



INVITATION TO COMMENT

Withdrawal of the Charities SORP (FRSSE) and Proposals to widen the scope of Charities SORP (FRS 102)

Replacing the Charities SORP (FRSSE) issued in July 2014 for:

- **Draft amendments set out in FRED 59 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Small entities and other minor amendments* as issued by the Financial Reporting Council on 19 February 2015 in relation to the new small entities regime**
- **The Charities Act 2011 (Accounts and Audit) Order 2015 made 19 February 2015 for increasing the charity audit income threshold from £500,000 to £1 million in England and Wales that also affects the definition of 'larger charity' in the Charities SORP (FRS 102) and Charities SORP (FRSSE).**

Publication date: 18 June 2015

Closing date for comments: 18 September 2015

1 Background

- 1.1 *The Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard for Smaller Entities (Charities SORP (FRSSE))* was issued on 14 July 2014 by the Charity Commission and the Office of the Scottish Charity Regulator in their role as the joint SORP-making body, recognised by the Financial Reporting Council, for charities in the UK and Republic of Ireland. The SORP applies to charities preparing accounts under UK-Irish Generally Accepted Accounting Practice (GAAP) who are required to present a 'true and fair view' in those jurisdictions where the FRSSE (small entities) option is permitted.
- 1.2 The SORP supplements accounting standards and other legal and regulatory requirements to reflect the special factors prevailing or transactions undertaken in the charity sector. The SORP is developed in line with a Code of Practice issued by the Financial Reporting Council (FRC). Prior to the SORP being issued, it is subject to review by the FRC and when issued carries a statement confirming, as appropriate, that the SORP does not appear to contain any fundamental points of principle that are unacceptable in the context of current accounting practice or in conflict with an accounting standard.
- 1.3 Before a new SORP is issued, an Exposure Draft must be subject to a wide consultation which should include organisations and individuals from the charity sector, auditors and their advisers. The Charities SORP-making body and Charities SORP Committee considered carefully all the options open to charities currently using the FRSSE and this Invitation to Comment document explains the conclusions, the reasoning for them and seeks views on the proposed way forward following the expected withdrawal of the FRSSE.
- 1.4 The proposals contained in this Invitation to Comment document were developed in collaboration with the Charities SORP Committee. Membership of the SORP Committee includes members from charities, charity umbrella groups, funding organisations, accountancy firms, academia and charity regulators drawn from all jurisdictions preparing accounts under UK-Irish GAAP.

2 Changes to Generally Accepted Accounting Practice (UK-Irish GAAP) effective from 1 January 2016

2.1 Charities that prepare their accounts on an accruals basis to give a true and fair view follow the accounting standards that constitute UK-Irish GAAP. These accounting standards are now changing as a consequence of:

- the changes to company law arising from the implementation of the EU Accounting Directive which predominantly affect the small entities regime; and
- other minor amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and the Republic of Ireland*.

The above amendments have been incorporated in the FRC's FRED (Financial Reporting Exposure Draft) 59 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – small entities and other minor amendments* issued in February 2015.

2.2 FRED 60 proposes that the *Financial Reporting Standard for Small Entities (FRSSE)* is withdrawn and replaced with a new section of FRS 102 developed specifically for small entities. FRED 59 sets out this proposed new small entities regime, Section 1A Small Entities. The SORP-making body understands that FRED 59's small entities regime allows the option for a 'small entity' not to provide a Statement of Cash Flows. This option is independent of the disclosure regime for 'small entities' set out in Section 1A of FRED 59.

2.3 As a result of the proposals in FRED 60, the Charities SORP Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard for Smaller Entities (the FRSSE) (effective 1 January 2015) will not be applicable for financial years beginning on or after 1 January 2016. It is important to note that as a result of the definition of small entities included in FRED 59¹, the proposals set out in this Invitation to Comment document are likely to apply to the majority of the charity sector who are preparing accrual accounts.

¹ The definition of small entities for accounting purposes is set out in UK Company Law as a company which does not exceed two or more of the following criteria: (a) Turnover £10.2 million; (b) Balance sheet total £5.1 million; (c) Average number of employees 50

3 Options considered following the withdrawal of the FRSSE

- 3.1 The Charities SORP making-body and Charities SORP Committee have endorsed the principle of promoting a common approach to financial reporting in all charities adopting an accruals approach to financial reporting. The current SORPs promote a single recognition and measurement approach for charity specific transactions wherever possible but with differences in the level of disclosure required. Charities that meet the criteria of small entities are currently permitted to adopt the Charities SORP (FRS102) to allow them to report on the same basis regardless of size or adopt the Charities SORP (FRSSE).
- 3.2 FRED 59 sets out the minimum requirements for small entities. However, as the accounts must give a true and fair view, FRED 59 goes further and expects the preparer to consider and provide any additional disclosures from FRS 102 that may be required for that purpose. It is because of the requirement for the accounts to give a 'true and fair view' that the disclosure required of charities that are smaller entities should align closely with those required of charities applying the Charities SORP (FRS 102). This is the shared view of the SORP-making body and Charities SORP Committee.
- 3.3 In considering a replacement for the Charities SORP (FRSSE) the Charities SORP Committee adopted the common recognition and measurement approach, as required by FRED 59. In reviewing the level of disclosure required, the Charities SORP Committee considered both the need for charity reports and accounts to give a 'true and fair view' and to fulfil the stewardship requirements of charities to their stakeholders. The Charity SORP Committee concluded that if the treatment of an item depends upon its character and not the size of the reporting charity then, unless it is immaterial, the item is reported in the accounts. If it is reported in the accounts, for the accounts to give a true and fair view in accordance with FRS 102, then the disclosures are the same whether the charity meets the criteria of a small entity or not. This was an important factor in the consideration of the various options.
- 3.4 A fully worked solution was developed and considered for each of the options so that an informed decision could be made. The options considered to allow for the withdrawal of the FRSSE were initially set out at the December 2014 meeting and then debated in turn:
- A guide (SORP Update Bulletin) to accompany the Charities SORP (FRS 102) interpreting the small entities regime in FRED 59 section 1A for charities that qualify as 'small entities'.

- A dedicated Charities SORP FRS 102 (Small Entities) to replace the Charities SORP (FRSSE). Effectively this would be a reworking of the Charities SORP (FRS 102) with the section 1A disclosures in FRED 59 substituted for those of FRS 102 where appropriate.
- Amending the Charities SORP (FRS 102) to permit charities that meets the definition of a 'small entity' not prepare a Statement of Cash Flows.
- Amending the Charities SORP (FRS 102) to only require those charities that the SORP classifies as 'larger charities' to prepare a Statement of Cash Flows and permit smaller charities the option not to prepare a Statement of Cash Flows.

The final option is the approach that the Charity SORP making-body and the Charity SORP Committee propose to allow for the withdrawal of the FRSSE.

3.5 The guide referred to at 3.4 was considered at the February 2015 meeting of the Charities SORP Committee. The guide would have taken the form of a separate update bulletin for 'small entities' that the preparer would have read alongside the Charities SORP (FRS 102) and the revised FRS 102 standard with the new section 1A included in FRED 59. The Committee felt that having to refer to three documents would place too great a demand on the preparer. It would also require considerable judgement, familiarity with the small entities regime section 1A in FRED 59 and the confidence when using the Charities SORP (FRS 102) to identify the disclosures FRS 102 requires that would need to be retained and ensure that those disclosures required by the SORP itself were provided. Such a complex solution would be particularly difficult for smaller charities and would give preparers more practical problems than those simply following FRS 102. It is likely that this option would also lead to less comparability between the accounts of different charities. As a result, this option was rejected as inappropriate and impractical.

3.6 A dedicated Charities SORP FRS 102 (Small Entities) was considered at the March 2015 meeting. A replacement SORP would have the advantage of a simple substitution with the existing features of the Charities SORP (FRS 102) retained i.e. its modules and illustrations with the clarity of substituting the specific Section 1A disclosures for those of FRS 102. However, given the requirement to prepare accounts that give a true and fair view, it would mean that, aside from the option to not prepare a Statement of Cash Flows, there would be very few practical differences between the two SORPs other than some minor disclosure requirements. With the similarities in practical terms between the requirements of the proposed Charities SORP FRS 102 (Small Entities) and the existing Charities SORP (FRS 102), the Charities SORP Committee decided at its May 2015 meeting that maintaining two SORPs was not justified or desirable. It would be simpler

for the Charities SORP (FRS 102) to apply to all charities preparing accruals accounts for accounting periods beginning on or after 1 January 2016.

3.7 The SORP Committee then debated at its May 2015 meeting whether to simply require all charities to follow the existing Charities SORP (FRS102) but with the option for some charities not to prepare the Statement of Cash Flows. This would give the benefit of simplification with all charities being subject to the same SORP with the level of disclosure determined by materiality and the type of transactions undertaken by the charity.

3.8 The SORP Committee initially considered allowing the option to not provide a Statement of Cash Flows to all charities that meet the definition of a small entity under FRED 59 (see paragraph 4.2 of this document for the definition of small entity). The Committee decided against this solution for a number of reasons:

- The raising of the income criterion for small entities to £10.2m from the current £6.5m is a significant one which means many charities would be able to provide less information than they currently do. Of those charities that must by law prepare accruals accounts, 99% would qualify as small entities under this definition and so would have the option not to prepare a Statement of Cash Flows.
- The Financial Reporting Council places a greater emphasis on considering the appropriateness of applying the going concern basis of accounting and disclosing material uncertainties that may make it inappropriate in the future, such as significant liquidity or solvency risks. The preparation of the Statement of Cash Flows is valuable to the charity as it ensures that the degree to which cash balances are rising or falling is actively considered as part of its annual reporting on the stewardship of its assets to stakeholders through its accounts.
- The discipline of preparing Statement of Cash Flows is valuable to a charity as it ensures that its cash position is actively considered as part of its annual reporting cycle.
- The Statement of Cash Flows is useful for funders in considering the underlying solvency of a charity at the reporting date and for enquiring about its solvency going forward.
- Those charities that opted to follow Charities SORP (FRS 102) for 2015 accounting years or previously opted not to adopt the FRSSE were required to provide a Statement of Cash Flows irrespective of size and so will be familiar with the preparation of a Statement of Cash Flows.

- 3.9 The Committee considers that the preparation of a Statement of Cash Flows is a useful primary financial statement in its own right. The preparation of the Statement of Cash Flows by any charity would always be encouraged as good practice regardless of that charity's size.
- 3.10 As a result the SORP Committee then considered at what level the Statement of Cash Flows was to be made mandatory if the threshold was not to be set on the basis of what constitutes a 'small entity' in FRED 59. Introducing an arbitrary threshold just for the Statement of Cash Flows preparation was considered but rejected as inappropriate and potentially confusing.
- 3.11 The SORP-making body and the Charities SORP Committee are of the view that following the withdrawal of the FRSSE, preparation of the Statement of Cash Flows should be mandatory for those charities that the SORP classifies as larger charities (those with gross income exceeding £500,000 UK or 500,000 euros Republic of Ireland) in the reporting period from 1 January 2016 onwards.² This will mean that only those charities classified as larger charities by the SORP will have to prepare a Statement of Cash Flows whilst others may choose to adopt the cash flow requirements if they wish. Of those charities that must by law prepare accruals accounts, 67% would therefore not need to prepare a Statement of Cash Flows.
- 3.12 Since the 1995 SORP, more detailed reporting has been expected of those charities the SORP defines as larger charities. This solution would unify and simplify reporting for charities and provide to donors and users of the accounts with a common recognition, measurement and presentation of financial information. Implementation of this option would require an amendment to Draft Update Bulletin 1: Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland (Charities SORP (FRS 102)) to only require those charities classified as larger charities to produce a Statement of Cash Flows. This Draft Update Bulletin 1 is also being consulted on at this time and already proposes a standard definition of a larger charity.

² The definition of larger charities is being consulted on in Draft Update Bulletin 1 Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland (Charities SORP (FRS 102))

4 Definition of Small Entities and the term Larger Charities used by SORP

4.1 In the charity law jurisdictions of Scotland and England and Wales, charities with a gross income of less than £250,000, that are not charitable companies, can choose to prepare accounts on a receipts and payments basis and so are not required to follow UK-Irish Generally Accepted Accounting Practice and the SORP. There is no corresponding cash based accounting regime for charitable companies. The different criteria referred to in this section are summarised in table 1.

Table 1: Thresholds shown by reference to gross income

Charity type	Receipts and payments option	Proposed definition of 'larger charity'	Audit criteria – charity law	Small entity definition
Charitable companies	None	Gross income £500,000 (€500,000 Republic of Ireland)	Gross income £1m England and Wales Gross income £500,000 Scotland. (An audit will also be required in England, Wales if a charity's income exceeds £250,000 and its gross assets exceed £3.26m. In Scotland, an audit would also be required if a charity prepares accrued accounts and its gross assets exceed £3.26m) No charity law requirement in Northern Ireland or Republic of Ireland	Gross income £10.2m (not an option in the Republic of Ireland)
Non-company charities	£250,000 gross income (Northern Ireland £100,000 and Republic of Ireland no option)	Gross income £500,000 (€500,000 Republic of Ireland)	Gross income £1m England and Wales Gross income £500,000 Scotland (An audit will also be required in England, Wales if a charity's income exceeds £250,000 and its gross assets exceed £3.26m. In Scotland, an audit would also be required if a charity prepares accrued accounts and its gross assets exceed £3.26m) No charity law requirement in Northern Ireland or Republic of Ireland	Gross income £10.2m UK Republic of Ireland - annual turnover (gross income for charities) not exceeding €8.8m

4.2 The definition of small entities for accounting purposes is set out in UK Company Law with the for-profit sector in mind. The definition of a small company is one which does not exceed two or more of the following criteria:

(a) Turnover £10.2 million

(b) Balance sheet total £5.1 million

(c) Average number of employees 50

Although the smallest companies can opt for a simplified form of reporting if they are classified as micro-entities, UK company law excludes UK charities from applying the micro entities regime.

4.3 In the interests of transparency to donors and funders the SORPs issued since 1995 have required a greater level of reporting by 'larger charities'. The definition of a larger charity has been linked to the charity law audit threshold. Regulations have increased the charity audit income threshold from £500,000 to £1million in England and Wales with effect for reporting periods ending on or after 31 March 2015. At the date of issue in July 2014, the current SORPs which are effective for financial years beginning on or after 1 January 2015, were framed with a gross income audit threshold of £500,000 (UK) or €500,000 (Republic of Ireland) in the reporting period.

4.4 In linking disclosures to the audit threshold additional detail in the trustees report and in respect of specific disclosures in the accounts is only required of charities required by charity law to have an audit. With the increase in the audit threshold in England and Wales, the Charities SORP-making body is consulting separately on whether the definition of larger charity, to which these additional requirements would apply, be changed to simply require those charities with a gross income of £500,000 and above (UK) or €500,000 (Republic of Ireland) in the reporting period to provide greater disclosure in their trustees' annual report and notes to the accounts. This proposed change is subject to a separate consultation (see Draft Update Bulletin 1: Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland (Charities SORP (FRS 102)).

5 Proposed amendment to the Charities SORP (FRS102)

5.1 FRED 59 included requirements that affect FRS 102 and these have been included in Draft Update Bulletin 1: Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance

with the Financial Reporting Standard applicable in the UK and Republic of Ireland (Charities SORP (FRS 102)) which is also under consultation and an amendment to the definition of 'larger' charity which is also subject to consultation.

- 5.2 It is proposed that this bulletin would also need to make the preparation of a Statement of Cash Flows a requirement of the SORP for larger charities. This would then permit those charities that do not meet the definition of larger charities under the SORP the option not to produce a Statement of Cash Flows.
- 5.3 In launching the consultation, we are aware that the amendments to FRS 102 arising from the FRC's FRED 59 have not been finalised and as a result, further changes may have to be made to the charities SORP (FRS 102) to ensure the SORP is consistent with the settled text of FRS 102 effective for reporting periods beginning on or after 1 January 2016.

6 Consultation

- 6.1 The joint SORP-making body and the SORP Committee are interested in your views. In summary we are consulting on how best to handle the withdrawal of the FRSSSE from 1 January 2016. Of the possible courses of action, our preference is to require all charities preparing their accounts on an accruals basis to follow Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS 102) (effective 1 January 2015). The SORP-making body and the Charities SORP Committee, therefore, are consulting on the option of moving from 2016 to a single SORP and, as a consequence, disapplying the small entities regime option included in Section 1A in FRED 59. Dropping the 'small entity regime' option would unify the reporting framework and provide to donors and users of the accounts a common presentation of financial information.
- 6.2 In addition the SORP Committee is proposing that only those charities that meet the SORP definition of a larger charity are required to prepare a Statement of Cash Flows. This would leave those charities not meeting the definition of a larger charity in the same practical position had the SORP Committee pursued the option to prepare a dedicated Charities SORP FRS 102 (Small Entities) to replace the Charities SORP (FRSSE).
- 6.3 The consultation also sets out some specific questions relating to the proposed solution following the withdrawal of the FRSSSE with the requirement that all charities follow the Charities SORP (FRS102). If you favour this option, we also welcome any explanation of your reasons for this and any additional comments you may have.

- 6.4 Your comments will receive careful consideration prior to the decision on whether to require all Charities to follow the Charities SORP (FRS102). The SORP Committee will be meeting in August 2015 and October 2015 to reflect on the consultation process and to consider the approach to be taken.
- 6.5 It is intended that all charities preparing accounts on an accruals basis will follow the Charities SORP (FRS 102) for reporting periods beginning on or after 1 January 2016, the same date at which the EU Accounting Directive and the proposed changes to FRS 102 becomes effective.

7 Consultation questions

- 7.1 We welcome comments on any aspect of the Invitation to Comment, in particular:

Question 1 Given the underlying requirement for the accounts to give a true and fair view and the requirements of FRS 102 that result in all charities applying the same underlying recognition and measurement policies, do you agree with the SORP-making body disapplying the small entities regime proposed in FRED 59? This would have the result that all charities will have to apply the Charities SORP (FRS 102) for reporting periods beginning on or after 1 January 2016. Please give reasons for your response. If your answer is no, what alternate approach would you recommend and why?

Question 2 Do you agree with the proposal to amend the Charities SORP (FRS 102) so that it requires only larger charities to prepare a Statement of Cash Flows? This would mean that all charities with a gross income exceeding £500,000 (€500,000 in the Republic of Ireland) would have to prepare a Statement of Cash Flows. Please give reasons for your response.

Question 3 If your answer to question 2 was no, what alternative threshold would you propose for the preparation of a Statement of Cash Flows? Please state what threshold you would propose and give reasons for your response.

- 7.2 In your response, please say what kind of organisation you are involved with or responding on behalf of, and what your role is. The joint SORP-making body is particularly interested in receiving comments from both preparers and users of charity accounts and reports, including charity finance staff, treasurers, trustees, auditors, independent examiners, funders and others with an interest in charity reporting.

7.3 Your comments will help shape the amendments to the Charities SORP (FRS 102) which, subject to FRC approval, are likely to be issued in the form of an Update Bulletin in February 2016.

8 How to respond to the consultation

8.1 The consultation will run for 3 months with a closing date of Friday 18 September 2015.

8.2 There are two ways to respond to this consultation:

Email:

Submit your response or enquiry via email to charities.sorp@cipfa.org

Post:

Send a written response to:

Charities SORP
CIPFA
77 Mansell Street
London
E1 8AN

If you have any questions about the consultation, please e-mail them to charities.sorp@cipfa.org

The joint SORP making-body will publish all responses to formal consultations unless the respondent explicitly requests otherwise (please see data protection guidance). We will aim to publish responses as soon as possible and at least within one month of receipt.

8.3 We will acknowledge receipt of all responses, and all responses will be carefully considered. The aim is for a summary of the consultation responses to be published in November 2015.

8.4 These responses together with the feedback from consultation events will inform the final editing of any proposed changes to Charities SORP (FRS 102) before it is submitted to the Financial Reporting Council for its sign-off review in autumn 2015.

9 Data protection

- 9.1 All information contained in the consultation responses (including personal information) may be published or disclosed in accordance with the access to information regime. This is primarily set out in the Freedom of Information Act 2000 (FOIA), Freedom of Information Act (Scotland) 2002, Data Protection Act 1998 and Environmental Information Regulations 2004.
- 9.2 The joint SORP-making body can only treat information in your consultation response as confidential if that's consistent with the law. There is a statutory Code of Practice under the FOIA which public authorities must comply with. This sets out how confidential information must be dealt with. The joint SORP-making body can't give assurances that all information will be kept confidential, but it will take into account any representations that you make.
- 9.3 If you object to any information in your consultation response (including your personal details) being published, please say so. Please explain why you think the information should be confidential. This will help the joint SORP-making body to decide whether there are grounds for not publishing it.