SORP Committee

Minutes of the SORP Committee Meeting of 13 October 2010
(Approved at the December 2010 SORP Committee Meeting)

Contact: Nigel Davies, Secretary to the SORP Committee
01823 345470
Nigel.davies@charitycommission.gsi.gov.uk

Present:

Laura Anderson, Deputy Chair of the SORP Committee
Tidi Diyan
Pesh Framjee
Peter Gotham
Ray Jones
Lynne Robb
Carol Rudge
Kate Sayer
Catriona Scrimgeour

In attendance:

Nigel Davies, Secretary to the SORP Committee
Punam McGookin, Deputy Chief Executive, Charity Commission for Northern Ireland
Sam Younger, Chief Executive, Charity Commission

Apologies:

Debra Allcock-Tyler
John Graham
Chris Harris
Keith Hickey
Noel Hyndman
Tris Lumley
Paul Spokes

Item 1: Opening remarks and declarations of interest

1.1 The Chair opened the meeting by welcoming Sam Younger, the new Chief Executive of the Charity Commission to the meeting. She also welcomed Punam McGookin, Deputy Chief Executive, Charity Commission for Northern Ireland (CCNI), who was attending as an observer member.

1.2 The Chair noted that the development of the next SORP in a new modular format was an opportunity for the Committee to work together as a team in the development phase. Constructive debate would be very important and she encouraged all members to relish this challenge and opportunity to develop the new SORP.

Item 2: Approval of the minutes and matters arising

2.1 The minutes of the meeting of the 8 July 2010 were considered and were approved.

2.2 The Secretary advised that the attendance of Charity Commission's and Office of the Scottish Charity Regulator's (OSCR) information technology (IT) staff had been deferred to the December meeting. The IT staff needed to know how many and of approximately what size each SORP module would be before developing an outline specification and costing. Their initial advice was that the proposed electronic version of the SORP with self select and navigation features was technically feasible.

2.3 The Secretary advised the Committee that the results of the Charity Commission's desk based research on the use of the Financial Reporting Standard for Smaller Entities (FRSSE) would be available for the December meeting. Early results indicated that the FRSSE was more frequently used than had been anticipated.

2.4 The Committee invited Punam McGookin to outline recent developments in charity regulation in Northern Ireland. She advised that the registration process had been delayed pending resolution of a technical issue with the legislation. in Northern Ireland. Charity Commission for Northern Ireland were concentrating on setting up systems and processes and recruiting staff whilst the legal issue was resolved.

Items 3: Update on the ASB proposals for the future of UK GAAP

3.1 Ray Jones introduced this item and reminded that Committee of the Accounting Standard's Board (ASB) proposal for a three tier framework for financial reporting.

- Tier 1: Full EU adopted IFRS would be mandatory for all listed companies and entities with listed debt.
- Tier 2: The Small and Medium-sized Entities (SME) Standard developed by the International Accounting Standards Board (IASB) which would apply to those companies or entities with no listed debt or equity.
- Tier 3: The Financial Reporting Standard for Smaller Entities (FRSSE) which would apply to those companies or other entities meeting the definition of small under the Companies Act.

3.2 The ASB's anticipated that all 3 Tiers could apply to charities. Only those few charities with listed debt were likely were likely to fall within Tier 1 on a mandatory basis. Although any charity could choose to apply full IFRS if so wished. Similarly, a charity falling into to Tier 3, the FRSSE, could move up a tier and adopt the SME Standard. The ASB's plans for the future of UK GAAP include a high level Public Benefit Entity (PBE) Standard which will address the key aspects of PBE accounting not dealt with by general standards. The ASB's Committee for Public Benefit Entities (CAPE) is charged with developing the PBE Standard.

3.3 He noted that Joanna Spencer had joined the ASB from the Australian Accounting Standards Board to assist with the development of the PBE Standard. The first draft is to be developed by December 2010 and it is anticipated that a version for consultation will be issued in the first half of 2011.

3.4 Early indications were that the PBE Standard will be relatively short high-level document and will draw on existing accounting solutions. The ASB Statement of Principles – Interpretation for Public Benefit Entities and the Charities SORP being two key sources. Some of the solutions may be rather purist and need testing at the consultation stage.

3.5 The areas the PBE Standard was likely to cover are:

- impairment of assets used for service potential rather than generating cash flows;
- non-exchange transactions (gift accounting);
- soft loans;
- heritage assets (existing standard FRS 30);
- valuation of fixed assets;
- business combinations; and
- boundaries of the reporting entity.

It was not anticipated that the PBE Standard would cover either narrative reporting or fund accounting which would be within the remit of relevant SORPS.

3.6 The Committee was concerned that merger accounting was not an option under IFRS and discussed the treatment of goodwill under acquisition accounting . The concept of acquisition does not fit well with sector combinations often at nil consideration and where net liabilities may on occasions be assumed as part of the combination. Goodwill arises where the cost of acquisition exceeds the value of the net assets acquired. The Committee agreed that goodwill should be credited to the SoFA as a gain where the substance of the acquisition was a gift of assets. Where net liabilities are acquired the Committee considered this would be a charge to the SoFA. Merger accounting where the two charities would consider to have always been combined avoids this problem. The Committee noted that ‘fresh start’ accounting as an alternative to merger accounting had not been developed yet as an option.

3.7 The Committee were concerned that the ASB may propose that soft loans made to further a charity’s objects would be treated as a financial instrument. In commerce a soft loan as a form of sales incentive is considered as a financial instrument with the difference between the market rate and the soft loan rate treated as a financing cost related to the sale. This model is not representative of why charities provide soft loans although it could be argued the discount reflects the gift element inherent in a loan below market rates.

3.8 The Committee noted that the normal ASB consultation period was 3 months but this could be extended at ASB discretion. Ray Jones is a member of CAPE drafting committee working on the development of the draft PBE Standard.

3.9 The Committee concluded that:

- **The development of the PBE Standard was very welcome.**
- **The Charities SORP Committee should submit a response once the draft PBE Standard is issued as an Exposure Draft for comment.**

Items 4 Update on the progress of the modules for the new SORP

4.1 Ray Jones advised the Committee that the modules would be divided between core modules that applied to all charities preparing accruals accounts, pathway modules that depended upon the tier under which the accounts are prepared and specialist modules for certain specific types of transaction, for example heritage assets.

4.2 The new SORP would be designed as a navigable electronic application with a sequence of pages and the selection by the preparer of the relevant modules. A loose leaf hard copy version would also be published.

4.3 The SORP research conducted in 2008-09 across the UK had shown that preparers of accounts and users of the SORP wanted the SORP to remain as far as possible a 'one-stop' shop. This would now be a complex task given that there will be 3 frameworks to write the new SORP modules around. Previously there had only been the one framework of UK GAAP and Financial Reporting Standards. The SORP might well be significantly longer but each individual charity would only need to download modules relevant to the framework it adopted and its particular activities.

4.4 The Committee discussed the implications of a lengthier SORP in terms of total pages compared to the advantages that the modules would bring. In many cases longer was shorter in so far as the user would select only those pages that mattered. Issues might also arise in relation to how a consultation might be conducted in the context of modular approach and the impact this might have on the timing of IT developments.

4.7 The Committee concluded that:

- **The consultation on the modular SORP might attempt to show the implications for a smaller charity in terms of the number of modules that would need to be downloaded compared to the length of the current SORP.**
- **The possibility of using a micro-site to host the modular SORP should be considered by the Charity Commission and OSCR.**

Item 5: New SORP balance sheet – FRSSE variant

5.1 Ray Jones introduced the draft module. He advised the Committee that initially he had attempted to draft a single balance sheet module that tried to combine the SME and FRSSE options but the resulting text was very complex and potentially misleading. On reflection a pathway approach worked better with the preparer selecting either the FRSSE option (tier 3) or the SME option (tier 2). Over 95% of charities fell within the definition of small and would be able to use the FRSSE.

5.2 He anticipated that the electronic version would not require the preparer to view the full text; instead the preparer would be prompted by a short sentence for each potential item on the balance sheet and then click to select those that applied to find out more.

5.3 The Committee debated whether the FRSSE pathway was needed. Would an immediate switch to the new SME based UK GAAP be a better solution than a phased change? The Committee were concerned that the ASB had not confirmed how long the FRSSE would be retained and whether it would be maintained. The FRSSE format and terminology would look increasingly antiquated as time passed and IFRS developed. If it was maintained, the FRSSE module made much greater sense than if the FRSSE was soon to be scrapped. However the FRSSE option would allow smaller charities to take a phased approach. It would provide more time for the sector to gain an understanding of the SME approach and what was involved. Moreover, it would be difficult for the SORP to deny smaller charities an option allowed by the proposed framework.

5.4 The Committee noted that terminology used by the FRSSE was very different to the SME and that the balance sheets of similar sized charities could look quite different depending upon the option that they selected. This might be an obstacle to comparability and mean that smaller charities increasingly look out of line with accounting developments. However, if the ASB were retaining the option perhaps it was not right that the Committee impose a burden on the smallest charities by removing a transitional option that could be very advantageous to them.

5.5 There were advantages to auditors and practitioners in smaller accounting firms in retaining a FRSSE option. It would give them longer to make the transition and gain the knowledge and experience of the SME Standard. It was noted that the FRSSE was designed to meet the requirements of for-profit entities complying with the Companies Act.

5.6 Reviewing the sections of the draft module in turn it was noted that the number of sections should match one for one each item or category in the balance sheet. Each category or item should retain the explanatory opening text. The Committee considered that sections 1 and 2 needed to be moved to an earlier module telling the user what the FRSSE eligibility criteria are. Sections 3 and 4 were well drafted and the balance sheet layout was agreed. Sections 5 and 6 were also agreed.

5.7 In section 7 intangible assets, it was noted that additional text concerning web site development was needed with the findings of the Urgent Issues task Force adapted for not-for-profit considerations of service potential. Section 8 needed some additional text on valuing donated assets and valuation of fixed assets. Further consideration should also be given to the valuation of donated services such as rent free premises, for example should they be valued at market values or value in use to the charity? Sections 10 to 12 were agreed.

5.8 Sections 13 and 14 provoked debate as to the treatment of long-term contracts and whether the FRSSE approach for long-term contracts should be categorised as a balance sheet item within work in progress or whether the issue is better handled as an income recognition point. Using an income recognition approach prepayments would be identified and income deferred if it had not been earned instead of recognition of work in progress. The income recognition approach would be simpler to implement.

5.9 Section 16 provoked some debate as to whether charities with cash holdings could be construe them as a current asset investment. The Committee felt cash could be held as a current asset investment despite the requirement for cash holding to separately disclosed and even though cash was a liquid asset not subject to any realisation process to convert into cash as is the case with other current asset investments. The Committee concluded its deliberations at this point and decided to consider the SME balance sheet module.

5.10 The Committee concluded that:

- **Both FRSSE and SME options be retained as it would be wrong to remove an option the ASB had specifically retained to assist smaller entities.**
- **In the electronic format there should be an initial index of items within the module so that the user can select relevant items for their circumstances.**
- **A protocol is developed to assist the Committee to notifying matters for discussion before the meeting so that better use could be made of the available time to debate substantive issues. Small drafting points should also be notified to the Secretariat so they can be addressed without taking up Committee time.**
- **Ray Jones should clarify with the ASB how long the FRSSE would be permitted as an option and to clarify if 2016 would be the earliest date that this option may be lost.**
- **The Committee agreed that the primary user of the SORP are preparers of accruals accounts but concluded that the Secretariat should nevertheless ensure that the final draft modules receive a plain English review. This should ideally make use of someone with an understanding of financial issues but not an accountant. The review would ensure that a technical message is put across as clearly as possible without losing the meaning.**
- **The changes identified by the Committee regarding the number of sections and additions for web site development should be made. A separate module or text on valuing gifts in kind, reviewing cash at bank and valuation of fixed assets and the treatment of long term contracts is needed. Once a module is reviewed it should be re-circulated by email with tracked changes for review.**

Item 6: New SORP balance sheet – SME variant

6.1 Ray Jones introduced the draft module and noted that the terminology of the SME Standard is very different from that of the FRSSE. However the IFRS approach does permit much greater flexibility, including changing the terminology used in the financial statements. A key decision was how similar should the terminology be to the existing UK GAAP?

6.2 The Committee debated the merits of keeping with the SME terminology or using the flexibility the IASB have allowed and reverting to existing UK GAAP terms instead. If UK GAAP terminology were adopted it would allow greater comparability with FRSSE prepared accounts. Conversely by using UK GAAP terminology this would make the transition to IFRS harder if the FRSSE was later to be dropped. Charity accounting would look antiquated and be out of synchronisation with developments in UK and global accounting. The Committee noted that by offering a FRSSE option, those charities wishing to retain UK GAAP terminology could and it was the role of their auditor or accountant to help trustees make an informed choice about if and when to change to the SME based formats.

6.3 It was questionable whether FRSSE terminology could be changed to fit better with the SME approach given the FRSSE is designed around company law formats and disclosures. Moreover, it would be odd to say to the sector the FRSSE is retained and then change all of the terminology it uses which smaller charities are accustomed to using.

6.4 Looking at the SME balance sheet the greater structural flexibility was noted. The opportunity to move away from striking a total of net total assets (total assets less liabilities) which then matched the total funds figure was noted. This flexibility might, for example, permit pension deficits to be shown alongside the total funds figure or to present long term liabilities in the lower half of the statement. The balance sheet model format offered in the SORP would not be a 'must' so that preparers could use the full flexibility the SME approach offers where it offers a more 'true and fair' view.

6.5 In principle the SORP should not add to the general note disclosures required by the SME Standard unless sector specific requirements need to be met. It was noted that the SME disclosures were minimalistic but there was always flexibility for preparers to give more information if they wished or if donors and financial supporters required it.

6.6 The SORP could not be an accounting text book or manual. Where additional sources provide helpful accounting information, for example on discount and present value calculations, these sources should be signposted rather than reproduced in the SORP.

6.7 In concluding their discussion of the module, the Committee considered how far the principle of discounting should be taken. It was noted that IASB saw discounting as being central to identifying current values and applied it to debtors and creditors as well as financing instruments. The Committee agreed that for trade debtors and creditors and other amounts where settlement is expected within 12 months, the SORP should advise that discounting is not required. The Committee concluded its deliberations of the draft module.

6.8 The Committee concluded that:

- **The SME module should adopt SME terminology. Consideration should be given to preparing a guide to SORP that sets out the terminology of the FRSSE and SME alongside each other to assist users. This guide, if taken forward, would follow on from the production of the SORP which has the greater priority.**
- **The balance sheet format set out in the SORP could follow the FRSSE sequence of assets and liabilities more closely. The format would be a 'may' rather than a 'must' and the flexibility the SME approach offers should be highlighted. However the SORP must require separate sections in the balance sheet setting out current and non-current assets and liabilities and fund balances.**

- **The SORP should signpost to other sources of advice and help, for example regarding discounted cash-flow techniques, it need not illustrate every possible calculation but could signpost, for example, to IASB SME training materials.**

Item 7: New SORP module – Fund Accounting

7.1 Nigel Davies introduced this module. He noted that the 2008-09 SORP research findings had identified that the analysis of funds was an essential aspect of charity accounting and that real difficulties existed in practice in properly identifying the funds held. The module drew on the existing SORP appendix and had been revised to provide additional guidance.

7.2 He noted that new text that distinguishes trusts law restrictions from grant and contract terms that did not give rise to a restriction was added. Also the trust law requirement that income be spent within a reasonable period of receipt was highlighted. He also noted that a section on recognition of income and expenditure included in the draft might be better located elsewhere. It was agreed that the text would need to be subject to a check regarding the position for Scottish Trust law.

7.3 Due to pressure of time, the Committee concluded its business with the remaining items to be deferred until a future meeting.

7.4 The Committee concluded that:

- **The module should be amended for the comments made concerning transfers of trusteeship and changes to make the text clearer to the reader.**
- **The section on income and expenditure recognition should be relocated to the Statement of financial Activities modules.**

Item 8: New SORP module – Heritage assets
Consideration was deferred

Item 9: New SORP module – Do the accounts have to follow SORP?
Consideration was deferred.

Item 10: Dates for Committee meetings

10.1 The next meeting will be on 17 December 2010 at the Charity Commission's London office.

Item 11:

11.1 There being no other business the meeting closed.