

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

Introduction

- 3.1. This module explains how accounting standards, policies, concepts and principles are applied by charities adopting the FRSSE. Charities adopting this SORP should also refer to section 2 of the FRSSE.
- 3.2. Accounting policies provide the basis on which the accounts are prepared and explain the accounting treatment of material transactions or items in the accounts. The concept of materiality is an important consideration when selecting accounting policies. Materiality relates to the financial information provided in the accounts and an item is material when its omission or misstatement could influence the economic decisions that users make on the basis of those accounts.
- 3.3. This module sets out:
- what are accounting standards, policies, concepts and principles?;
 - length of the reporting period;
 - presentation currency;
 - going concern;
 - prudence;
 - accruals;
 - materiality;
 - offsetting;
 - prior period adjustments;
 - selection of accounting policies;
 - compliance with the SORP; and
 - disclosure of accounting policies, changes in estimation techniques and prior period adjustments.

What are accounting standards, policies, concepts and principles?

- 3.4. Accounting standards set out the basis for recognising and measuring assets, liabilities, income and expenses and for their disclosure in accounts. Charities preparing accounts in accordance with the FRSSE and this SORP will normally, in so doing, meet the relevant legal requirements for their accounts to give a true and fair view of their financial position and activities.

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- 3.5. Accounting policies are the principles, bases, conventions, practices and rules by which transactions and items are recognised, measured and presented in the accounts. The accounting policies adopted by a charity using the FRSSE must follow the requirements of that accounting standard unless the effect of not following a particular requirement would be immaterial, or in special circumstances, where to do so would conflict with the legal obligation for the accounts to give a 'true and fair' view.
- 3.6. The SORP supplements the FRSSE and has been developed in the light of the special factors prevailing or transactions undertaken within the charity sector.
- 3.7. Charities using the FRSSE must prepare their accounts on the accruals basis of accounting. In certain jurisdictions, it is a legal requirement for charities preparing their accounts on an accruals basis to adhere to the methods and principles of this SORP. Charities should refer to the guidance issued by the charity regulator in their jurisdiction(s) of registration to find out whether they are subject to a legal requirement to follow this SORP.
- 3.8. Accounting policies are supplemented by estimation techniques where judgement is required to establish the monetary amounts of assets, liabilities, gains and losses included in the accounts.
- 3.9. Charity accounts must be prepared on a timely basis and be presented in a way that makes financial information understandable to users who have a reasonable knowledge of charity financial management and/or accounting and a willingness to study the information with reasonable diligence.
- 3.10. The accounts must present financial information that is relevant, reliable, comparable and understandable. Information should not be excluded simply because it is complicated; however, the preparer should also balance the cost of obtaining information with the benefit it provides both internally to management and externally to funders and other stakeholders.
- 3.11. Transactions and events must also be accounted for with prudence and presented in a way that represents their substance and not merely their legal form. This will require the exercise of judgement and may on occasion dictate the disclosure of more information than specifically recommended in this SORP.

Length of the reporting period

- 3.12. All charities must prepare a set of accounts annually and they should normally have a 12-month reporting period. If the accounts are prepared for a shorter or longer reporting period, this SORP requires that a charity must disclose:
 - that the reporting period is for less than or more than 12 months;
 - the reason for the shorter or longer reporting period;
 - the legal authority it has for the change to its reporting period; and
 - the fact that the comparative amounts presented in the accounts (including the related notes) are not entirely comparable.

Presentation currency

- 3.13. The presentation currency is the currency in which the accounts are denominated. A charity should normally prepare its accounts in the currency of the jurisdiction of its administration unless it operates predominantly by generating and spending its cash in a different currency. Where a charity operates predominantly in a different currency, it should prepare its accounts in that currency.

Going concern

- 3.14. Charities normally prepare their accounts on the basis of being a going concern. However, when preparing accounts, the FRSSE requires that trustees must assess whether there are significant doubts about the charity's ability to continue as a going concern. Any material uncertainties, of which the trustees are aware in making their assessment, must be disclosed. Where the period considered by the trustees in making this assessment has been limited to a period of less than one year from the date of approval of the accounts, that fact shall be stated. Accounts must not be prepared on a going concern basis if the trustees determine after the balance sheet date either that they intend to liquidate the charity or to cease its activities, or that they have no realistic alternative but to do so.

Prudence

- 3.15. The preparation of accounts may involve the exercise of the judgments in making the estimates required under conditions of uncertainty. Prudence requires that a degree of caution is exercised in making judgments to ensure that gains and assets are not overstated and liabilities are not understated. However it is not necessary to exercise prudence where there is no uncertainty. Nor is it appropriate to use prudence as a reason to understate deliberately assets or gains or overstate liabilities or losses.

Accruals

- 3.16. Accounts, with the exception of cash flow information, must be prepared on the accruals basis of accounting. Hence, all income and charges relating to the financial year must be brought into the accounts without regard to the date of payment or receipt.

Materiality

- 3.17. The FRSSE and this SORP set certain accounting treatments and disclosures in the context of their materiality. Charities, in preparing their accounts, should therefore give particular consideration to material items or transactions as their omission or misstatement could influence economic decision-making by the user of the accounts and any assessment of the stewardship of charitable funds. An omission or misstatement of a material item may result in the accounts failing to give a 'true and fair view'.

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- 3.18. Materiality needs to be considered in the context of the accounts and depends on:
- the size of the item or error;
 - the nature of the item or error;
 - the impact of its omission or misstatement on the reported gross income or total expenditure and net assets; and
 - the impact of its omission or misstatement on particular analysis headings within the statement of financial activities, balance sheet and, where applicable, statement of cash flows and on the disclosures made in the notes to the accounts.
- 3.19. Charities should only disclose accounting policies that apply to material items or transactions. Charities should avoid providing unnecessary information for non-material items or transactions.
- 3.20. Although the FRSSE and this SORP need only be applied to material items or transactions, it is inappropriate to make, or leave uncorrected, immaterial departures from this SORP to achieve a particular presentation of an entity's financial position, financial performance or cash flows.
- 3.21. This SORP specifies when a charity must always consider a particular item or transaction material, for example the disclosure of related party transactions. Also, as a matter of emphasis, SORP modules may make particular reference to materiality.

Offsetting

- 3.22. In determining the aggregate amount of any item in the accounts, a charity must not offset assets and liabilities, or income and expenses, unless required or permitted by the FRSSE or this SORP. Offsetting does not include making provisions for the write-down of stock or for bad debts. Similarly, a charity reports any gains and losses on the disposal of its fixed assets by deducting the carrying amount of the asset and related selling expenses from the proceeds of the disposal.

Prior period adjustments

- 3.23. Prior period adjustments must be accounted for by restating the comparative figure for the preceding period in the primary statements and notes and adjusting the opening balance of funds for the cumulative effect. The cumulative effect of the adjustments must also be noted at the foot of the statement of financial activities.
- 3.24. This SORP sets out the accounting treatment(s) and the disclosures required in the notes to the accounts that apply to charities preparing their accounts using the FRSSE.
- 3.25. Charities preparing their accounts, under the FRSSE must apply the relevant requirements of that standard and the recommendations of this SORP.

Selection of accounting policies

- 3.26. Charities preparing their accounts using the FRSSE must refer to that standard and the relevant modules contained in this SORP when selecting their accounting policies for the treatment of particular items, transactions or events in the accounts.

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- 3.27. This SORP requires that charities must adopt current accounting practice as set out in this SORP to reflect the special factors prevailing or transactions undertaken in the charity sector. The introduction to each of the SORP's modules specifies when the SORP requires a charity to adopt current accounting practice.
- 3.28. For all other transactions that are not specifically dealt with in the FRSSE, charities may follow their existing accounting policies provided that the policy and related disclosures made are consistent with accepted accounting practice. Where a charity undertakes a new transaction for which it has no existing policy and where it is not dealt with in the FRSSE, the FRSSE requires a charity to have regard to current practice in developing its accounting policies.
- 3.29. Where a charity undertakes a new transaction for which it has no policy and where it is not dealt with in the FRSSE or this SORP, the FRSSE requires a charity to have regard to FRS 102 in establishing current practice.
- 3.30. In special circumstances a charity may conclude that compliance with a particular provision of the FRSSE or this SORP would conflict with the requirement for the charity's accounts to give a true and fair view. In such instances the charity must depart from that provision to the extent necessary to give a true and fair view.
- 3.31. If there is a doubt whether applying the provisions of the FRSSE or this SORP would be sufficient to give a true and fair view, adequate explanation must be given in the notes to the accounts of the transaction or arrangement concerned and the treatment adopted.
- 3.32. Accounting policies and estimation techniques must be consistent with the requirements of the FRSSE, this SORP and relevant legislation. Where this permits a choice, a charity must select the policies and techniques most appropriate to its particular circumstances for the purpose of giving a true and fair view.
- 3.33. Accounting policies must be applied consistently within the same accounts and from one financial year to the next. Accounting policies must be reviewed regularly to ensure that they remain the most appropriate to the charity's particular circumstances for the purpose of giving a true and fair view. Following a change in accounting policy, the amounts for the current and corresponding periods must be restated on the basis of the new policies.

Compliance with the SORP

- 3.34. For a charity to state that its report and accounts are compliant with this SORP, both its trustees' annual report and its accounts must be prepared fully in accordance with the reporting and accounting recommendations of this SORP. To state that their accounts have been prepared in accordance with this SORP, a charity must:
- consider those SORP modules that apply to the activities, transactions and circumstances of the reporting charity;
 - comply with applicable format requirements and accounting treatments specified by this SORP and provide those disclosures that this SORP specifies 'must' be provided;

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- make any additional disclosures required by the FRSSE; and
 - only depart from the requirements if this SORP if necessary for the accounts to give a true and fair view.
- 3.35. This SORP uses the term 'must' to indicate those recommendations that are likely to affect the ability of the accounts to give a true and fair view if not applied to material transactions or items. Where the SORP states that an item is always material or the recommendation is one which 'must' be followed, non-adherence to that recommendation is a departure from this SORP.
- 3.36. The SORP also identifies particular recommendations that 'should' be followed. These recommendations are aimed at advancing standards of financial reporting as a matter of good practice. While charities are encouraged to follow all the SORP's recommendations, a failure to follow a 'should' recommendation is not regarded as a departure from this SORP.
- 3.37. Where the SORP states that a particular accounting treatment or disclosure 'may' be adopted, this provides an illustration of an approach to a particular disclosure that a charity may choose to adopt or identifies that an alternative accounting treatment or disclosure of a transaction or event is allowed by the SORP. Charities may choose whether such examples or alternative treatments are adopted at their discretion.

Disclosure of accounting policies and changes in estimation techniques and prior year adjustments

- 3.38. The notes to the accounts must, in order to comply with the Application of Financial Reporting Requirements (FRS 100) and the FRSSE, state whether the accounts were prepared:
- in accordance with this SORP;
 - in accordance with the FRSSE; and
 - in accordance with applicable charity and/or company law in the jurisdiction(s) of registration.
- 3.39. The FRSSE also requires that the notes to the accounts must provide:
- a description of each material accounting policy followed;
 - details of any changes to the accounting policies to those followed in the preceding period including a brief explanation of why each new accounting policy is thought more appropriate and, where practicable, an indication of the effect of the change on the results for the current period;
 - where practicable, the effect of prior period adjustments on the results for the preceding period; and
 - where the effect of a change to an estimation technique is material, a description of the change and, where practicable, the effect on the results for the current period.

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- 3.40. The FRSSE also requires that where the trustees are aware of any material uncertainties as to whether the charity is a going concern, this concern must be disclosed. In addition, where the period considered by the trustees in making their assessment of whether the charity is a going concern has been limited to a period of less than one year from the date of approval of the accounts, that fact must also be stated.
- 3.41. In addition, the FRSSE requires that where there has been a material departure from the requirements of the FRSSE or relevant legislation, the notes to the accounts must:
- state that there has been a departure from the requirements of the FRSSE or relevant legislation and that the trustees have concluded that the departure is necessary to give a true and fair view;
 - state why the treatment prescribed would not give a true and fair view;
 - state the treatment required by the FRSSE or relevant legislation and a description of the treatment adopted; and
 - provide a description of how the position shown in the accounts is different as a result of the departure (which should be quantified where practicable).
- 3.42. Where charities have made a material departure from a recommendation of this SORP, FRS 100 requires that the notes to the accounts must provide:
- a brief description of how the accounts depart from the recommended practice set out in the SORP;
 - the reasons why the treatment adopted is judged more appropriate to the charity's particular circumstances; and
 - brief details of any disclosures required by this SORP that have not been provided, and the reasons why they have not been provided.
- 3.43. The effect of a departure from a SORP need not be quantified, except in those rare cases where such quantification is necessary for the accounts to give a true and fair view.
- 3.44. If a material departure from the requirements of the FRSSE is also a departure from the requirements of this SORP, a combined note may be provided.