SORP Committee

Minutes of the SORP Committee Meeting of 8 November 2012
(Approved at the December 2012 SORP Committee Meeting)

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Present:

Laura Anderson, Joint Chair of the SORP Committee
Debra Allcock- Tyler
Tidi Diyan
Pesh Framjee
Peter Gotham
Ray Jones
Carol Rudge
Kate Sayer
Paul Spokes

In attendance:

Nigel Davies, Secretary to the SORP Committee
Joanna Spencer, Financial Reporting Council (observer member)

Apologies:

John Graham
Caron Bradshaw (observer member)
Frances McCandless (observer member)
Keith Hickey
Noel Hyndman
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 by recording the Committee's thanks to MHA MacIntyre Hudson for hosting the meeting. She invited any declarations of interest to be made. No declarations of interest were noted.

Item 2: Approval of the minutes and matters arising

2.1 The minutes of the meeting of the 17 October 2012 were considered and were approved.

2.2 Nigel Davies advised that the agenda items for the December meeting were: performance reporting in the Trustees' Annual Report (TAR), social investment, grant income recognition, and the option of the reduced disclosure framework permitted by FRS 102.

2.3 The Committee discussed the agenda items planned for the December meeting. The importance of addressing social investment at a principle level from both the investor's and recipient's perspective was noted. Kate Sayer indicated that she would forward a note setting out the issues that had arisen in recent sector discussion on reporting and measuring social investments.

Item 3: Statement of Financial Activities

3.1 Nigel Davies introduced this item by referring to Paper 2 which set out the four principles that under-pinned the Statement of Financial Activities (SoFA). A plain English version of the current SoFA format was also tabled for discussion and identified additional disclosures for consideration. The four principles were: identifying in a single statement all the resources receivable; the differentiation of restricted, endowment and unrestricted funds; grouping or aggregating categories of income and expenditure together; and, the linking of categories of income to related items of expenditure by the use of analysis headings.

3.2 The Committee debated the principles and how these had worked out in practice based on the experience of SORP 2005. They noted the considerable variation in practice especially over the treatment of grant income and the practical difficulty of differentiating between grants as gifts, performance related grants and contract income.

3.3 Accepting the principles as the basis for the SoFA, the Committee wondered if the SoFA was in practice attempting to do too much. This could result in a cluttered and complicated statement that some users found hard to understand and some preparers found problematic to compile.

3.4 The notes already offered the opportunity to analyse items of income and expenditure in more detail if required. The more sophisticated users of the accounts would refer to the notes when analysing the SoFA and consequently simplifying the SoFA's headings would not necessarily compromise accountability and transparency.

3.5 The Committee considered the arguments put forward by some practitioners that the SoFA analysis provided too much potentially commercially valuable information. The Committee noted that charities had a duty of public transparency and accountability. Moreover, the aggregation of financial information in accounts and its summarised presentation in the SoFA mitigated these potential problems.

3.6 The Committee noted that the fourth principle of linking an item of income with expenditure did not result in matching because expenditure may be incurred ahead of the income generated. A classic example is in the area of fundraising where substantial upfront costs may be incurred before income streams from the new fundraising activity come on line. However, the Trustees' Annual Report does provide trustees with the opportunity to explain the charity's financial results where such a mismatch of timing occurs.

3.7 The Committee welcomed the plain English version of the SoFA but noted that it highlighted some of the issues that arisen from the SoFA's analysis categories attempting to do too much. For example, the analysis of cost between gifts (voluntary income) and fundraising (exchange transactions to raise funds) was confusing in practice. To the public and fundraisers there is often little distinction between fundraising through events and fundraising seeking donations. Costing systems often did not provide the degree of cost allocation and apportionment necessary to support this differentiation. In addition to the need to 'plain English' the headings used in the SoFA, there was also a need to simplify the analysis provided within the SoFA.

3.8 The term expenditure on charitable activities must be retained as this was the purpose of any charity. The terms incoming resources and resources expended also need to be retained as the statement included the receipt of endowment funds. The preparer should be encouraged to provide any detailed analysis of components of income and expenditure in the notes to the accounts and use the analysis provided on the face of the SoFA to aggregate income and expenditure into broader categories.

3.9 The Committee considered whether endowment receipts, transfers to income, and related expenditure of endowment should be shown in a separate section of the SoFA rather than as a separate column of the SoFA. However, this approach might confuse the reader as it would add complexity and so the current columnar approach should be retained.

3.10 The Committee agreed that the SoFA should differentiate between donations, earned income and investments/ other. Earned income should differentiate between trading income and income from providing charitable services. The Committee considered, but rejected, differentiating income earned from service provision between contracts and non-contact income as this was not straight forward with the use of contact style language in service level agreements. For those charities where investment income was not material, it could be included with other income but where investment income was material, for example for endowed charities, they would need to differentiate income from investments from other income

3.11 The Committee considered whether cost of fundraising could be split between the cost of raising donations and trading for fundraising purposes through the sale of goods and services. The Committee noted that in charity shops, bought in goods would be sold alongside goods donated for resale and in practice this was in substance one source of income. It was pointed out that concerns had been raised in the past over combining trading costs with other fundraising costs. Some argued trading to raise funds and seeking donations were conceptually different and had very different cost profiles. On balance, the Committee concluded that the SoFA should identify the cost of fundraising as a single line with further analysis, as necessary, provided in notes to the accounts.

3.12 The Committed noted that the new SORP offered an opportunity to support the Financial Reporting Council's (FRC) objective to cut clutter by simplifying the SoFA. Before settling the headings used it the Committee would review the whole SoFA module to assess how the new format will work in practice.

3.13 The Committee tentatively concluded that:

The SoFA should retain the terms incoming resources and resources expended and continue to differentiate between unrestricted, restricted income and endowment funds in a columnar format.

The analysis of income should be between: donations, earned and investments/ other.

Earned income should differentiate between trading income and provision of charitable service.

Expenditure should be analysed between the costs of fundraising, expenditure on charitable activities, and other expenditure.

An analysis of the material components of income and expenditure should be provided in the notes to the accounts with the SORP providing specific guidance on what is required.

Item 4: Donated Goods and Services Module

4.1 Nigel Davies introduced this paper. He noted that the Committee had previously considered this module at its May 2011 meeting but had been unable to conclude its discussion because of the changes it was seeking, at that time, to the Accounting Standards Board's (ASB) proposals. The subsequent FRC proposals, contained in FRED 48 and subsequently announced through their website were in line with current sector practice and so the module was resubmitted for discussion.

4.2 The FRC has accepted that if establishing fair value on receipt is impractical then goods donated for resale can be recognised on their sale. It was now also anticipated that FRS 102, when issued, would require donated services and facilities to be measured at value to the charity rather than fair value.

4.3 In considering income recognition criteria, the Committee noted that although performance conditions rarely applied to donated gifts of goods and services such circumstances can arise on occasions, for example where matched funding was required before a gift was made. Although the income recognition criterion of likelihood had been accepted previously, the term probable should be used to better align the terminology used in the SORP with FRS 102. For clarity, the discussion of measurement provided in the module should also be split between donated goods and donated services and facilities.

4.4 The Committee noted that the draft module included the term 'value in use' rather than the FRC term 'value to the charity'. For consistency with the FRC, the term value to the charity should be used even though it resulted in a similar approach to measurement and recognition.

4.5 Nigel Davies introduced the topic of the valuation of volunteers. He noted that the draft of FRS 102 did not expect the contributions made by volunteers to be recognised as income due to the difficulty in measurement. The findings of the SORP research in 2008-09 had also indicated clearly that there was little support for valuing the contribution made by general volunteers.

4.6 The Committee noted that some charities argue they can measure the economic contribution made be volunteers. However, suggested approaches to measurement differed with some, for example, suggesting the use of UK minimum wage and others suggesting more elaborate measurement systems. However, at present, there is no consistent and comparable basis on which measurement of general volunteers could be based.

4.7 The Committee noted that it would be inconsistent to value volunteers based on their profession (salary sacrifice made in volunteering) as then different values would be placed on different volunteers undertaking the same roles. The Committee also noted that in practice some business models were only sustainable through the contribution of volunteers and if the activities had to be paid for they simply would not happen, for example volunteer staffed help lines and the staffing of certain charity shops.

4.8 The test for recognition is whether the charity would have had to pay for the service had it not been provided free; this would be the case with activities such as audit, legal advice or rent free space in a building.

4.9 The Committee noted that the module also dealt with donated goods received by a charity for its own use and the keeping of a stock of goods donated for onward distribution to beneficiaries. The current SORP required items donated for distribution to be recognised on distribution. However, FRS 102 required stock (inventory) to be valued at the lower of cost or the estimated selling price less cost to complete and sell (also known as net realisable value). Joanna Spencer advised that the FRC was now of the view that upon receipt stock is measured at fair value with subsequent remeasurement at cost adjusted, when applicable, for any loss of service potential.

4.10 The Committee were reassured that the FRC was not looking for the revaluation of stock based on movements in current prices but instead were seeking to ensure that a value was attributed to stock held for the charity's own use.

4.11 The Committee concluded that:

The three income recognition criteria should be: entitlement (which included meeting of any performance conditions), probability and measurement.

For clarity, the discussion of measurement should be split between donated goods and donated services and facilities and the term 'use' should be substituted for 'utility'.

The current SORP requirement that the contribution of general volunteers should not be valued should be kept.

Item 5: Update from the FRC

5.1 Joanna Spencer advised the Committee that FRS 102 is likely to be approved by the FRC at the end of January 2013. This timetable could not be guaranteed as it was dependent upon the standard being approved at each stage of the FRC's processes.

5.2 It was likely that charities would be ineligible to use FRS 101 due to the prohibition on company charities in the UK and non-company charities in Scotland, and England and Wales using IFRS.

5.3 Application guidance contained in FRED 45 regarding the definition of a Public Benefit Entity is to be incorporated into FRS 102.

Item 6: Any other business

6.1 There being no other business the meeting closed