3. Accounting standards, policies, concepts and principles, including estimates and errors

Introduction

3.1. The reporting tiers applied for module 3 are as specified in the table below.

Table 3.1A: Tiered reporting requirements for module 3

All tiers	The requirements for accounting standards, policies, concepts and principles, including estimates and errors in this module apply fully to all charities.

3.2. This module explains how accounting standards, policies, concepts and principles are applied in charity accounting. Charities should refer to Sections 2, 2A, 3, 8 and 10 of FRS 102 for more information:

- Section 2 of FRS 102 describes the objective of financial statements. It also sets out the concepts and basic principles underlying the financial statements of entities within the scope of FRS 102
- Section 2A of FRS 102 describes fair value measurement when another section of FRS 102 requires or permits fair value measurement
- Section 3 of FRS 102 sets out that the financial statements of an entity are required to give a true and fair view, what compliance with FRS 102 requires, and what is a complete set of financial statements (note, however, the additional requirements of this SORP).
- Section 8 of FRS 102 sets out the principles underlying the information that is required to be presented in the notes and how to present it including the reporting requirements for accounting policies
- Section 10 of FRS 102 sets out the requirements for selecting accounting policies, accounting for changes in estimates and the accounting for corrections of errors

3.3. Accounting policies provide the basis on which the accounts are prepared and explain the accounting treatment of material transactions or items in the accounts. The concept of materiality is an important consideration when selecting accounting policies and is explained in more detail in paragraph 3.20 to 3.25 below.

3.4. This module covers:

What are accounting standards, policies, concepts and principles?

3.5. Accounting standards set out the basis for recognising and measuring assets, liabilities, income and expenses and for their disclosure in accounts. Charities following this SORP are required to follow FRS 100 Application of Financial Reporting Requirements and FRS 102, and in so doing, will normally meet the relevant legal requirements for their accounts to give a true and fair view of their financial position and activities.

3.6. The SORP supplements FRS 102 and has been developed in light of the special factors prevailing or transactions undertaken within the charity sector.

3.7. Accounting policies are the principles, bases, conventions, practices and rules by which transactions and items are recognised, measured and presented in the accounts. The accounting policies that a charity adopts must follow the requirements of FRS 102 unless the effect of not following a particular requirement would be immaterial, or in very rare circumstances, where to do so would conflict with the objectives of providing information useful for economic decision making by users of the accounts and/or the legal obligation for the accounts to give a 'true and fair' view.

3.8. In certain jurisdictions, it is a legal requirement for charities preparing their accounts on an accruals basis to adhere to the methods and principles of this SORP. Charities should refer to the guidance issued by the charity regulator in their jurisdiction(s) of registration to find out whether they are subject to a legal requirement to follow this SORP.

3.9. Accounting policies are supplemented by estimation techniques where judgement is required in measuring income and expenditure and assets and liabilities. It is essential that the accounts are accompanied by an explanation of the bases and estimation techniques used in their preparation (see paragraphs 3.46 to 3.50 for the description of accounting estimates and changes in accounting estimates).

3.10. FRS 102 specifies that if financial information is to be useful, it must both be relevant and faithfully represent what it claims to be showing. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable.

3.11. Users of charity accounts must be able to compare charity accounts through time, users must also be able to compare the accounts of different charities. Comparability of charity accounts is enhanced by charities setting out the accounting policies adopted when preparing accounts. When information contained in charity accounts is verifiable it helps to assure users that the information is faithfully represented. Verifiable means that different knowledgeable and independent observers could reach consensus that a particular representation is a faithful representation.

3.12. Charity accounts must be prepared on a timely basis. Timeliness means having information available to decision makers in time to be capable of influencing their decisions. Generally, the older the information is the less useful it is. Information must be presented in a way that makes financial information understandable to users. Classifying, characterising and presenting information clearly and concisely makes it understandable. However, excluding information from financial statements about events that are inherently complex and cannot be made easy to understand would make these reports incomplete and therefore possibly misleading (more guidance on the enhancing qualitative characteristics of useful financial information is included in FRS 102 paragraphs 2.19 to 2.23 of FRS 102).

3.13. Reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information. Reporting financial information that is relevant and faithfully represents what it is claiming to show helps users to make decisions with more confidence. An individual user, funder, donor or other stakeholder also receives benefits by making more informed decisions. The benefits may also include better management decisions because financial information used internally is often based at least partly on information prepared for the accounts.

3.14. When reporting transactions in the accounts, charities must consider the substance of the transaction and its legal form. In many situations the substance and legal form will be the same. If the substance and legal form are not the same providing information only about legal form would not faithfully represent the transaction. Determining the substance and legal form will require the exercise of judgement and may on occasion require the disclosure of more information than specifically recommended in this SORP.

Length of the reporting period

3.15. All charities must prepare a set of accounts annually and they should normally have a 12-month reporting period. If the accounts are prepared for a shorter or longer reporting period, the charity must disclose:

- that the reporting period is for less than or more than 12 months
- the reason for the shorter or longer accounting period
- the fact that the comparative amounts presented in the accounts (including the related notes) are not entirely comparable
- this SORP also requires a charity to state the legal authority it has for

the change to its reporting period

Presentation currency

3.16. The presentation currency is the currency in which the accounts are denominated. This SORP requires that a charity should normally prepare its accounts in the currency of the jurisdiction of its administration unless it operates predominantly by generating and spending its cash in a different currency. Where a charity operates predominantly in a different currency, it should prepare its accounts in that currency.

Going concern

3.17. Charities normally prepare their accounts on the basis of being a going concern. The trustees must make their own assessment of their charity's ability to continue as a going concern to assure themselves of the validity of this assumption when preparing their accounts. In making this assessment, a charity's trustees should take into account all available information about the future for at least, but not limited to, 12 months from the date the accounts are approved.

3.18. When a charity prepares its accounts on a going concern basis this must be disclosed along with confirmation that it has considered information about the future as set out in paragraph 3.17. Charities must also disclose any significant judgments made in assessing the charity's ability to continue as a going concern. This SORP requires that where there are no material uncertainties about the charity's ability to continue to report on a going concern basis, this judgment should be disclosed.

3.19. When the trustees are aware, in making their assessment, of material uncertainties related to events or conditions that may cast significant doubt on the charity's ability to continue as a going concern, the charity must disclose those uncertainties. A charity not reporting on a going concern basis must disclose that fact, together with the basis on which it prepared the financial statements and the reason why it is not regarded as a going concern.

Materiality

3.20. In preparing their accounts charities should give particular consideration to material items or transactions. Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the users of the accounts make on the basis of those financial statements. An omission or misstatement of a material item may result in the accounts failing to give a true and fair view. Information is obscured if it is communicated in a way that would have a similar effect for users of financial statements to omitting or misstating that information. Examples of circumstances that may result in information being obscured could include:

- use of vague or unclear language
- inappropriate aggregation of dissimilar information or disaggregation of similar information
- including too much detail so that material information cannot be easily

identified

3.21. Materiality is entity specific. It depends on the nature or magnitude of information, or both. A charity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole. It depends on:

- the size of the omission or misstatement
- the nature of the omission or misstatement
- the impact of its omission or misstatement on the reported gross income or total expenditure and net assets
- the impact of its omission or misstatement on particular analysis headings within the statement of financial activities, balance sheet and, where applicable, statement of cash flows and on the disclosures made in the notes to the accounts

3.22. Assessing whether information could reasonably be expected to influence decisions made by the users of a charity’s accounts, requires a charity to consider the characteristics of those users while also considering the charity’s own circumstances.

3.23. Charities should only disclose accounting policies that apply to material items or transactions. Charities should avoid providing unnecessary information for non-material items or transactions.

3.24. Although FRS 102 and this SORP need only be applied to material items or transactions, it is inappropriate to make, or leave uncorrected, immaterial departures from this SORP to achieve a particular presentation of a charity’s financial position, financial performance or cash flows.

3.25. This SORP specifies when a charity must always consider a particular item or transaction material, for example the disclosure of related party transactions. Also, as a matter of emphasis, SORP modules may make particular reference to materiality.

Offsetting

3.26. A charity must not offset assets and liabilities, or income and expenses, unless required or permitted by FRS 102 and reflected in this SORP. Measuring assets net of valuation allowances is not offsetting. Similarly, a charity reports any gains and losses on the disposal of its fixed assets by deducting the carrying amount of the asset and related selling expenses from the proceeds of the disposal.

Source of reporting and accounting disclosure requirements

3.27. This SORP distinguishes the accounting treatment(s) and the disclosures required in the notes to the accounts that:

- apply to charities in each of the tiers 1 to 3

- are required by FRS 102
- are required by this SORP due to charity law or in order to provide a higher standard of transparency and disclosure in the interests of funders, donors and users of charity accounts

3.28. In preparing the charity's accounts, the charity must:

- apply the relevant requirements of FRS 102
- apply the recommendations of this SORP
- select accounting policies that comply with FRS 102 and this SORP

Alternative measurement bases

3.29. For certain items in the accounts, FRS 102 permits a choice between measurement at historical cost or current value, see paragraph 2.73 of FRS 102. Current value measurement bases include:

- fair value
- value in use for assets and fulfilment value for liabilities
- current cost

3.30. Fair value measurements must follow the requirements of Section 2A Fair Value Measurement of FRS 102. Section 1 of FRS 102 sets out how charities should apply the relevant changes to FRS 102 relating to fair value measurement.

3.31. FRS 102 also requires donated services and facilities to be measured at the value of the donation to the charity. Where a balance sheet heading contains items measured at both historical cost and fair value, a charity must identify the accounting bases the charity has used in the relevant note.

Selection of accounting policies

3.32. Charities must refer to FRS 102 and the modules contained in this SORP when selecting their accounting policies for the treatment of particular items, transactions or events in the accounts.

3.33. Where FRS 102 offers an accounting policy choice and this SORP has not prohibited the use of that choice or limited its application, for example in the recognition of income from government grants, then a charity may exercise the accounting policy choice. If exercising a policy choice the charity must make any additional disclosures required by this SORP or FRS 102 when making such choices, for example in choosing to treat certain leases as short-term leases or leases for which the underlying asset is of low value.

3.34. If FRS 102 does not address the matter, then charities adopting FRS 102 should refer to the hierarchy of sources set out in Section 10 of FRS 102 (see FRS 102 paragraph 10.5).

3.35. In extremely rare circumstances a charity may conclude that compliance with a particular requirement of FRS 102 or this SORP would conflict with the objective of providing information useful for economic decision making by users of the accounts and/or a legal obligation for the accounts to give a true and fair view.

3.36. Charities must not depart from either FRS 102 or the SORP simply because it gives the user a more appealing picture of the financial position or the results of the charity.

Compliance with the SORP

3.37. For a charity to state that its report and accounts are compliant with this SORP, both its trustees' annual report and its accounts must be prepared fully in accordance with the reporting and accounting recommendations of this SORP. To state that their accounts have been prepared in accordance with this SORP, a charity must:

- consider those SORP modules that apply to the activities, transactions and circumstances of the reporting charity
- comply with applicable format requirements and accounting treatments specified by this SORP and provide those disclosures that this SORP specifies 'must' be provided
- make any additional disclosures required by the FRS 102
- only depart from the requirements of this SORP or the FRS 102 if necessary for the accounts to give a true and fair view

3.38. This SORP uses the term 'must' to indicate those recommendations that are likely to affect the ability of the accounts to give a true and fair view if not applied to material transactions or items. Where the SORP states that an item is always material or the recommendation is one which 'must' be followed, non-adherence to that recommendation is a departure from this SORP.

3.39. The SORP also identifies particular recommendations that 'should' be followed. These recommendations are aimed at advancing standards of financial reporting as a matter of good practice. While charities are encouraged to follow all the SORP's recommendations, a failure to follow a 'should' recommendation is not regarded as a departure from this SORP.

3.40. Where the SORP states that a particular accounting treatment or disclosure 'may' be adopted, this provides an illustration of an approach to a particular treatment or disclosure that a charity may choose to adopt or identifies that an alternative accounting treatment or disclosure of a transaction or event is allowed by the SORP. Charities may choose whether such examples or alternative treatments are adopted at their discretion but any treatment chosen must ensure that the accounts give a true and fair view.

3.41. Charity accounts must also state that the charity is a public benefit entity.

Changes in accounting policies

3.42. FRS 102 requires accounting policies to be applied consistently for similar transactions, events and conditions and between reporting periods.

3.43. A change to an existing accounting policy is only justified if:

- it is required due to a change in FRS 102 that applies to the reporting period
- it results in the accounts providing reliable and more relevant information about the effect of transactions, other events or conditions that affect the reported financial position, financial performance or cash flows of the charity or group

3.44. A change in an accounting policy must be applied retrospectively to comparative information for all prior periods to the earliest date for which it is practicable, as if the new accounting policy had always applied. This is except where an accounting standard, FRS 102 or an amendment to FRS 102 requires or permits an alternative treatment on its first adoption.

3.45. When it is impracticable to determine the individual-period effects of a change in accounting policy on comparative information for one or more prior periods presented, the charity shall apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of funds for that period. Charities should refer to paragraph 10.12 of FRS 102.

Accounting estimates

3.46. An accounting policy may require items in financial statements to be measured at monetary amounts that cannot be observed directly and must instead be estimated. In such a case, a charity must develop an accounting estimate to achieve the objective set out by the accounting policy. Developing accounting estimates involves the use of judgements or assumptions based on the latest available, reliable information. Examples of estimates include depreciation expense and the fair value measurement of an asset or liability.

3.47. A charity uses measurement techniques and inputs to develop an accounting estimate. Measurement techniques include estimation techniques and valuation techniques.

Changes in accounting estimates (including disclosure requirements)

3.48. A charity may need to change an accounting estimate if changes occur in the circumstances on which the accounting estimate was based or as a result of new information, new developments or more experience.

3.49. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in accounting estimate. The effects on an accounting estimate of a change in an input or a change in a measurement technique are changes in accounting estimates unless they result from the correction of prior period errors. Except for a change to the cost model when a reliable measure of fair value is no longer available (paragraph 10.9(c) of FRS 102) a change in the measurement basis applied is a change in an accounting policy and is not a change in an accounting estimate. The effect of a change in an accounting estimate, other than a change to assets, liabilities or funds, must be recognised prospectively by including it in the statement of financial activities in the period of change or the period of change and future periods. Where a change relates to assets, liabilities or funds a charity must recognise it in the period of change by adjusting the carrying amounts of the balance sheet items.

3.50. A charity must disclose the nature of any change in an accounting estimate and the effect of the change on assets, liabilities, income and expenses for the current period. If it is practicable for the charity to estimate the effect of the change in one or more future periods, it must disclose those estimates.

Correction of a prior period error

3.51. Charities must correct material errors resulting from an omission or misstatement in a prior period by either:

- restating the comparative amounts for the prior period(s) in which the error occurred, or
- if the error occurred before the earliest prior period presented, restating the opening balance of the asset or liability for the earliest prior period presented

Charities should refer to paragraph 10.12 of FRS 102.

Disclosure of accounting policies (including changes in accounting policies), and prior period errors

3.52. In order to comply with FRS 100 *Application of Financial Reporting Requirements* and FRS 102 the notes to the accounts must:

- state whether the accounts were prepared in accordance with FRS 102
- state whether the accounts were prepared in accordance with this SORP
- set out a summary of material accounting policy information (see paragraph 3.54 below)

This SORP requires a charity to state whether the accounts were prepared in accordance with applicable charity and/or company law in the jurisdiction(s) of registration.

3.53. A charity must disclose material accounting policy information. Accounting policy information is material if, when considered together with other information included in a charity’s accounts, it can reasonably be expected to influence decisions that the users of accounts make on the basis of those accounts. The disclosure must include the measurement basis (or bases) used in preparing the accounts. For more information on material and immaterial accounting policy information see paragraphs 8.5A to 8.5D of FRS 102.

3.54. A charity’s accounts must disclose:

- along with its material accounting policy information, or other notes the judgements, apart from those involving estimations, that management has made in the process of applying the charity’s accounting policies that have the most significant effect on the amounts recognised in the accounts
- the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next reporting period
- in respect of those assets and liabilities where there is a significant risk of material adjustment within the next reporting period, the notes must include details of their nature and their carrying amount as at the end of the reporting period

3.55. In special circumstances where there has been a material departure from the requirements of FRS 102, the notes to the accounts must:

- state that the trustees have concluded that the accounts present a true and fair view of the charity’s financial position, financial performance (as reported in the statement of financial activities) and cash flows
- confirm that it has complied with FRS 102 or applicable legislation, except that it has departed from a particular requirement of FRS 102 or applicable legislation to achieve a true and fair view
- explain the nature and effect of the departure, including the treatment required by FRS 102 or applicable legislation, the reason why that treatment would be so misleading in the circumstances that it would conflict with the requirement to give a true and fair view, and the treatment adopted

3.56. Where charities have made a material departure from a recommendation of this SORP that must be followed, FRS 100 requires that the notes to the accounts must:

- provide a brief description of how the accounts depart from the recommended practice set out in this SORP
- for any treatment that is not in accordance with the SORP, the reasons why the treatment adopted is judged more appropriate to the charity’s particular circumstances
- give brief details of any disclosures required by this SORP that have not been provided, and the reasons why they have not been provided

This SORP requires that if the departure was necessary for the accounts to give a true and fair view, the effect of the departure must also be quantified.

3.57. Where a material departure from the requirements of FRS 102 is also a departure from requirements of this SORP, a combined note may be provided.

3.58. Where a charity has changed an accounting policy, the notes to the accounts must disclose:

- the nature of the change in accounting policy

- the reasons why applying the new accounting policy provides reliable and more relevant information
- to the extent practicable, the amount of the adjustment for each line item in the accounts affected for the current period, each prior period presented and the aggregate amount of the adjustment relating to periods before those presented

3.59. If it is not practicable to disclose the amount of the adjustment in paragraph 3.58 above the charity must give an explanation of the adjustment.

3.60. If a charity identifies material prior period errors, it must correct them and disclose in the notes to the accounts:

- the nature of the prior period error
- for each prior period presented in the accounts, to the extent practicable, the amount of the correction for each account line item affected
- to the extent practicable, the amount of the correction at the beginning of the earliest prior period presented in the accounts

3.61. If it is not practicable to disclose the amount of the correction relating to prior period errors then an explanation must be provided.

Comparative information

3.62. FRS 102 requires that comparative information must be provided for all amounts presented in the current period's financial statements, which includes the notes. Therefore, charities must provide comparative information for all amounts presented in the accounts and notes to the accounts unless otherwise stated in FRS 102. This requirement for comparative information applies to all those disclosures that are additionally required by this SORP.