# Appendix 4: Basis for conclusions

## Introduction

B.1. This appendix summarises the main issues considered by the joint SORP-making body in producing the second edition of the Charities SORP (FRS 102). It summarises the deliberations of the joint SORP-making body in updating the first edition of the Charities SORP (FRS 102) approved by the FRC on 22 May 2014 for developments in UK-Irish Generally Accepted Accounting Practice and charity and company law since the SORP was first published. It accompanies, but is not part of, the SORP. The second edition was approved by the FRC on 2 October 2019.

## Background

B.2. The first edition of the Charities SORP (FRS 102) was issued in July 2014. In accordance with the FRC's *Policy on Developing SORPs*, the joint SORP-making body reviews the SORP annually for changes in accounting standards and new developments.

B.3. Since July 2014, the joint SORP-making body has consulted on a number of consequential amendments to the SORP to reflect changes in accounting standards and legislation subsequent to its issue. This edition of the SORP updates the first edition by incorporating these amendments, as well as number of other minor amendments to reflect changes in legislation and changes to SORP definitions. It is intended to assist preparers by providing a revised edition of the Charities SORP (FRS 102) ('the SORP') which consolidates the relevant requirements and reduces need for SORP users to refer to multiple points of reference.

B.4. The amendments to the SORP are set out in two Update Bulletins which are accessible from the Charities SORP's microsite. Preparers should refer to these documents for more detail on these amendments described below.

## Amendments made by Update Bulletin 1

B.5. Update Bulletin 1 updated the SORP for:

- Amendments to FRS 102 set out in *Amendments to FRS 102 – Small entities and other minor amendments* issued by the FRC in July 2015;
- The withdrawal of the *Accounting and reporting by charities: statement of recommended practice applicable to charities adopting the Financial Reporting Standard for Smaller Entities* (the Charities SORP (FRSSE)); and
- The Charities Act 2011 (Accounts and Audit) Order 2015 made on 19 February 2015.

B.6. The amendments to the SORP were proposed in an exposure draft issued in June 2015. The feedback from this draft was considered in the finalisation of Update Bulletin 1 published in February 2016.

B.7. The amendments made by Update Bulletin 1 were effective for accounting periods beginning on or after 1 January 2016. Provided it would not be contrary to charity or company law in the charity's jurisdiction of filing, early application was permitted provided all the amendments in this section were applied at the same time.

## Scope of Charities SORP (FRS 102) widened

B.8. In 2015 the FRC withdrew the Financial Reporting Standard for Smaller Entities (FRSSE) and replaced it with a new section for small entities (Section 1A Small Entities) within FRS 102. The FRSSE was withdrawn for accounting periods beginning on or after 1 January 2016. As a result, the Charities SORP (FRSSE) was no longer applicable, with all charities preparing accruals accounts required to apply the Charities SORP (FRS 102) for accounting periods beginning on or after 1 January 2016. The SORP (FRS 102) was amended to implement the withdrawal of the Charities SORP (FRSSE) and the requirement for all charities to apply the Charities SORP (FRS 102).

B.9. The joint SORP-making body considered various solutions for the replacement of the Charities SORP (FRSSE). They consulted on its withdrawal and the proposal to widen the scope of the Charities SORP (FRS 102) in 2015. Respondents to the consultation supported the proposal to move to a single SORP. Although a charity can follow the SORP and apply the small entities regime option (Section 1A Small Entities) within FRS 102 in order to produce true and fair accounts the preparer must also follow all the applicable requirements of the SORP. This solution was considered as unifying the reporting framework and providing donors and users of the accounts with a common presentation of financial information.

## Definition of a larger charity

B.10. Prior to Update Bulletin 1, the definition of a larger charity in the SORP was linked to the charity law audit threshold. The SORP required those charities required by charity law to have an audit to provide greater disclosure in their trustees' annual report and notes to the accounts.

B.11. *The Charities Act 2011 (Accounts and Audit) Order 2015* increased the charity audit income threshold from £500,000 to £1 million in England and Wales with effect for reporting periods ending on or after 31 March 2015. As a result, the definition of a larger charity was amended so it is not linked to the statutory audit threshold in order to ensure that the definition of smaller charity remained the same across the UK charity law jurisdictions. The glossary of the SORP now defines larger charities as those charities with a gross income exceeding £500,000 (UK) or 500,000 euros (Republic of Ireland) in the reporting period.

B.12. The joint SORP-making body consulted on the definition of a larger charity in 2015. Respondents supported the proposal to de-link the definition from the statutory audit threshold. The joint SORP-making body concluded that the revised definition preserved the current consistency in reporting practice for charities in the UK and the Republic of Ireland, avoided confusion for charities operating in different jurisdictions and sought to future proof the SORP from any further divergent changes in audit thresholds.

## Preparation of a statement of cash flows

B.13. Prior to Update Bulletin 1, the preparation of a statement of cash flows was required by all charities applying the SORP (FRS 102). This reflected the requirement of FRS 102 and differed to the SORP (FRSSE), where the preparation of a statement of cash flows was optional. In 2015 the FRC withdrew the FRSSE and replaced it with a new section for small entities (Section 1A Small Entities) within FRS 102. Section 1A does not require small entities to prepare a statement of cash flows. Similarly, section 7 of FRS 102 was also amended to exempt small entities applying full FRS 102 from the requirement to prepare a statement of cash flows.

B.14. As set out in paragraph B.9, following the withdrawal of the FRSSE, the Charities SORP (FRSSE) was no longer applicable. All charities preparing accruals accounts were required to apply the Charities SORP (FRS 102) for accounting periods beginning on or after 1 January 2016. These changes would have resulted in all charities preparing a statement of cash flows based on the requirements of the Charities SORP (FRS 102) prior to Update Bulletin 1.

B.15. The joint SORP-making body consulted on this requirement to present a statement of cash flows in 2015. They considered various options, including whether to allow charities which meet the definition of a small entity with the option not to provide a statement of cash flows. Respondents to the consultation supported only those charities defined as larger charities by the SORP being required to prepare a statement of cash flows. In considering the requirement, it was noted that the preparation of the statement of cash flows is valuable to a charity as it ensures the movement of its cash balances and cash position are actively considered as part of its annual reporting cycle. The statement was also noted as being useful to funders considering the underlying solvency of a charity at the reporting date, and for enquiring about its solvency going forward.

B.16. The joint SORP-making body concluded that the preparation of the statement of cash flows would only be mandatory for those charities that the SORP classifies as larger charities (those with a gross income exceeding £500,000 (UK) or 500,000 euros (Republic of Ireland) in the reporting period, see paragraph B.12). However, the presentation of the statement of cash flows would always be encouraged as good practice regardless of a charity's size. Therefore, charities that do not meet the definition of a larger charity may choose to adopt the cash flow requirements if they wish.

### Application of merger accounting

B.17. UK company law does not permit merger accounting where UK charitable companies enter into a business combination with a third party. Section 34 of FRS 102 was amended in July 2015 to clarify the application of merger accounting by public benefit entities. This clarification is reflected in paragraphs 27.4 and 27.4A of the SORP.

### Inventories held for distribution at no or nominal consideration

B.18. The July 2015 amendments to FRS 102 introduced a requirement for inventories held for distribution at no or nominal consideration to be measured at the lower of cost, adjusted for any loss of service potential, and replacement cost. Paragraph 6.12 of the SORP reflects this change in respect of goods donated for distribution.

### Other amendments

B.19 Three other amendments were made to the SORP as follows:

- Module 10: Balance Sheet and Module 24: Accounting for Groups and the Preparation of Consolidated Accounts: increased the maximum period over which goodwill and other intangible assets may be amortised from five to ten years in those exceptional cases where an entity is unable to make a reliable estimate of the asset's useful economic life;
- Module 12: Impairment of assets: prohibiting the reversal of impairment losses for goodwill; and
- Appendix 1: Glossary: amending the definition of related parties.

B.20. Preparers should refer to Update Bulletin 1 for the detail of these amendments.

## Amendments made by Update Bulletin 2

B.21. Update Bulletin 2 updated the SORP for amendments to FRS 102 made as part of the 2017 Triennial Review of FRS 102. These are set out in *Amendments to FRS 102 – Triennial review 2017 – Incremental improvements and clarifications* issued by the FRC in December 2017. The amendments to the SORP were limited to only those considered as being necessary as a result of the changes made in response to the 2017 Triennial Review of FRS 102.

B.22. The amendments to the SORP were proposed in an exposure draft issued in February 2018. The feedback from this exposure draft was considered in the finalisation of Update Bulletin 2 published in October 2018.

B.23. Update Bulletin 2 made 23 amendments to the SORP. These amendments have been divided into three categories, as follows:

- Clarifying amendments;
- Significant amendments; and
- Other amendments.

### Clarifying amendments

B.24. These amendments ensure that the SORP remains consistent with the original drafting intention of FRS 102. They are applicable to accounting periods beginning on or after the date of publication of Update Bulletin 2 (i.e. 5 October 2018). Although, as they reflect the existing requirements of FRS 102, they are already applicable for charities preparing accounting in accordance with that standard.

### Comparative information

B.25. Section 3 of FRS 102 requires that unless an exception is permitted by FRS 102, comparative information must be provided for all amounts presented in the current period's financial statements, which includes the notes. Paragraph 3.49 of the SORP clarifies this requirement.

### Gift aid payments made by a subsidiary to its parent

B.26. FRS 102 requires payments by subsidiaries to their charitable parents that qualify for gift aid to be accounted for as distributions to owners, and treated akin to dividends. Section 23 of FRS 102 requires dividends to be recognised when the shareholder's right to receive payment is established. The parent charity's right to receive payment is established when the subsidiary has a legal obligation to distribute its profits to its owners at the reporting date. Therefore, a gift aid payment shall not be recognised as a liability in the individual accounts of a subsidiary unless a legal obligation for the subsidiary to make the payment exists at the reporting date.

B.27. The following paragraphs of the SORP reflect this treatment from the parent charity's perspective:

- Paragraph 5.52 clarifies that gift aid income is accrued when a gift aid payment is payable to a parent charity under a legal obligation.
- Paragraph 13.5 clarifies that when a gift aid payment is payable to a parent charity under a legal obligation at the reporting date, the determination of the payment amount is an adjusting event which occurs after the end of the reporting period.

### Depreciation of major components

B.28. Section 17 of FRS 102 requires major components of an item of property, plant and equipment that have significantly different useful economic lives to be depreciated separately over their useful economic life. The accounting treatment for depreciating assets comprising of two or more major components in paragraph 10.31 of the SORP was aligned to reflect this requirement.

### Significant amendments

B.29. These amendments relate to changes to the text of FRS 102 made as part of the 2017 Triennial Review. They are considered to be more likely to have an impact on the accounts of charities compared to the 'Other amendments' (see paragraphs B.43 to B.45).

B.30. These amendments were effective for accounting periods beginning on or after 1 January 2019. Provided it would not be contrary to charity or company law in the charity's jurisdiction of filing, early application was permitted provided all the amendments in this section and the other amendments below were applied at the same time.

### Investment properties including those rented to another group entity

B.31. The 2017 Triennial Review introduced an accounting policy choice for entities that rent investment property to another group entity whereby they can choose to measure that investment property using the cost model or fair value. Paragraph 10.48A of the SORP reflects this change.

B.32. In reflecting this accounting policy choice, the joint SORP-making body concluded that not requiring charities to measure the fair value of investment property rented to another group entity removes the cost of obtaining this information. This cost was considered to outweigh its benefit to users of the accounts and the charity, as the information is of little use when the investment property would be treated as property, plant and equipment in the consolidated financial statements.

B.33. The 2017 Triennial Review also removed the undue cost and effort exemption for measuring investment property at fair value. FRS 102 requires all investment property (with the exemption of investment property rented to another group) to be measured at fair value. This is consistent with the treatment required by the SORP prior to Update Bulletin 2, which did not permit charities to measure investment properties at cost (less depreciation and impairment).

B.34. The SORP only included an undue cost and effort exemption for the measurement of the investment property component of a mixed use property prior to Update Bulletin 2. Paragraph 10.47 of the SORP no longer permits this exemption.

### Group reconstructions

B.35. The *2017 Triennial Review* expanded the definition of a group reconstruction to incorporate the transfer of a business in certain circumstances. These reconstructions can be accounted for using merger accounting, provided the use of this method is not prohibited by company law or other relevant legislation.

B.36. Paragraph 27.12 of the SORP includes examples of charity reconstructions that may be accounted for as mergers. These examples have been expanded to include the transfer of activities to a wholly-owned subsidiary undertaking as an example of group reconstruction that may be accounted for as a merger. The joint SORP-making body considered the example as common to the sector.

### Net debt reconciliation

B.37. The *2017 Triennial Review* introduced a new requirement for an entity to disclose a net debt reconciliation. The SORP module 'Statement of cash flows' now requires charities to prepare a reconciliation of net debt as a note to the statement of cash flows.

B.38. In reflecting this additional disclosure in the SORP, the joint SORP-making body concluded that it would be helpful to provide an example of how this reconciliation may be adapted for the reporting purposes of a charity. Table 10A gives an example of how a net debt reconciliation may be shown.

### Definition of service potential

B.39. The 2017 Triennial Review introduced a new glossary definition of service potential. This was inserted into the glossary of the SORP given its application in determining the 'value in use' of assets which are primarily held by charities to provide services to their beneficiaries (see the SORP module 'Impairment of assets').

### Disclosure of stock recognised as an expense

B.40. The *2017 Triennial Review* removed the requirement for entities to disclose the amount of stock recognised as an expense. Paragraph 10.63 of the SORP reflects this change.

### Other amendments made by Update Bulletin 2

B.41. The other 12 amendments relate to changes to the text of FRS 102 made as part of the 2017 Triennial Review. They are considered to be less significant and likely to have an impact on the accounts of only a limited number of charities, or editorial amendments necessary to ensure the SORP remains in line with the language of FRS 102.

B.42. These amendments were effective for accounting periods beginning on or after 1 January 2019. Provided it would not be contrary to charity or company law in the charity's jurisdiction of filing, early application was permitted provided these amendments and the significant amendments above were applied at the same time.

B.43. Preparers should refer to Update Bulletin 2 for the detail of these amendments.

## Other amendments

### Reporting requirements for charitable companies reporting in the Republic of Ireland

B.44. The Companies Act 2014 replaced the Companies Acts 1963-2013 in the Republic of Ireland. The legal references in paragraphs 15.11 and 15.15 of the SORP have been amended to reflect this change.

### Threshold for charities reporting in Northern Ireland

B.45. The Charities (Accounts and Reports) Regulations (Northern Ireland) 2015 commenced on 1 January 2016. Appendix 3, 'Thresholds for the UK and the Republic of Ireland' has been amended to reflect this change.

B.46. The thresholds and requirements in Appendix 3 apply to registered charities for reporting periods beginning on or after 1 January 2016, or their date of registration with the Charity Commission for Northern Ireland if later.