SORP Committee

Minutes of the SORP Committee Meeting of 26 February 2013
(Approved at the 13 March 2013 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
John Graham
Keith Hickey
Ray Jones
Carol Rudge
Paul Spokes

In attendance:

Caron Bradshaw (observer member)
Nigel Davies, Secretary to the SORP Committee
Fiona Muldoon, Charity Commission Northern Ireland (observer member)
Joanna Spencer, Accounting Standards Board (observer member) present for items 2, 3 (social investment only) and 5.

Apologies:

Noel Hyndman
Tris Lumley
Lynne Robb
Catriona Scrimgeour
Kate Sayer
Sam Younger

Item 1: Opening remarks and declarations of interest

1.1 Laura Anderson opened the meeting by welcoming Fiona Muldoon as the new observer member representing the Charity Commission Northern Ireland.

1.2 On behalf of the Committee, Laura Anderson thanked Grant Thornton for hosting the meeting. She invited any declarations of interest to be declared. No declarations of interest were noted.

Item 2: Approval of the minutes and matters arising

2.1 The minutes of the meeting of the 7 February 2013 were considered and approved.

2.2 To expedite business, matters arising on the core SORP modules were deferred as an item until the consideration of the selected modules had been completed. Two matters arising on the core modules were noted: the classification of income and costs in the statement of financial activities (SoFA) and the treatment of recognised and unrecognised gains and losses in the SoFA.

2.3 Nigel Davies advised that there were two other matters arising concerning the SORP and alms houses and academy schools.

2.4 Regarding alms houses, Nigel Davies informed the Committee that the SORP Secretariat had been approached by a representative of the Almshouse Association to request that the charities SORP is amended to extend its scope to those alms houses which are also registered social landlords. He advised the Committee that he understood that a minority of almshouses were also registered as social landlords but that the Association felt that its members should be reporting under a single framework. **The Committee were sympathetic to amending the next SORP on this basis subject to the Association's proposal having the approval of both the SORP making body for registered social landlords and the regulator for social housing.**

2.5 The Secretariat had been approached by the Education Funding Agency (EFA), which is an arm of the Department of Education, to request a meeting. The EFA are interested in the SORP making process. The EFA currently set the broader accounting framework for academy schools, which otherwise report using the charities SORP. Nigel Davies anticipated that there may be interest in an Academy School version of the SORP or indeed perhaps a desire by the EFA to develop its own separate SORP and so he requested the Committee's feedback on whether such a development might be welcomed.

2.6 The Committee noted that the aim of SORPs is to bring consistency to accounting and reporting and that the Financial Reporting Council had reviewed the place of the existing SORPs as part of its standard setting process for the new Generally Accepted Accounting Practice (new GAAP). The Committee concluded that if one small part of the sector sought its own SORP then there was a risk of fragmentation. This kind of sub- sector SORP had been considered in the past for cathedrals but in the end a cathedral guide to applying the SORP had been developed instead. A similar situation had arisen for grant making charities which had been resolved by issuing a guide. Academy schools had existed for more than 15 years and reported without apparent difficulty using the Charities SORP.

2.7 The Committee concluded that:

- **a better way forward was for any academy school specific issues to be identified and dealt with in the charities SORP; and**
- **a consultation question should invite users of the SORP to identify any specific issues which the SORP needs to address.**

Item 3: Review of the SORP selected modules

3.1 Nigel Davies introduced this item by referring to paper 2. He noted that the drafting stage of the SORP development process was now drawing to a conclusion. He noted that the paper set out the next steps in the SORP development process including seeking clearance from the Financial Reporting Council's procedures prior to the planned issuing of the draft SORP later this year.

3.2 He noted that the selected modules were those topics that would apply to some but not all charities preparing their accounts on an accruals basis. Paper 2 identified the major drafting amendments made by the SORP Secretariat by module and included a reference to the Committee meeting and minute relating to each module.

3.3 He highlighted the following changes to the Committee:

- the module on retirement and post-employment benefits anticipated the FRC approving a change to FRS 102 which requires the recognition of a liability for an agreed funding arrangement to make good a scheme deficit where the scheme was not accounted for as a defined benefit plan;
- the module on social investments now included a typology of social investments and a section on the reclassification of investments;
- the treatment of charity combinations was now split across several modules, including a new overview module which uses a flowchart setting out their application; and
- an amendment to the mergers module had been made to address charity reconstructions and in particular to deal with the conversion unincorporated charities to corporate status.

3.4 The Committee debated whether the term social investments was helpful given that it is not well defined and could be potentially misleading. Although the SORP can identify what it means by social investment, there was a danger in using 'in vogue' terminology that might quickly date. Also it was questioned whether ethically made investments and share purchases motivated by shareholder activism should be classed socials investments even though these financial investments yield a market return.

3.5 Arguably the previous SORP with its clear distinction between programme related investments made exclusively to further the investing charity's objects offered a clearer approach. The situation was now more complex due to the Charity Commission's latest investment guidance responding to sector developments. This guidance identified a new class of mixed motive investment. The Committee debated whether mixed motive investments should be split based on investor judgement as to that proportion which represents a financial investment and that proportion that relates to furthering the charity's aims, or, whether a judgement using a preponderance approach was preferable whereby a social investment might be classified according to whether it was acquired mainly to further a charity's aims or mainly as a financial investment.

3.6 The Committee noted that the use of guarantees to meet the first element of a loss were a longstanding innovation. Guarantees, for example may be used to facilitate bank loans with a charity standing as a guarantor to the bank for the first element of a loss and thereby facilitating a loan at a favourable interest rate to the recipient. Given the range of social investment, the module rightly dealt with the topic at a principle level, requiring the user to consider the substance of the social investment and then to apply relevant principles to accounting for it.

3.7 It was noted that gains and losses on social investments that are financial investments would be treated differently from those on programme related investments. Gains and losses on financial investments are shown 'below the line' whereas a loss on a programme related investment is treated as charitable expenditure and a gain on disposal is treated as other income.

3.8 The agenda matter arising on the treatment of gains and losses on investments was then discussed. It was noted that taking realised and unrealised gains and losses on investments into the SoFA after striking the total for net incoming resources (resources expended) was not consistent with the requirement of FRS 102 that gains and losses on investments measured at fair value are taken through profit and loss. Nor was the SORP's approach consistent with company law as realised gains and losses are required by company law to be taken to profit and loss. When 'fair value' rules were applied the draft FRS 102 also requires unrealised investment gains to be taken to profit and loss. This approach was considered by the standard to be consistent with company law.

3.9 Historically, the SORP had adopted its current approach to avoid volatility in income and expenditure resulting from investment revaluation gains and also because unlike for-profit companies, the question of what was a distributable profit and what was a non-distributable reserve was irrelevant. Charities cannot make a dividend or similar distribution to equity holders. However, arguably for endowed charities the change in the value of endowments was an operational matter whereas other charities investing funds may be more of a matter of good housekeeping than an operational activity.

3.10 Regarding the classification of social investments, the Committee noted that the acid test was if the investment was written off could the investing charity have made a grant for that same purpose.

3.11 The Committee considered whether a broad brush portfolio approach could be taken used to classify social investments. However, because each investment decision is unique such an approach could be unreliable. Each investment had to be considered and classified individually.

3.12 The Committee, in considering the use of merger accounting methods, agreed that in substance that a charity incorporation was a restructuring and so the use of merger accounting gives a true and fair view of the continuing nature of a charity under the control of the same trustees. Even though the legal position involved the creation of a new corporate entity, in substance the charity was continuing within a corporate structure. This conclusion applies equally to an incorporated charity which changes the legal form of its incorporation, for example a charitable company converting into a charitable incorporated organisation (CIO).

3.13 The Committee agreed to the division of the various modules dealing with charity combinations. However, some text might usefully be added to clarify that for charities which have a common trustee body, where there is no constitutional relationship establishing control, there is a need to clarify that related party disclosures still apply.

3.14 The second matter arising on the classification of income and expenditure in the SoFA was discussed. The key issue was whether the new SoFA clarified the boundary to identify which grants fall within donations and which grants fall outside of donations. The Committee debated whether the distinction between the grant treatment was simply due to a service level agreement being in place, in which case it was a performance related grant, or not, in which case it was a donation. However, it was agreed that the conditions requiring the delivery of activities, goods or services are key to the distinction between earned income and donations.

3.15 If such a differentiation is not made consistently by users of the SORP there was a danger that sector statistics and comparators would be rendered meaningless. The Committee noted that this aspect had been dealt with by the first Information Sheet issued in support of SORP 2005. Similarly care was needed to ensure a consistent treatment of costs associated with negotiating grants.

3.16 The Committee agreed that the following changes should be made to the core modules:

- **the section on the types of social investment be moved to the introduction to that module;**
- **the module on social investment should more clearly distinguish the treatment by recipients from that of investors;**
- **a consultation question be posed to determine if the preponderance approach to classifying mixed motive investment should apply in place of the draft SORP's treatment as a sub-class of financial investments;**
- **the text on social investment should more explicitly identify that the purpose served by a social investment could be equally served by a grant;**
- **a consultation question should invite comment on whether the treatment of an associate and joint venture should show separately the gross income and gross expenditure rather than simply striking a net figure as is the practice for commercial accounting;**
- **the Secretariat should check that the useful clarification on the classification of grant income provided in Information Sheet 1 (SORP 2005) is reflected in the text of the new SORP; and**
- **the text on expenditure recognition should explicitly state that costs to do with negotiating contracts or performance related grants are allocated to charitable expenditure as they represent a component of support costs.**

Item 4: SORP Information Sheet on early adoption of FRS 102

4.1 Ray Jones introduced this item. He noted that FRS 102 did provide for the early adoption for industries and sectors which have an existing SORP 'providing that it does not conflict with the requirements of a current SORP or legal requirements for the preparation of the financial statements'.

4.2 The draft information sheet considered whether early adoption was consistent with SORP 2005 and charity law as it applies in each jurisdiction covered by UK-Irish GAAP. It concluded that a charity could not report under FRS 102 and claim to be reporting under SORP 2005. It also concluded that reporting under FRS 102 was not consistent with charity law as it applies to all charities registered in Scotland and all non-company charities registered and excepted from registration in England and Wales.

4.3 The Committee agreed that:

- **FRS 102 was not consistent with SORP 2005;**
- **the conclusions drawn by the Information Sheet were clearly articulated and correct;**
- **early adoption of FRS 102 is not consistent with the current charity reporting and accounting framework; and**
- **a charity cannot adopt FRS 102 early and claim to be preparing its accounts in accordance with SORP 2005.**

Item 5: Update from the FRC

5.1 Joanna Spencer advised the Committee that the Accounting Council would anticipate that the SORP was an application guide to new GAAP which will be cross referenced to FRS 102. She encouraged the Secretariat to ensure that in the introduction to each module that the relevant sections of the FRS 102 (Financial Reporting standard applicable for the UK and Republic of Ireland) and FRSSE (Financial Reporting Standard for Smaller Entities) are referenced so that practitioners and users of the SORP understand its context.

5.2 She noted that the FRC's Board will consider the Financial Reporting Standard applicable for the UK and Republic of Ireland (FRS 102) again at its March meeting.

Item 6: Any other business

6.1 There being no other business the meeting closed