CIPFA The Chartered Institute of Public Finance & Accountancy

Analysis of responses to consultation on Update Bulletin 2

Committee	Charities SORP Committee
Date	8 May 2018
Author	Secretariat to the Charities SORP Committee
Subject	Analysis of responses to the consultation on Update Bulletin 2

SECTION 1: Overview of research and analysis undertaken

1 **Purpose**

1.1 To report on the responses to the consultation on Update Bulletin 2.

2 **Overview of the responses to the consultation**

2.1 Responses to the consultation took two forms. Firstly, feedback from consultation events organised by the SORP-making body's partner, umbrella and professional bodies and meetings where the consultation was discussed (outreach events). Secondly, 29 written responses were received to the consultation. The profile of the written responses is given in the table below:

Respondent category	No.	As a %
Auditors & audit firms	14	48%
Independent examiners	4	14%
Professional bodies	4	14%
Sector umbrella bodies	4	14%
Charity finance staff	3	10%
Total	**29**	**100%**

2.2 This analysis considers the written responses received[1]. The feedback gathered from the outreach events is also given to provide another perspective. The outreach events varied in format and consequently not every question or proposed amendment to the Charities SORP (FRS 102) was discussed. Similarly, respondents were not required to answer all questions, with many choosing to answer only one and offer comments on a selection of the proposed amendments.

2.3 The Invitation to Comment which accompanied the draft Update Bulletin posed two questions. Section B explain the approach taken to interpreting and analysing the responses received for each question.

2.4 Quotations from confidential responses are not used, as these are unavailable for public view although they are included in numbers and analysis of responses.

[1] Copies of the responses received were made publically available on CIPFA's website within the 10 day period allowed by the FRC (per paragraph 24, *Policy on Developing Statements of Recommended Practice* - March 2016).

SECTION 2: Analysis of consultation questions

Question 1	*Answered*
Do you agreed with how the amendments to FRS 102 have been reflected in the proposed amendments to the Charities SORP (FRS 102) in draft Update Bulletin 2? *If not, which of the proposed changes do you not agree with, and why?*	28 (97% of total)

All but one respondent answered this question. The question was well debated at consultation events.

The analysis considers the respondents comments to each part of the question.

Part 1:
Do you agreed with how the amendments to FRS 102 have been reflected in the proposed amendments to the Charities SORP (FRS 102) in draft Update Bulletin 2?

Table 1: Respondents views on Question 1, Part 1

	No. of respondents
Agreed	-
Agreed with reservations	14
Disagreed	1
Total	**15**
Did not comment	13
Total	**28**

A bare majority of respondents answered the first part of the question. The vast majority of these expressed general agreement with how the amendments to FRS 102 had been reflected in the draft Update Bulletin. However, this view was qualified on the basis of those amendments detailed in their response to the second part of this question.

Part 2:
If not, which of the proposed changes do you not agree with, and why?

Appendix A sets out the number of respondents that offered views on the proposed amendments included draft Update Bulletin 2 and proposals detailed in the Invitation to Comment.

Responses typically focused on the proposed change(s) to the Charities SORP that the respondent did not agree with. Respondents typically provided suggestions of possible changes to the amendment or suggestions of further guidance which could be provided in the SORP.

Section 3 provides a detailed analysis of the comments received for each proposed amendment.

Question 2	*Answered*
Are there any other amendments to the Charities SORP (FRS 102) that you consider to be necessary based on the recent amendments to FRS 102? *If so, please state the amendment to FRS 102 and the relevant SORP paragraph(s).*	15 (52% of total)

Responses to this question fell into three categories and were analysed as follow:

- Suggestions for amendments to the SORP not based on the recent changes to FRS 102 made as part of the FRC's triennial review 2017
  Contained in Appendix B

- Comments related to the amendments within the draft Update Bulletin
  Included within the analysis of the relevant amendment within Section 3

- Comments on the proposed second edition of the SORP
  Analysed separated and included within Section 3

One audit firm provided a suggestion for an amendment to the SORP based on the recent amendments to FRS 102. This is set out in Appendix C.

SECTION 3: Detailed analysis of comments on proposed amendments

This section provides a detailed analysis of each proposed amendment and is ordered based on the number of respondents that provided comments.

Where the amendment generated a large level or range of responses, findings have been separated between 'main findings', and 'other comments'. Those findings included within 'other comments' represent the views of a smaller number of respondents, or views which are contradictory to the overall view expressed by respondents.

The detailed analysis of those amendments where five or less respondents offered comments is included in Appendix D.

Interpretation of comments

As Question 1 focused on those amendments that respondents did not agree with, the majority of comments detailed the respondent's dissatisfaction with the proposed change. Therefore the number of respondents can be largely considered to indicate the level of disagreement with the proposed amendment.

In a minority of instances, respondents indicated their support for the proposed amendment. The analysis indicates where comments of this nature were received. Where an unequivocal statement was not made in support of the amendment, then the response was interpreted based on any comments made.

Clarifying the requirement to provide comparative information	
Proposed amendment to Charities SORP (FRS 102)	3.49
Draft Update Bulletin 2, Paragraph No.	3.1, Clarifying amendments

No. of responses which offered comments: 17 (59% of total respondents)

This amendment attracted the highest level of interest within the written feedback.

MAIN FINDINGS

Consequences of the requirement for comparative information

Impact for users

The vast majority of respondents considered the consequences of the amendment as negative for both charities and the users of accounts. Respondents believed the requirement to provide comparative information would lead to an increase in the length of charity accounts. This was considered as impacting the understandability of the financial statements, making them more difficult for users to read and interpret.

Three audit firms observed that a large amount of information in the notes to the accounts is presented in tables. As a result comparative information is commonly disclosed by reproducing the tables from the prior year accounts, which are often displayed on separate pages within current year accounts. This was considered as confusing for readers and making it difficult for them to make any meaningful comparisons. Respondents also felt the clarity of the financial statements would be negatively impacted by the increased volume of information being presented.

Impact for preparers

Respondents from across all categories believed the amendment would result in an increase in the time and cost of preparing accounts. One independent examiner believed the burden placed on preparers by the amendment could potentially provide non-company charities filing accruals accounts with an '*extra incentive to switch to receipts and payments accounts*' (Frank Learner, Independent Examiner, No. 19).

Three respondents warned of the difficulties which would be encountered by charities in presenting comparative information in a format that can be easily read and understood. Similarly, four respondents believed the requirement would act as a disincentive for charities to disclose information in their financial statements which is non-mandatory or which the SORP encourages as good practice, therefore reducing the level of transparency in charity reporting. The following examples of such disclosures were given:

- Additional analysis of current year balances in the notes to the accounts, e.g. analysis of incoming resources split by fund type
- Balance sheet/statement of cash flows analysed by class of fund
- An analysis of fund movements for each fund on an individual basis

Contradictory to the aims of the FRC and SORP

Of those that offered comments, over a third believed the requirement for comparative information was contradictory to the aims of the FRC. Respondents either referenced:

- the FRC's 'cutting clutter' agenda;
- the FRC's overriding objective in developing financial reporting standards: '*to enable users of accounts to receive high-quality understandable financial reporting*

proportionate to the size and complexity of the entity and users' information needs' (Paragraph A.1, FRS 102); or
- the rationale for the inclusion of comparative information for narrative and descriptive information stated in paragraph 3.14 of FRS 102 ('*when it is relevant to an understanding of the current period's financial statements*').

Two independent examiners felt the FRC's clarification failed to take account of the accounting needs and format and users of charity accounts, which were considered different to corporate entities.

One audit firm also commented that the requirement was contrary to the objectives of recommendations of the SORP which are indented to enhance the understandability of the information presented in charity accounts.

Reasoning for the irrelevancy of comparative information

Of those respondents who disagreed with the requirement for comparative information for all amounts, few justified why this information was considered to be irrelevant to readers and not useful in helping them gaining an understanding of the current period's accounts.

One independent examiner believed that the nature of charity funding meant that providing comparative information related to the different types funds held by a charity was of limited benefit.

Charities that relay on grant funding often have different projects funding in different years. So prior year Restricted Funds and Movement of Funds merely tell you what happened in the prior year. They do not provide a meaningful comparison for the current year. (Dr Neil K Dickson, Independent Examiner, No. 2)

Four respondents noted that comparative information was available to users in prior year accounts, which were easily accessible online. It was felt users could obtain an understanding of the charity's prior year performance by accessing this information, which would allow a detailed comparisons to be made.

Action needed

Over half of the respondents recommended that exemptions from comparatives should be introduced for disclosures required by the SORP. A number of these respondents specifically called on the joint SORP-making body to revisit this issue with the FRC in order to be given the ability to provide these exemptions in the SORP.

Suggestions of disclosures where an exemption from comparatives was considered needed was provided at outreach events and by the majority of respondents. These included disclosures which were felt as being akin to reconciliations or required information to be presented in a two-dimensional table format. The following disclosures were suggested:
- Analysis of movements in funds
- Analysis of support costs
- Analysis of expenditure on charitable activities
- Analysis of governance costs
- Analysis of net assets between funds
- Components of income and expenditure analysed by fund type

Some respondents recommended that where current year information presented in a two-dimensional table, comparative information should be limited to the total of the table's rows and columns.

Similarly, other respondents recommended that the amount of comparatives information in the current SORP should be limited. Three independent examiners referenced the requirement for comparatives contained in the 2005 SORP, which was advocated as proportionate and considered to provide users with useful and focused comparative information.

OTHER COMMENTS

Reflection of the clarification in the SORP

Four respondents believed that the SORP still had discretion to provide exemptions from the general requirement contained in FRS 102 for entities to give comparatives information for all amounts presented in their financial statements. This was based on an understanding that the current SORP already contains a number of exemptions from this requirement to provide comparative information which are specific to disclosures required only by the SORP.

Suggested changes to the amendment

Two respondents suggested the following changes to the amendment:
- Replace 'financial statements' with 'accounts' - *for consistency given that 'accounts' is the main term used throughout the SORP when referring to financial statements*
- Replace 'and' with 'or' [second sentence] - *to reflect that the SORP can require comparatives to be included which are not required by FRS 102*

Two respondents also suggested including guidance around the consideration of materiality in applying the requirement.

Suggested amendments to other SORP Modules and related guidance

Two respondents recommended that the SORP should be updated following the clarification on the requirement to provide comparative information. These suggested amendments relate to requirement to provide comparative information within the following primary financial statements:
- Module 4: Statement of financial activities
  Paragraph 4.2 should be updated to be more consistent with the requirement for comparatives
- Module 10: Balance Sheet
  Paragraph 10.9 should be updated to reflect the requirement to provide comparative information where the balance sheet is analysed by class of fund
- Module 14: Statement of cash flows
  Paragraph 14.7 should be updated to reflect the requirement to provide comparative information where the statement is analysed by class of fund

Respondents also noted that the following sources of guidance would require to be updated:
- Model accounts available on the Charities SORP Microsite
- Charity accounting templates for accruals accounts produced by the Charity Commission for England and Wales

Further guidance

Three respondents called for additional guidance to assist preparers implement the requirement to provide comparative information. Of these respondents, two felt the guidance should cover the presentation of comparative information.

One audit firm suggested that the SORP should provide clarity about where comparative information should be presented in the financial statement. It recommended that the comparative information should '*be given equal prominence and thus presented alongside current period information*' (PricewaterhouseCoopers LLP, No. 15).

The potential need for greater standardisation in the presentation of comparative information was also raised in the response of the Institute of Chartered Accountants in England and Wales (No. 23). It considered the potential consequence of the current diversity in presentation for users of accounts.

Charities are currently free to present the comparative information in different ways … The comparative information is, therefore, often of limited use to the main users of the accounts who may as easily refer to the prior year accounts for the comparative information. We suggest that consideration be given as to whether flexibility on presentation is in the interest of charities and users or whether, in some cases, a more standardised approach would be preferable. (ICAEW, No. 23)

Clarifying when payments by subsidiaries to their charitable parents that qualify for gift aid are adjusting events occurring after the end of the reporting period	
Proposed amendment to Charities SORP (FRS 102)	13.5
Draft Update Bulletin 2, Paragraph No.	3.5, Clarifying amendments

No. of responses which offered comments: 14 (48% of total respondents)

MAIN FINDINGS

Implementation guidance

The vast majority of respondents called for greater guidance to assist preparers implement the clarification and corresponding change to FRS 102 in this area of accounting. Respondent's comments observed that the proposed amendment and guidance contained within draft Update Bulletin 2 failed to address all aspects of the accounting for expected gift aid payments by subsidiaries and their charitable parents.

Comments received fell into three main themes.

1. Presentation of change

Six respondents recommended guidance should cover how the change should presented in the subsidiary's financial statements. It was observed that it has been common for constructively obligated gift aid payment to be accrued by subsidiaries at the reporting date. This practice would no longer be in keeping with the required accounting treatment which has been clarified by the FRC and would have to be changed. It was also noted that this consideration would also be relevant to charitable parents which have previously recognised constructively obligated gift aid receipts at the reporting date.

Respondents queried whether this change should be presented as either a:

- Change in accounting policy; or
- Correction of prior period error.

Respondents called for guidance in order to establish an agreed approach. Of the four respondents who offered a view, three advocated that the change should be presented as change in accounting policy.

Two respondents observed that in the absence of guidance, professional advisors are likely to take different approaches. They believed this would create uncertainty, confusion and inconsistencies between charity accounts.

2. Examples of 'present legal obligations'

Five respondents recommended that there should be additional examples of the types of 'legal obligations' which would allow a subsidiary to accrue a gift aid payment at the reporting date. It was observed that draft Update Bulletin 2 only refers to a deed of covenant. It was felt that guidance should provide clarity on what would suffice as a legal obligation. This was also echoed at outreach events.

Respondents and attendees gave the following examples of possible situations which could create a 'legal obligation':

- a shareholder resolution of the charity as member of the subsidiary (Sayer Vincent LLP, No. 10 & ICAEW, No. 23)

- an explicit requirements in the governing documents of the subsidiary (Sayer Vincent LLP, No. 10)
- a provisions in the subsidiary's memorandum and articles of association (MHA, No. 8)
- the approval of a payment by the subsidiary through a general meeting or written resolution before the end of the reporting period (HW Fisher & Company, No. 13)
- a declaration by the directors before the end of the reporting period (Event attendee)

3. Recognition by the charitable parent

Four respondents called for guidance on the recognition of gift aid payments by charitable parents to be provided within Module 5 of the SORP. It was observed that the income recognition policy used by charitable parents may now change and should be address in the SORP.

Other amendments

Four respondents provided suggestions about how the clarity of the current guidance and amendment could be improved. They made the following recommendations for changes to paragraph 13.5 of the SORP and paragraph 3.5 of the draft Update Bulletin:

- it should be explicitly stated that in the absence of a present legal obligation, a post year end gift aid payment is not an adjusting event
- it should be made clear that in most cases, the changes required as a result of the clarification and changes to FRS 102 will impact the accounting treatment of the subsidiary
- the changes in FRS 102 apply to distributions from wholly-owned subsidiaries only
- it should be made clear that FRS 102 does not provide any transaction relief in this area

The following recommendations were made for changes to other sections of the SORP:

- **Paragraph 13.7** (*Examples of non-adjusting events occurring after the end of the reporting period*)
  Include a reference to a gift aid payment made after the end of the reporting in the absence of a present legal obligation
- **Module 10: Balance Sheet**
  Include guidance covering the presentation of accrued of gift aid payments which arise from events after the balance sheet date

OTHER COMMENTS

Application of the amendment

Three respondents provided comments on the timing of the clarification and corresponding change to FRS 102. This issue was also discussed in detail at outreach events. Comments focused on the requirement for charities to apply the clarification issued by the FRC with 'immediate effect'.

Respondents questioned the status of the new accounting treatment in this area as a clarification of the treatment which should have been adopted by entities applying FRS 102. They called for the effective date for the clarification to be brought into line with the other changes to FRS 102 and amendments to the SORP (reporting period beginning on or after 1 January 2019). This included one professional body that cited the challenges of requiring charities to apply the changes immediately.

FRS 102 provides for specific treatment of distributions in the form of dividends but this does not necessarily mean that all distributions are dividends for this purpose. While the expected accounting treatment has now been clarified there has been diversity of approach historically. It follows that some charities will now need to change their approach and it is only reasonable that they be allowed some time to do so. FRC made the clarification as a 'practicable' solution to a somewhat intractable issue and it is important that implementation takes account of the practicalities too. (ICAEW, No. 23)

Respondents also highlighted the time and legal costs which would be incurred by a charitable group which intended to put in place the necessary arrangements to allow a subsidiary to accrue a gift aid payment at the reporting date. One professional body observed that the timeframe for charities with a 31 March 2018 year end to make these arrangements had been limited.

Many charities have a March year end and it may be impracticable for them to do this for the 2018 financial year. The changes to FRS 102 can be expected to achieve the objective of bringing consistency of accounting treatment over the next couple of years. Requiring immediate implementation could lead to unintended short term consequences that do not seem to be warranted in the context. (ICAEW, No. 23)

Issuing-body and location of guidance

Three respondents offered comments on which body should issue guidance in this area. In all cases it was acknowledged that the clarification and corresponding change to FRS 102 concerned the accounting treatment for non-charitable subsidiaries which do not apply the SORP.

Two respondents called on the joint SORP-making body to take a role in the provision of guidance, highlighting the significance of the impact of the changes to FRS 102 on the consolidated accounts of charity groups. This included a sector umbrella body:

While it can be argued that this is a 'for profit' accounting issue it has deep importance for charities and we would be grateful if the SORP Making Body could champion the need for implementation guidance. (Charity Tax Group, No. 24)

One audit firm recommended the guidance included in paragraph 3.5 is reduced, providing a dissenting view. They considered the current guidance to be unhelpful as it covered the accounting treatment for gift aid payments from the perspective of non-charitable subsidiaries which do not apply the SORP. This contrasted with the views of the majority of respondents who indicated that further explanatory guidance for subsidiaries should be included within the SORP. In doing this, two respondents specified that the SORP should aim '*to provide a single reference source for charities and their groups*'.

Comments on the clarifications/changes to the underlying accounting standard

Two respondents expressed dissatisfaction about the clarification and corresponding change to FRS 102 as issued by the FRC.

Inserting the date from when the amendments in the draft Update Bulletin would be effective	
Proposed amendment to Charities SORP (FRS 102)	18A
Draft Update Bulletin 2, Paragraph No.	4.1, Significant amendments
Effective date of those amendments set out in Section 3	
Draft Update Bulletin 2, Paragraph No.	1.3, Introduction

Interpretation of comments

Within the written feedback, respondents offered comments on the effective date of the proposed amendments in relation to paragraph 18A of the SORP and paragraph 1.3 of the draft Update Bulletin. These comments were collectively analysed.

Comments on the effective date of a specific amendment were included in the analysis relevant to this amendment.

No. of responses which offered comments: 5 (17% of total respondents)

MAIN FINDINGS

Interpretation of 'apply immediately'

The majority of comments focused on the requirement for the amendments contained in Section 3 of the draft Update Bulletin to be 'applied immediately' by charities. They called for greater clarity about how 'immediately' should be interpreted and when the amendments should be applied. This was echoed at outreach events, where there was confusion amongst attendees about the point at which these amendments were effective.

Respondent's comments highlighted the different approaches which could be taken by preparers in determining these amendments effective date:

- Following the issue of the '*Amendments to FRS 102 - Triennial review 2017*' - December 2017
- Following the publication of the draft Update Bulletin 2 – February 2018
- Following the issue of the final Update Bulletin – expected October 2018

Suggested changes

Three respondents provided suggestions about how the current guidance in draft Update Bulletin 2 could be improved. They made the following recommendations:

- Indicate in the 'Background' section that the Update Bulletin has two effective dates – signposting that there is an immediate effective date for clarifying amendments.
- Include additional application guidance which sets out the date that each amendment applies in all four charity law jurisdictions and whether early adoption is available as part of a package of amendments.

OTHER COMMENTS

Impact for charities

Two audit firms warned against the negative implications of charities being required to immediately apply the amendments contained in Section 3. They raised concerns about the short amount of time which charities would have to comply with these requirement and make the necessary changes to their existing accounting policies.

Classification of amendments as clarifications

Only one audit firm disagreed with the classification of the amendments contained in Section 3 as 'clarifications' based on the existing requirements of FRS 102.

While the amendments may be represented as "clarifications" to reflect the original drafting intention of FRS 102, they are amendments and were required as the original drafting intentions of FRS 102 were not clear. (Sayer Vincent LLP, No. 10)

This firm called for the effective date for the clarification to be brought into line with the other changes to FRS 102 and amendments to the SORP (reporting period beginning on or after 1 January 2019).

The joint SORP-making body's intention to issue a second edition of the Charities SORP (FRS 102) which will consolidate and incorporates both Update Bulletins and other legislative changes into the current SORP	
Invitation to Comment, Paragraph No.	1.25

The joint SORP-making body's intention to issue a second edition of the Charities SORP (FRS 102) which will consolidate and incorporates both Update Bulletins and other legislative changes into the current SORP (Invitation to Comment, Paragraph 1.25)

No. of responses which offered comments: 12 (41% of total respondents)

MAIN FINDINGS

The vast majority of respondents welcomed the proposed second edition of the SORP.

Impact of multiple publications

Five respondents criticised the current requirement for charities to refer to multiple publications when preparing their accounts and reports. This was considered as being confusing for preparers and contributing to an increased regulatory burden for charities. Respondents highlighted the challenge this presented preparers and the additional care that it demanded to ensure that the applicable requirement were followed. One audit firm observed that this is made more difficult as a result of the SORP not cross-referring or linking to the Update Bulletin documents.

Benefits of a second edition of the SORP

Respondents supported the second edition of the SORP as they felt it would create a single source of authoritative and complete guidance for charities. Three respondents felt removing the need for preparers to refer to several documents would make it the SORP easier to use and positively impact charities compliance with the framework.

OTHER COMMENTS

Recommendations for a second edition of the SORP

Two audit firms recommended that a second edition of the SORP should be issued by the SORP-making body in a timely manner, given the difficulties currently being experienced by preparers in referring to a number of documents.

Another firm recommended that the clarification contained in *Information Sheet 1: Implementation Issues* should be incorporated into a second edition.

Recommendations for the final version of Update Bulletin 2

Two respondent provided suggestions of changes to the Update Bulletin in order to improve users' application of the document in the absence of a second edition of the SORP being issued:

- Publish each amendment in the order they are made to the SORP
- Highlight the interplay between the documents which make up the reporting framework for charities

Changes to the definition of a financial institution	
Proposed amendment to Charities SORP (FRS 102)	Paragraph 20.
Draft Update Bulletin 2, Paragraph No.	5.1, Other amendments

No. of responses which offered comments: 11 (38% of total respondents)

MAIN FINDINGS

Reflection of the definition in the SORP

Of those respondents which offered comments, five questioned or disagreed with how the amendment has reflected the revised FRS 102 definition of a financial institution. Their comments focused on the potential inclusion of charities which hold mixed motive investments and/or provide concessionary rate finance within the definition. Respondents considered these charities as being not similar to financial institutions which hold assets in a fiduciary capacity, take deposits or are involved in investing activities on behalf of other individuals or entities.

Of these respondents, two provided an explanation of their reasoning for this conclusion. Both respondents focused on the link between an entity’s decision to hold investments and the furthering of its charitable purpose.

The underlying intent of a mixed motive investment is to generate returns for charitable purposes; to imply that this activity is similar to that undertaken by financial institutions such as banks would be to misrepresent the different strategies and approaches foundations use in their investments. (Association of Charitable Foundations, No.6)

… to suggest that they are fundamentally misconceives the nature, motivation and activities of the charities concerned. (Royal Commission for the Exhibition of 1851, No.1)

Three respondents observed that impact of amendment in potentially widening which charities will meet the revised definition was in conflict with the FRC’s intended aim of reducing the number of entities meeting the definition of a financial institution.

No respondents offered comments on the inclusion of charitable incorporated friendly societies within the revised FRS 102 definition of a financial institution.

Impact of the amendment

Those charities that meet the revised definition of a financial institution will be required to make the additional disclosures required by section 34 of FRS 102. Four respondents considered the potential wider impact of these disclosures.

Of these respondents, three believed the increased reporting requirements could act as a disincentive for both charities which currently hold social investment, and those considering making such investments in the future. This included a sector umbrella body which set out the concern of its members:

Feedback has also suggested that the additional disclosures required could deter some foundations from making mixed motive investments, if they felt that reporting required was unduly burdensome. We recognise that the intention is not to influence investment decisions, but this may be an unintended consequence of this amendment. (Association of Charitable Foundations, No.6)

Respondents also considered the impact of the disclosures for the users of the accounts. Concerns were raised about the quantity of the disclosures, which one audit firm believed would result in three additional pages in the notes to the financial statements. Respondents felt the disclosures would lengthen and complicate charity accounts, which would be of little benefit to users given the complexity of the information being reported.

Improvements to the guidance

Five respondents also offered specific comments on the guidance contained in the amendment. The majority of respondents felt the current guidance could be improved in order to better assist preparers to:

- determine if a charity will meet the definition of a financial institution
- comply with the disclosure requirements of section 34 of FRS 102

Similarly, a need for greater guidance to assist charities to identify when and if they will meet the definition of a financial institution was raised at an outreach event.

Respondents suggested the following changes:

- Greater guidance on the interpretation of 'principal charitable activity' (*'what quantum of activity in this area would constitute it being a 'principal activity''* - Royal Commission for the Exhibition of 1851, No.1)
- Greater guidance on the interpretation of 'lending'
- An explanation of the concept of 'market rate' and determining the difference between the market rate/concessionary rate in practice
- Example of charities which meet the definition of a financial institution

One firm questioned whether the SORP should offer definitive guidance about whether charities which hold different types of social investments will meet this definition. This was based on the requirement for preparers to exercise their professional judgement in this area.

As explained in the Basis for Conclusions to the FRS 102 amendments, we would consider this to be a judgement for the preparer and should be a conclusion based on the facts and circumstances of the specific entity and its business. (BDO LLP, No. 29)

OTHER COMMENTS

Current and future exemption for charities

Two respondents called for a general exemption for charities which meet the definition of a financial institution where the investing activities are done in the furtherance of their charitable objectives, even where there is an element of market return.

Similarly, the following exemptions from the FRS 102 definition of a financial definition were suggested at outreach events:

- A general exemption for charities
- A specific exemption for grant making charities providing social investment

One sector umbrella body recommended that SORP Committee make representation to the FRC which call for an exemption for social investments to be explicitly removed from the scope of any future changes in this area. This was considered necessary '*given the difficulty in many cases in evaluating their significance because many investments are unique and providing context or useful information can be challenging'.* (Charity Finance Group, No. 25)

Requiring charities to prepare a reconciliation of net debt as a note to the statement of cash flows	
Proposed amendment to Charities SORP (FRS 102)	14.17A, 14.17B & Table 10A
Draft Update Bulletin 2, Paragraph No.	4.9, Significant amendments

No. of responses which offered comments: 10 (34% of total respondents)

MAIN FINDINGS

The majority of respondent's comments focused on Table 10A. Of these respondents, four welcomed the inclusion of the table as a useful source of guidance which would assist accounts preparers.

Inclusion of current assets investments as a component of net debt

Six respondents queried why 'current asset investments' was included as a row within Table 10A. This query was also raised at outreach events.

The majority of comments recommended that this row should be removed as its inclusion is inconsistent with the FRS 102 definition of 'net debt' which includes cash equivalents which would normally have a short maturity of three months or less. Therefore this definition would not normally include current asset investments. Similarly, it was also noted that any current asset investments which were included as part of an entity's net debt would be included as cash equivalents.

Applicability of Table 10A

Although a number of respondents considered Table 10A to be a useful source of guidance, respondents' comments included suggestions on how it could be improved. These acknowledged that the pro-forma had been developed to cover the majority of circumstances which may be encountered by charities, but recommended it should be amended in order to make it clearer, less complicated and more relevant for the majority of entities applying the SORP.

Respondents suggested the following:

- Make it clear that the form of the reconciliation in the table is only illustrative and can be adapted as required;
- Combine three columns (new finance leases, foreign exchange movements & other non-cash changes) into a single column (headed 'other non-cash movements');
- Ensure that the table can be adapted to accommodate the option included in paragraph 14.7 of the SORP ('*a columnar presentation may be adopted to distinguish between cash flows relating to restricted funds and cash flows relating to unrestricted funds*')

OTHER COMMENTS

Clarity around 'borrowings of a charity'

Two respondents suggested greater guidance or examples about what might be included within the 'borrowings' component of net debt.

A professional body observed that Table 10A is limited in only including references to bank loans. They recommended that the guidance refers to a wider range of sources of borrowings that may be held:

… *for example loans from supports or from grant-making bodies*. (ACCA, No. 9)

Inclusion of derivatives as a component of net debt

One firm suggested that 'derivatives relating to debt' should be included as a row within Table 10A, given that derivatives are included in the definition of net debt within paragraph 14.17A.

Requirement for comparative information

One firm suggested additional clarity should be provided around the requirement for comparative information. They recommended that the exemption for the provision for comparative information should make clear that this is a requirement of FRS 102.

Threshold for the preparation of a statement of cash flows

One professional body raised concerns around the requirement for the reconciliation creating an additional regulatory burden for charities. They felt that the current threshold for the preparation of a statement of cash flows (gross annual income over £500,000) should be raised in light of this change, suggesting a threshold of gross income of over £1m. They observed that the net debt reconciliation was intended to be prepared by much large entities (i.e. private companies with a turnover of more than £10.2m).

Depreciation for assets which comprise of two or more major components which have substantially different useful economic lives	
Proposed amendment to Charities SORP (FRS 102)	10.31
Draft Update Bulletin 2, Paragraph No.	3.3, Clarifying amendments

No. of responses which offered comments: 7 (24% of total respondents)

MAIN FINDINGS

The majority of respondents agreed with:

- the rationale for making the amendment in order to bring the SORP in line with the requirements of FRS 102; and
- the amendments status as a clarification, given it is not derived from the triennial review of FRS 102.

However, there were concerns that the amendment would impact a large number of charities. Respondents warned of the challenge and costs of compliance which would be incurred by charities by implementing component accounting for fixed assets. This was noted as being dependent on the type of assets held by the organisation and their use. Two respondents includes the following examples in their response:

- '*charities which have a number of properties which are used for charitable purposes*' (Knox Cropper, No. 27)
- '*charities which work with heritage or unique assets*' (Charity Finance Group, No. 25)

This was echoed at outreach events, where there were concerns about the gravity of the amendment for the sector based on social housing providers' experiences of applying this requirement of FRS 102 when it was introduced in the Housing SORP 2014 and the practical and operational difficulties caused.

OTHER COMMENTS

Respondents suggested the following changes to the amendment:

- Exclude functional assets from the requirement (Charity Finance Group, No. 25)
- Reintroduce an exemption from the requirement where *'it is not possible to obtain a reliable estimate of the individual component costs*' (MHA, No. 8)
- Provide further guidance on how to apply requirement (ICAEW, No. 23 & Chiene + Tait LLP, No. 12)
- Include guidance around the consideration of materiality in applying the requirement (BDO LLP, No. 29)
- Include an additional sentence to highlight the significance of the requirement and its potential widespread application: '*An example of an asset which comprises two or more components is a freehold property*' [sic] (Knox Cropper, No. 27)

Permits charities that rent investment property to another group entity to measure the investment property at either cost or at fair value	
Proposed amendment to Charities SORP (FRS 102)	10.36A, 10.48A, 10.48B & 10.56
Draft Update Bulletin 2, Paragraph No	4.3, Significant amendments

No. of responses which offered comments: 6 (21% of total respondents)

MAIN FINDINGS

Support for the change

Of the respondents who offered comments, two respondents welcomed the introduction of the option for charities to measure investment properties rented to another group entity at cost. This was echoed at outreach events, where the introduction of the accounting policy choice in this area was considered as a positive change.

One sector umbrella body disagreed with the underlying change to FRS 102. They believed measuring these investment properties at cost failed to give users of the accounts a clear understanding of the use of the property.

Reference to the transition accounting arrangements within FRS 102

Three audit firms suggested that the amendment should reference the transition arrangements which exist within paragraph 1.19(a) of FRS 102. These arrangements provide an exemption to retrospective application by allowing an entity which elects to measure an investment properties rented to another group entity using the cost model (where this property has previously been measured at fair value), to use that fair value as its deemed cost at the date of transition.

OTHER COMMENTS

Definition of 'group entity'

One professional body recommended that the SORP should define the term 'group entity' in order to support charities application of the requirement.

Reference to measurement basis for non-rented component

One sector umbrella body suggested paragraph 10.48B could be clearer in reiterating the measurement base that should be used to measure the non-rented component of the investment property.

Appendix A:

Question 1, Analysis of responses to the proposed amendments in draft Update Bulletin 2

Ref. in Bulletin	Section of SORP	Description of draft amendment	No. of responses
SECTION 3: *Clarifying amendments*			
3.1	3.49	*Clarifies the requirement to provide comparative information*	17
3.3	10.31	*Removes undue cost or effort exemption for depreciating assets*	7
3.5	13.5	*Clarifies when payments by subsidiaries to their charitable parents that qualify for gift aid are adjusting events*	14
SECTION 4: *Significant amendments*			
4.1	18.A	*Inserts the effective date of the amendments*	12
4.3	10.36A - 10.56	*Permits charities that rent investment property to another group entity to measure the investment property at either cost or at fair value*	6
4.5	10.47 & 10.48	*Removes the undue cost or effort exemption for the investment property component of mixed use property*	2
4.7	10.63	*Removes the disclosure of stocks recognised as an expense*	-
4.9	14.17A - Table 10A	*Requires charities to prepare a reconciliation of net debt as a note to the statement of cash flows*	10
4.11	27.12	*Includes the transfer of activities to a subsidiary as an example of a charity reconstruction that can be accounted for as a merger*	4
4.13	Glossary of terms	*Inserts a definition of the term service potential*	2
SECTION 5: *Other amendments*			
5.1	20.	*Changes the guidance for charities that meet the definition of a financial institution*	11
5.3	Table 7	*Changes the reference of non-convertible preference shares and non-puttable ordinary shares*	2
5.5	11.7 & 11.12	*Change the language for those paragraphs that cover the initial measurement of basic financial instruments*	-
5.7	11.35A	*Inserts a reference to those suggested disclosures where the risks arising from financial instruments are particularly significant*	5
5.9	11.35	*Removes the requirement to disclose the carrying amounts of financial assets & liabilities at amortised cost & cost less impairment*	-
5.11	18.17	*Changes to the language that covers the initial measurement of heritage assets at fair value*	2
5.13	21.29	*Changes to the language that covers the initial measurement of investments at fair value*	2
5.15	24.13A	*Insertion to cover the exclusion of immaterial subsidiaries from consolidated financial statements*	2
5.17	24.34A - 24.34C	*Insertion of the requirements for the accounting treatment of intangible assets acquired in a business combination*	3
5.19	24.35	*Requires unconsolidated interests in special purpose entities to be disclosed where consolidated accounts are prepared*	1
5.21	24.39	*Requires the disclosure of intangible assets which are acquired in a business combination and not separately recognised*	-
5.23	Glossary of Terms	*Amended to align the glossary definition of an intangible asset with that in FRS 102*	-
Invitation to Comment			
	Paragraph 1.25	*The proposed second edition of the SORP*	12

Appendix B:

Question 2, Suggested changes/amendments to the Charities SORP (FRS 102) not based on the recent changes to FRS 102 made as part of the FRC's triennial review 2017

Summary of suggested change/amendment	**Included in response**	
	No.	**Name**
Disclosures in the notes to the accounts of defined benefit plans (Paragraph 17.24)		
Only require charities to disclose and explain 'very key information' Provide a link to a website where the full information is provided	4	Mary Wallbank
Accounting treatment used where a charity adopted a total return to the investment of endowment (Paragraph 20.8 and 20.8)		
Allow charities adopting a total return approach to investment to show the amount of capital that trustees have converted to income in the year in the total income column Provide clarification about how charities can show the conversion of capital gains in the endowment to income available for expenditure to avoid expenditure appearing disproportionately high compared to income	6	Association of Charitable Foundations
Disclosures in the notes to the accounts of defined benefit plans (Paragraph 17.24)		
Make clear that the exemption from disclosing transactions between group entities provided by paragraph 33.1A of FRS 102 cannot be taken by charities Incorporate paragraph 23.4 of the SORP within Module 9: *Disclosures of trustees and staff remuneration*	15	PricewaterhouseCoopers LLP
Disclosures in the notes to the accounts of defined benefit plans (Paragraph 17.24)		
Provide greater clarification around the exemptions for smaller entities under Section 1A of FRS 102 can be applied by charities	15	PricewaterhouseCoopers LLP
Reconsider if Section 1A of FRS 102 could be a feasible option for charities which qualify as small entities	10	Sayer Vincent LLP
Consider the changes required to the legal framework for charity reporting which would permit charities to apply Section 1A of FRS 102	20	ICAS

Summary of suggested change/amendment	Included in response	
	No.	**Name**
Interaction with legal and other regulatory requirements		
Inclusion of employer pension contribution as part of employee benefits (Paragraph 9.30)		
The Charity Commission of England and Wales Annual Return for 2018 requires charities to provide the number of employees whose total employee benefits fell within each band of £10,000, from £60,000 upwards, including employer pension contributions Change the SORP requirement for the disclosure of employees who receive benefits of more than £60,000 (or 70,000 euros if in the RoI) to also include pension contributions for consistency	15	PricewaterhouseCoopers LLP
Concession to provide only a consolidated SOFA		
Provide an exemption for a parent charity established as a CIO to present a 'charity only' SoFA and a 'group' SoFA	3	Anonymous
Fundraising disclosures brought in by the Charities (Protection and Social Investment) Act 2016 - *England & Wales only*		
Include guidance on the disclosure of fundraising activities as required under provisions of section 13 of the Charities (Protection and Social Investment) Act 2016 ('the Act')	7 22	Kreston Reeves LLP Association of Charity Independent Examiners
Areas of perceived inconsistency with FRS 102		
Exclusion of subsidiaries from consolidated financial statements (Paragraph 24.13)		
The SORP requirement for all investments in subsidiaries held as part of an investment portfolio or as social investments to be excluded from consolidation is perceived as inconsistent with the requirements of FRS 102	28	Wellcome Trust

Appendix C:

Question 2, Suggested amendment to the Charities SORP (FRS 102) based on the recent changes to FRS 102 made as part of the FRC's triennial review 2017

Amendment to FRS 102:
Recognition of unrealised gains from income from non-exchange transactions by charitable companies
Reference within *Amendments to FRS 102 - Triennial review 2017*:
149
Reference within FRS 102 (March 2018):
A3.37B and A3.37C
Extract of amendment to FRS 102:
Appendix III: *Note on legal requirements* Insert new paragraph A3.37B: Recognition of incoming resources from non-exchange transactions by charitable companies Paragraph PBE34.67 requires the receipt of resources from non-exchange transactions to be recognised in income. This includes situations when items of property, plant and equipment, or inventory, are received. The income will be measured at the fair value of the assets received, which are measured in accordance with paragraphs PBE34.73 and PBE34B.15 to PBE34B.18. Insert new paragraph A3.37C: Charities that are companies are required to comply with the requirements of the Regulations, and may need to consider whether any gains are unrealised. Unrealised gains cannot be recognised in profit or loss, and should be presented as part of other comprehensive income.
Suggested amendment to Charities SORP (FRS 102):
We suggest that guidance is incorporated into Module 15: Charities established under company law of the SORP so that preparers are aware of which gains and profits can, under company law, be recognised in the income and expenditure account (realised profit and gains on certain assets measured at fair value) and which gains and profits cannot (other unrealised gains) and therefore need to be recognised in other comprehensive income. We suggest that the SORP should also refer to the ICAEW/ICAS TECH 02.17 guidance on determining realised profits. (PricewaterhouseCoopers LLP, No. 15)

Appendix D:

Question 2, Detailed analysis of comments on proposed amendments (< 5 responses)

To encourage charities to make additional disclosures where they hold financial instruments and the risks arising from these are particularly significant	
Proposed amendment to Charities SORP (FRS 102)	11.35A
Draft Update Bulletin 2, Paragraph No	5.7, Other amendments

No. of responses which offered comments: 5 (17% of total respondents)

MAIN FINDINGS

Improvements to the amendment and guidance

Four respondents made suggestions of changes to the amendment which they believed would assist preparers to:

- identify when the additional disclosure requirements in section 34 of FRS 102 are applicable to their charity; and
- provide the information required by these suggested disclosure requirements.

Two respondents believed this guidance was necessary to avoid preparers either:

- inadvertently ignoring these disclosures requirements, therefore preventing financial statement users from evaluating the significance of the financial instruments held by the charity; or
- providing the all information required by section 34 of FRS 102 in a way that obscures material information about the risks posed by the financial instruments held.

Identify when the additional disclosure requirements are applicable

The following changes were suggested:

- Revise the language used in paragraph 11.35A to help preparers determine if the additional disclosure requirements are mandatory, best practice or optional (i.e 'must', 'should' or 'may')
- Include examples of where the risks arising from financial instruments could be considered to be of 'particular significance' to the charity and the additional disclosures would be encouraged
- Specify that the disclosure requirements are only applicable to charities which are financial institutions

Provide the information required by the disclosure requirements in section 34 of FRS 102

The following changes were suggested:

- Signpost the paragraphs in section 34 of FRS 102 where the additional disclosures are located (paragraphs 34.19 to 34.30)
- Include application guidance which assists charities determining which disclosures may be required and includes:
  - A description of the credit, market and liquidity risks in more detail
  - References to the application of materiality

Two respondents also referenced the approach taken in Table 7 of the current SORP which assists users in identifying how to account for common basic financial instruments.

OTHER COMMENTS

Practical difficulties of disclosure

One sector umbrella body identified charitable foundations which hold financial instruments that are '*complex and/or not managed in-house*' would experience difficulties determining if the disclosure requirements in section 34 of FRS 102 were applicable to their charity.

They considered it to be '*unreasonable to expect foundations – particular smaller ones with limited capacity – to offer the additional disclosures'*. (Association of Charitable Foundations, No. 6).

Including the transfer of activities to a subsidiary undertaking as an example of a charity reconstruction that should be accounted for as a merger	
Proposed amendment to Charities SORP (FRS 102)	27.12
Draft Update Bulletin 2, Paragraph No.	4.11, Significant amendments

No. of responses which offered comments: 4 (14% of total respondents)

Clarification of the application for transfers to a non-wholly owned subsidiary

Two respondents sought clarification about whether criteria for merger accounting would be met where the transfer of activities took place between a parent charity and a subsidiary undertaking which is not wholly owned by the charity. (MHA, No. 8 & ICAS, No. 20)

Relevance of the example

The example's inclusion within the scope of the SORP and also Module 27 was queried by an audit firm (RSM UK Audit LLP, No.5). They questioned the relevance of the example based on the following:

- The scenario described in the example would only impacts the accounting of the non-charitable subsidiary entity, which is not required to apply the SORP – '*the consolidated charity accounts being unaffected because there is no change at consolidated level*'); and
- Module 27 applies to combining charities that meet the criteria for merger accounting (paragraph 27.2). The example involves a reconstruction involving a parent charity and a non-charitable subsidiary entity, and is therefore out with the scope of this module.

Signposting to Update Bulletin 1

An audit firm recommended signposting the amendments made to Module 27 as part of Update Bulletin 1. These amendments prohibited merger accounting for charities that are companies and enter into a business combination with a third party.

Suggestions not related to the amendments arising from the triennial review

One professional body recommended amending the second sentence of the paragraph, which had not been amended in the draft Update Bulletin. They suggested replacing 'trust' with 'entity' as the example is also applicable to unincorporated associations.

Accounting treatment of intangible assets acquired in a business combination	
Proposed amendment to Charities SORP (FRS 102)	24.34A, 24.34B & 24.34C
Draft Update Bulletin 2, Paragraph No.	5.17, Other amendments

No. of responses which offered comments: 3 (10% of total respondents)

Occurrence of this scenario and need for guidance

Two respondents offered differing views on how common it is for a charity to encounter a situation where the accounting treatment set out in the amendment would apply.

One sector umbrella body called for greater guidance around identifying and accounting for intangible assets to be included in the SORP. They believed this was needed given charities lack of experience in this area and the potential for audit firms to provide varying advice about the recognition of intangible assets.

Charities are increasing engaging in commercial partnerships which use intangible assets such as brand and reputation in order to generate income, we are concerned that there is a lack of sufficient detail in the proposed Update will not give charities confidence in identifying these assets and accounting for them. We believe that it may be useful for the Charities SORP-making bodies and SORP Committee to engage further with charity finance professionals and auditors about how clarity can be provided through the Charities SORP. (Charity Finance Group, No. 25)

An audit firm provided a contrary viewpoint. They recommended the amendment should be contained in a separate appendix of the Update Bulletin as it is not common for charities to purchase a non-charitable subsidiary and acquire intangible assets.

Reference to the transition accounting arrangements within FRS 102

One audit firm suggested that the amendment should reference the transition arrangements which exist within paragraph 1.19(b) of FRS 102. These arrangements provide an exemption to retrospective application, allowing the change to be applied prospectively. An entity is therefore not required to subsume intangible assets that previously have been separately recognised within goodwill.

Removing the undue cost or effort exemption for the investment property component of mixed use property to require measurement at fair value	
Proposed amendment to Charities SORP (FRS 102)	10.47 & 10.48
Draft Update Bulletin 2, Paragraph No.	4.5, Significant amendments

No. of responses which offered comments: 2 (7% of total respondents)

Both respondents highlighted the difficulties associated with obtaining a valuation for an investment property component of a mixed use property. One sector umbrella body felt difficulties would be encountered by professional valuers in those situation where the charitable and commercial components of a property overlap, giving the following example:

For example, imagine a café staffed by people living with disabilities, which serves to provide both investment income and employment opportunities. I would be interested to know how a professional valuers would split the property. (Association of Charitable Foundations, No. 6)

Respondents felt that obtaining a reliable valuation would be costly for those charities which hold mixed use property. One audit firm questioned whether the costs incurred would be proportionate to the benefit of the information presented by charities in their accounts.

Changing the reference of non-convertible preference shares and non-puttable ordinary shares	
Proposed amendment to Charities SORP (FRS 102)	Table 7
Draft Update Bulletin 2, Paragraph No.	5.7, Other amendments

No. of responses which offered comments: 2 (7% of total respondents)

Both respondents considered the language used to describe the basic financial instruments as complicated and incomprehensible by non-professionals.

One respondent proposed alternative wording:

Common basic financial instruments in respect of investment in ordinary shares or types of preference share.

Insertion to cover the exclusion of immaterial subsidiaries from consolidated financial statements	
Proposed amendment to Charities SORP (FRS 102)	24.13A
Draft Update Bulletin 2, Paragraph No.	5.15, Other amendments

No. of responses which offered comments: 2 (7% of total respondents)

Of the two respondents which offered comments, one suggested revisiting whether the amendment should be presented as clarification given the paragraph reinforces a concession which previously existed in FRS 102. They recommended the amendment should be categorised as a clarifying amendment within Section 3 of the draft Update Bulletin and therefore applied immediately by charities.

Inserting a definition of the term service potential	
Proposed amendment to Charities SORP (FRS 102)	Glossary of Terms
Draft Update Bulletin 2, Paragraph No.	4.13, Significant amendments

No. of responses which offered comments: 2 (7% of total respondents)

Two comments were made – one welcoming the amendment, and the other offering a minor drafting improvement.

Changes to the language that cover the initial measurement of heritage assets at fair value	
Proposed amendment to Charities SORP (FRS 102)	18.17
Draft Update Bulletin 2, Paragraph No.	5.11, Other amendments

No. of responses which offered comments: 2 (7% of total respondents)

Both respondents supported the proposed amendment

Changes to the language that cover the initial measurement of investments at fair value	
Proposed amendment to Charities SORP (FRS 102)	21.29
Draft Update Bulletin 2, Paragraph No.	5.13, Other amendments

No. of responses which offered comments: 2 (7% of total respondents)

Both respondents supported the proposed amendment

Requirement for unconsolidated interests in special purpose entities to be disclosed where consolidated accounts are prepared	
Proposed amendment to Charities SORP (FRS 102)	24.35
Draft Update Bulletin 2, Paragraph No.	5.19, Other amendments

No. of responses which offered comments: 1 (3% of total respondents)

One respondent included a comment specific to this amendment. They called for guidance about what would constitute a special purpose entity in the context of a group with a charitable parent.