS is a professional body for more than 21,000 world class business men and women who work in the UK and in more than 100 countries around the world. Our members have all achieved the internationally recognised and respected CA qualification (Chartered Accountant). We are an educator, examiner, regulator, and thought leader.

Almost two thirds of our working membership work in business and in the not-for-profit sector; many leading some of the UK's and the world's great organisations. The others work in accountancy practices ranging from the Big Four in the City to the small practitioner in rural areas of the country.

We currently have around 3,000 students striving to become the next generation of CAs under the tutelage of our expert staff and members. We regulate our members and their firms. We represent our members on a wide range of issues in accountancy, finance and business and seek to influence policy in the UK and globally, always acting in the public interest.

ICAS was created by Royal Charter in 1854.

Introduction

The ICAS Charities Panel welcomes the opportunity to respond to proposed amendments to the Charities SORP (FRS 102) (the SORP) set out in Update Bulletin 2.

We set out below:

- Some key issues arising from our consideration of Update Bulletin 2 and some wider issues we would like to see addressed; and
- Our detailed comments on the proposed amendments.

Any enquiries should be addressed to Christine Scott, Head of Charities and Pensions, at cscott@icas.com.

Key issues for the Charities SORP (FRS 102)

The future of the SORP
We support the scope of proposed Update Bulletin 2 which is to focus on clarifications and on changes to FRS 102. We believe that charities and their advisers welcome this period of relative stability. However, we are of the view that for the vast majority of charities preparing ‘true and fair’ accounts complying with full FRS 102 is too onerous and, that over the longer-term, an accounting framework should be developed which is more appropriate for charities which meet the Companies Act size criteria for a small company.

The accounting framework for UK charities
FRS 102 Section 1A provides disclosure exemptions for small entities but is incompatible with compliance with the SORP. There are differing views as to whether the legal framework, as whole, in each charity law jurisdiction of the UK, permits charities to apply Section 1A. However, there is broad agreement that in practice, application of the specific requirements of Section 1A, would not be near sufficient for any charity’s accounts to give a ‘true and fair’ view, meaning that for all intents and purposes Section 1A cannot be applied.

We recognise that creating an accounting standard which is less onerous than FRS 102 but more suitable than Section 1A is a challenging goal. There are difficulties with the legal framework, in part due to the interaction of charity law and company law, which need to be addressed in the first instance.

We believe that the Charities SORP-making Body has a key role to play in raising this issue with government and the UK Financial Reporting Council. We also believe that there is further scope for the SORP to be drafted in a more precise manner and that this in itself could reduce the regulatory burden for charities: the next significant revision of the SORP would be an opportunity to consider this issue.

Updating the on-line SORP
We recommend that the on-line version of the Charities SORP (FRS 102) is updated to reflect the changes made by Update Bulletin 1 and Update Bulletin 2. We believe that the new requirement to prepare an analysis of changes in net debt highlights that this would be appropriate way of ensuring that changes to the SORP are understood.

An update of the on-line version would reduce the regulatory burden on accounts' preparers and charity advisers from having to refer to multiple documents and reduce the risk of non-compliance. Ideally, reference to the SORP and FRS 102 should be sufficient to understand the accounting requirements. If this is not possible, we would recommend publishing each amendment in the final version of Update Bulletin 2 in the order they are made to the SORP.

Matters arising from Update Bulletin 1
In addition to the specific issues in this consultation, we remain concerned that proposed Update Bulletin 2 does not include amendments designed to reflect the new definition of a 'small charity' introduced by Update Bulletin 1.

Update Bulletin 1 defined a small charity as one with gross income up to £500,000, but it did not amend the numerous references throughout the SORP to 'smaller charities' defined with reference to other criteria. For example, there are several references to "charities below the audit threshold".

If, as indicated in Update Bulletin 1, the SORP-making Body now intends that the concessions based on size should uniformly apply to all charities with an income of up to £500,000, we recommend all uses of other terminology regarding 'smallness' are amended.

In relation to the Trustees' Annual Report, the SORP requires charities in England and Wales with incomes between £500,000 and £1 million to include material which goes beyond the requirements of the Charities (Accounts and Reports) Regulations 2008. We recommend that the Charities SORP-making body highlights to charity trustees and other users of the SORP where the SORP is more onerous that than 2008 Regulations.

We highlight, in our comments on comparative information, that the SORP goes beyond the requirements of the 2008 Regulations and there may be other areas where this is the case.

Application dates
In our detailed comments, we also highlight the need to be very clear about when each amendment in Update Bulletin 2 applies in each UK charity law jurisdiction.

Detailed comments on proposed amendments

Clarifying amendments

Module 3: Accounting standards, policies, concepts and principles, including the adjustment of estimates and errors

We understand that a new paragraph is being proposed to achieve consistency of practice, as accounts' preparers and auditors are not necessarily clear that comparative figures are required for movements in a charity's funds.

We understand that the requirement to include such extensive comparatives for funds is driven by FRS 102 rather than the Charities SORP. We believe that this requirement is overly burdensome for charities, particularly those charities with many restricted funds and it is our experience that this can add several pages to a charity's accounts without necessarily providing information of value to accounts' users.

Under the SORP, charities do not have to list every fund individually, but charities sometimes wish to provide more granularity for funders. Therefore, the requirement to provide comparatives for movements in funds could actually be hampering the level of transparency charities are seeking to provide.

Charity accounts are widely available, with the Charity Commission for England and Wales and OSCR publishing accounts on their websites. Also, the accounts of charitable companies are available from Companies House. Therefore, accounts' users who need extensive comparative information have access to it.

We would urge the Charities SORP-making Body, when FRS 102 is next being updated, to seek an exemption from the preparation of comparative figures for charity funds, in respect of movements in the year.

The Charities (Accounts and Reports) Regulations 2008, which apply in England and Wales, do not require non-company charities to include comparatives for:

- Interfund transfers
- Grants
- Movements in fixed assets

While the 2008 Regulations have not been updated to refer to the correct version for the SORP, we believe that exemptions set out in regulation could justifiably take precedence over the requirements of FRS 102 and the SORP on the grounds that disclosure is not necessary for the accounts to give a 'true and fair' view. N.B., we recognise that FRS 102 and the SORP do not require comparatives in relation to movements in fixed assets.

We believe the exemptions in 2008 Regulations are sensible and provide further justification that comparatives should not be required for movements in funds.

Proposed paragraph 3.49. We believe that the second sentence should be worded as follows:

"Therefore, charities must provide comparative information for all amounts presented in the accounts and notes to the accounts unless otherwise stated in FRS 102 **or** this SORP."

We believe 'and' should be replaced with 'or' to reflect that the SORP can require comparatives to be included which are not required by FRS 102.

Module 10: Balance sheet

We support the amendment to paragraph 10.31 of the SORP. This is a necessary clarification, as FRS 102 has no 'undue cost or effort' exemption in respect of assets comprising of two or more major components.

Module 13: Events after the balance sheet date

We understand and support the amendment to the SORP to address, in part, accounting for a gift aid payment made under a deed of covenant.

However, the changes made to FRS 102, arising from FRED 68, deal solely with payments to a charitable parent by a trading subsidiary, where a deed of covenant is not in place. Therefore, there is an absence of comprehensive and clear guidance of how a charitable parent should account for corporate gift aid payments whether they are made under a deed of covenant or not. We believe that the SORP should provide such guidance.

We recommend that:

- the revenue recognition and presentation aspects of accounting for corporate gift aid, including income due under a deed of covenant, is addressed in SORP Module 5, on the recognition of income; and
- the presentation aspects of accounting for corporate gift aid under a deed of covenant is addressed in SORP Module 10, on the balance sheet, which should be updated to deal with the accrual arising from an event after the balance sheet.

While we note that strictly speaking it is not the role of the Charities SORP-making Body to issue guidance on accounting by non-charitable companies, the accounting policies of non-charitable subsidiaries will have an impact on the consolidated accounts of a charity group, so we believe it is only reasonable that the Charities SORP-making Body should consider providing appropriate guidance in this area too, perhaps through the publication of an Information Sheet.

The changes in the treatment of corporate gift aid arising from FRED 68 apply to distributions from wholly-owned subsidiaries and this should be clarified within the SORP.

Significant amendments

Scope and application module

We believe that far more clarity is needed to explain to charities and their advisers when each of the changes to the SORP made in 2018 apply.

The Charities Accounts (Scotland) Regulations 2006 will need to be amended before Scottish charities can apply any amendments made to the Charities SORP but not to FRS 102. We believe that charities must comply with changes to FRS 102, as this is the underlying standard, but that any other changes need the force of regulation.

However, from a practical point of view it makes sense for changes to FRS 102 arising from the triennial review and changes to the SORP to be adopted as a package. This means that for Scottish charities the early adoption of any changes to accounting requirements, whether arising from FRS 102 or the SORP, should not be made in the absence of an amendment to the Charities Accounts (Scotland) Regulation 2006.

The clarifying amendments, of course, relate to matters which are extant. While this is clear from the Update Bulletin it does add a degree of complexity for charities. Therefore, we recommend that the final version of Update Bulletin 2 lists each amendment to the Charities SORP, the date the amendment applies in each charity law jurisdiction and whether early adoption is available as part of a package of amendments. This could be achieved in an Appendix to the Bulletin.

Module 10: Balance sheet

We welcome the introduction of an accounting policy choice so that a charity can measure investment properties rented to another group entity at cost less depreciation and impairment.

We recommend that the SORP includes a definition for ‘group entity’ to support the application of these requirements. We would expect a ‘group entity’ to be either a parent or a subsidiary.

We recommend the following minor changes to paragraph 10.56 of the SORP:

- At the end of the first bullet add ', if applicable.' This is needed due to the addition of the final bullet.

Module 14: Statement of cash flows

The inclusion by charities of an analysis of changes in net debt raises a question as to whether it is appropriate for all charities with a gross annual income of over £500,000 to produce a statement of cash flows, as this creates an additional regulatory burden intended, by the Financial Reporting Council, to apply to much larger entities.

While we understand that the £500,000 threshold was introduced to create a consistent definition of a larger charity which applies to all concessions given by the SORP, a private company applying full FRS 102 would not be expected to prepare a statement of cash flows unless it had a turnover of more than £10.2 million.

We appreciate that increasing the threshold for the preparation of a statement of cash flows may introduce some additional complexity to the SORP. However, we believe that it would be sensible to increase the threshold, perhaps to gross income of over £1 million, now that an analysis of changes in net debt is to be required.

Paragraph 14.7 of the SORP gives the option of providing a columnar presentation which distinguishes between restricted and unrestricted funds. It is therefore important that the template in Update Bulletin 2 for the analysis of changes in net debt can be adapted to accommodate this option.

There is a missing 'the' in the final sentence of 14.17B. The sentence should read "and **the** purpose…."

Module 27: Charity mergers

We recommend the following amendment to paragraph 27.12, which are amendments to the current text and not amendments to the proposed changes to the SORP: in the second paragraph replace 'trust' with 'entity' as this sentence is also applicable to unincorporated associations.

In relation to the amendment to paragraph 27.12, clarification is needed as to whether the reference to a 'subsidiary undertaking' should be to a 'wholly-owned subsidiary undertaking'. This may be necessary so that the criteria set out in paragraph 27.13 for merger accounting can be met.

Appendix 1: Glossary of terms

We are content with the inclusion of the definition of 'service potential'. This is a more appropriate definition for charities.

Other amendments

Scope and application module

The definition of a 'financial institution' proposed in paragraph 20 is not clear and we recommend that this is revised to more closely reflect the revised definition of a 'financial institution' in the glossary of FRS 102. The FRS 102 definition is more tightly worded, and it is important to reduce the risk that a charity will believe it meets the revised definition when it does not.

If possible, it would be helpful to provide examples of charities which will meet this definition by means of narrative description.

If the wording of paragraph 20 is to be retained, then the word 'only' should be removed in the final sentence so it states "…unless such lending is the charity's ~~only~~ principal or sole charitable activity".

Module 11: Accounting for financial assets and financial liabilities

We believe that it should be possible to provide a simpler definition than that proposed for Table 7: Common basic financial instruments in respect of investment in ordinary shares or types of preference share.

Proposed paragraph 11.35A refers to section 34 of FRS 102 on specialised activities. We understand that this paragraph is intended to apply to charities which are financial institutions and we recommend that this is made clear.

Module 18: Accounting for heritage assets

We are content with this change.

Module 21: Accounting for social investment

We are content with this change.

Module 24: Accounting for groups and the preparation of consolidated accounts

We recognise that proposed paragraph 24.13A on subsidiaries excluded from consolidation arises directly from amendments to FRS 102. However, in our view, this is more of a clarification rather than the introduction of a new concession and as such it may be reasonable for a charity to apply this concession separately from adopting the package of other amendments arising from the triennial review of FRS 102.

Paragraph 24.35 is to be amended to include a reference to special purpose entities in respect of accounting policies for consolidated accounts. However, no guidance is given as to what would constitute a special purpose entity in the context of a group with a charitable parent.

We note that no definition for a special purpose entity is included in the glossary of FRS 102, but an extensive description is given in Section 9 of FRS 102 on consolidated and separate financial statements.