SORP Committee

Minutes of the SORP Committee Meeting of 7 June 2011
(Approved at the July 2011 SORP Committee Meeting)

Contact: Nigel Davies, Secretary to the SORP Committee
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Present:

Debra Allcock-Tyler
Laura Anderson, Joint Chair of the SORP Committee
Tidi Diyan
Peter Gotham
Pesh Framjee (for item 5 only)
Keith Hickey
Noel Hyndman
Ray Jones
Carol Rudge
Kate Sayer
Paul Spokes

In attendance:

Nigel Davies, Secretary to the SORP Committee
Joanna Spencer, Accounting Standards Board

Apologies:

Frances McCandless, Chief Executive, Charity Commission Northern Ireland (observer member)
John Graham
Chris Harris
Tris Lumley
Lynne Robb
Catriona Scrimgeour
Sam Younger, Joint Chair of the SORP Committee

Item 1: Opening remarks and declarations of interest

1.1 Laura Anderson opened the meeting and invited any declarations of interest to be declared. None were noted.

Item 2: Approval of the minutes and matters arising

2.1 The minutes of the meeting of the 13 May 2011 were considered and were approved.

2.2 The first matter arising was the draft submission to the Accounting Standards Board's consultation on the draft Financial Reporting Standard for Public Benefit Entities (FRSPBE) also known as Financial Reporting Exposure Draft 45 (FRED 45). Ray Jones reviewed the draft and noted the additional comments received from SORP Committee members. One point was identified for further discussion.

2.3 The second matter was a proposal that the argument be put that goods donated for resale do not have a value as stock because accounting standards require that stock be valued at the lower of cost or net realisable value. Since the donated items were not purchased they have a nil cost value. The effect is that any initial recognition at fair value is immediately offset by an equivalent impairment charge.

2.4 The Committee noted that in their work, the International Public Sector Accounting Standards Board (IPSASB) had considered stock which had been gained through a non-exchange transaction. IPSASB had implicitly deemed the fair value on receipt to be deemed cost. However the FRSPBE was silent on this point. The Committee noted that stock could be a material item and that the initial recognition would show as a gain. However if stock is relatively stable the effect is only one of timing compared to current practice of recognising donated goods upon sale.

2.4 The Committee noted that items donated may range from the very valuable through to low value items or even items with a disposal cost to the charity. It could not therefore be argued that all donated items for resale had a nil value to the charity until sold as some were clearly intrinsically valuable eg a donated dress from a celebrity. Also many charities provided an estimated value for donated items for insurance purposes. However accounting standards relating to stock clearly state that stock is valued at the lower of cost or net realisable value (FRSSE section 8, and IAS2) or estimated selling price less costs to complete and sell (FRSME section 13). Since there is a nil acquisition cost of stock it follows that trading stock must be valued at nil. Otherwise a cost is being deemed to exist and such a deemed cost would be the fair value to the charity when the gift is received or receivable. However none of these standards nor the FRSPBE (section 7) refer to deemed cost.

2.5 Although the FRSPBE encouraged the use of estimation techniques, audit standards required the auditor to sample stock takes and so this would be a significant cost burden with little tangible benefit to the readers of the financial statements. Also many smaller charity shops did not maintain stock records or conduct stock takes and this would be a significant burden to a largely volunteer workforce. This burden is made greater if having to operate two systems as in administering gift aided donations for resale until the donor approves the gifting of the sale proceeds the item remains the property of the donor.

2.6 The Committee noted a point for discussion where charities with heritage assets might also have operational assets such as shops or buildings that were not heritage assets. It was important that just because a charity has purposes relating to advancing knowledge and culture it does not imply that an operational asset is necessarily a heritage asset. The National Trust for example has heritage properties but also operates restaurants, shops and administrative offices which are not heritage assets.

2.7 The Committee agreed that submission be amended to:

- **Seek a greater emphasis in the FRSPBE on materiality, practicality and measurability considerations in the recognition of donated goods for resale as stock. The FRSPBE needs to be drafted in such a way as to allow SORP to offer significant flexibility for trustees to exercise reasonable judgement.**

- **Note that assets that are used by an entity in its operations should be accounted for as operational assets in accordance with section 15 of the FRSME, notwithstanding historical or other heritage qualities, where these assets are not used principally as heritage assets in furthering the entity's aims or retained principally for the advancement of knowledge or culture.**
- **Where assets are donated for the charity's own use, for example the gift of a licence or lease at nil or nominal cost, the valuation should be what the charity would have paid.**
- **The recognition of legacy income arises after the point at which the executor decides that payment can be made. Notification by the executor or estate accounts may provide evidence that the executor has determined payment can be made.**

2.8 The Committee noted that the draft Financial Reporting Standard for Medium-sized Entities (FRSME) paragraph 2.52 did not permit offsetting an asset and liability unless it was explicitly approved elsewhere. Since paragraph 21.9 does not explicitly allow a reimbursement to be offset against a provision this meant that insurance claims would show as part of income. Practice in the sector was to distinguish between claims replacing income from claims relating to reinstating an asset which are offset.

2.9 The Committee agreed that submission be amended to:

- **Seek a change to the FRSPBE to permit the continuation of offsetting insurance claims and the related loss where a claim is reinstating a fixed asset.**

Item 3 Update from the ASB

3.1 Joanna Spencer gave a verbal update on the progress with FRED 43 and 44 following the close of the consultation. She noted that the ASB's Board were actively considering the submissions and considering the next steps and the timescale for changing UK Generally Accepted Accounting Practice. Given the importance of getting the changes right she anticipated that the ASB may wish to consult further before finalising its plans.

3.2 The Committee were very keen to learn of the ASB's plans for the Financial Reporting Standard for Smaller Entities. To emphasise its importance the sector the Committee agreed to:

- **Amend the submission on the FRSPBE to seek clarification about how long the FRSSE would remain in place and how it might be developed in light of the FRSME**.

Item 4 Disclosures when making grants

4.1 Ray Jones introduced this paper. He noted that the draft module largely followed the line taken by SORP 2005. There were two significant changes, firstly whether the exemption from disclosure of certain sensitive grants should remain and if it remains should details be filed with the charity regulator. Secondly should details of a significant and representative number of grants be required in the notes to the financial statements or should the existing alternative of having a separate document publicly be available remain an option.

4.2 The Committee noted that the SORP does exempt from disclosure those grants to institutions that would seriously prejudice either the grant maker or the recipient. In discussion it was noted that the public may be reassured to know that if details are not publicly available, they are being made available to the charity regulator. This would provide information to the regulator for use were a complaint about the grant-maker arise to do with these grants.

4.3 However, it was unclear what use the regulators made of this information and the requirement was in practice only being applied to filing with the Charity Commission and not by OSCR. Given that trustees decide when using the exemption, there was concern that accountability and transparency would be lost if there was no potential check, such as a filing requirement, on the exercise of this discretion. Auditors would consider any non disclosure if it was material and would qualify their opinion if use of the exemption was not justified. Also auditors had a duty to 'whistle-blow' in certain circumstances to the charity regulator. However, the Committee wondered to what extent the auditor's role might underpin public confidence regarding non-disclosure of grant details. How was transparency and accountability served through non-disclosure?

4.4 The Committee members representing the regulators noted that it was a non-statutory filing requirement and so in practice it cannot be enforced. Indeed was it the place of the SORP to require such a filing? Some Committee members voiced concern that if there was no requirement for disclosure to charity regulators then the discretion to use the exemption might be abused. The key issue was if the exemption is retained, how can public confidence be best maintained?

4.6 Opinion was divided on the second issue of the option to disclose information on the recipient of institutional grants in a separate document from the financial statements. It was noted that the draft module only required disclosure where grants were material and was limited to a sufficient number of institutional grants to provide an understanding of the range and type of institutions support and did not necessarily require all of them to be disclosed. Advocates noted that inclusion in the notes to the financial statements of an analysis ensured the reader had ready access to this information in one place and so facilitated transparency and accountability.

4.7 The contrary view was that in the internet age this information can be readily provided in a separate document giving grant-makers greater flexibility in presentation whilst also reducing the length of the notes. Motivated readers or researchers would seek out this information if they desired it. On the one hand the financial statements should be comprehensive and this information was very valuable to those seeking grants or wishing to know more about the grant-maker's activities.

4.8 The Committee noted that a form of activity analysis was very valuable in assisting the reader of the financial statements to understand the work of a grant-maker. However perhaps the terminology could be changed to emphasise the flexibility grant-makers have in setting out that analysis.

4.9 The Committee agreed that:

- **The regulators be requested to consider whether a requirement to file with the charity regulator should remain where sensitive grants are not disclosed.**
- **The SORP making body consider whether a question be posed in the SORP consultation about retaining the exemption from disclosure of details of grants where the trustees consider disclosure would seriously prejudice the grant-maker or the recipient.**
- **A question be posed in the SORP consultation about whether the option to provide an analysis of institutional grants in a separate publication rather than in the notes to the financial statements be retained.**
- **To avoid duplication, the explanation of grant-making policies and activity should be in the Trustees' Annual Report only.**
- **The module analysis referred to in the module should be expressed in terms of the total amount of grants paid by nature, category or type of activity or project supported.**

Item 5: Charities as subsidiaries

5.1 Nigel Davies introduced this draft module and he noted that charities may be subsidiaries either because they are a part of a charity group or because a non-charitable entity is considered to control them or as a result of a requirement of law or government accounting requirements or practice. The disclosure requirements were based on the requirements of the FRSME with the additional disclosures required for FRSSE users separately identified.

5.2 The Committee noted that whilst the treatment of an incorporated charity as the subsidiary of another charity was straight forward, the treatment of unincorporated charities needed to follow that of charity law. The definition of a subsidiary in the FRSME extends to unincorporated entities that are controlled by another entity.

5.3 When defining the group, the proposal that all unincorporated charities can be viewed as analogous to branches was not supportable. Charities, in England and Wales, that are special trusts or branches of a charity form part of that entity's accounts. The requirement to prepare separate financial statements arises when a charity is not a special trust or is not linked for accounting and reporting purposes. In such a situation the entity may be regarded as a subsidiary of another for accounting purposes when the tests of control are met.

5.4 Although a distinction for insolvency purposes can be drawn between unincorporated and incorporated charities this is insufficient given the FRSME's definition. Therefore the proposed simplification in the draft module on charity groups and combinations that unincorporated charities are never classed as subsidiaries was not sustainable.

5.5 The Committee noted that the module on branches was being revised and that the definition of special trusts was an important in differentiating those unincorporated charities which are treated as analogous to branches and those that must be classed as subsidiaries.

5.6 The Committee concluded that:

- **The disclosures were sufficient but the module should, for clarity, include the additional disclosures required for users of the FRSSE.**

Item 6: Consideration of the charity groups and combinations was deferred for consideration at a future meeting.

Item 7: Any other business

7.1 There being no other business the meeting closed.