SORP Committee

Minutes of the SORP Committee Meeting of 10 May 2012
(Approved at the October 2012 SORP Committee Meeting)

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

Present:

Laura Anderson, Joint Chair of the SORP Committee
Sam Younger, Joint Chair of the SORP Committee
Tidi Diyan
Pesh Framjee
Keith Hickey
Noel Hyndman
Carol Rudge

In attendance:

Nigel Davies, Secretary to the SORP Committee
Caron Bradshaw, Charity Finance Directors' Group (observer member)
Joanna Spencer, Accounting Standards Board (observer member)

Apologies:

Debra Allcock- Tyler
Peter Gotham
John Graham
Ray Jones
Tris Lumley
Frances McCandless (observer member)
Lynne Robb
Catriona Scrimgeour
Kate Sayer
Paul Spokes

Item 1: Opening remarks and declarations of interest

1.1 Laura Anderson opened the meeting and invited any declarations of interest to be declared. No declarations of interest were noted.

Item 2: Approval of the minutes and matters arising

2.1 The minutes of the meeting of the 14 March 2012 were considered and were approved with three amendments:

The correction of a split infinitive in minute 3.3 'to radically cut down' in minute 3.2.

Second sentence of Minute 3.6 substitute the intended word 'reflection' in place of 'refection'.

Third sentence of minute 4.3 delete the words 'current asset'.

2.2 The amended minutes were approved.

2.3 Nigel Davies noted that the submission to the Financial Reporting Council on the future of the UK Accounting Standards Board (ASB) had been sent to the ASB and subsequently circulated to the Committee. He advised that prior to the submission Ray Jones and himself had met with the Project Directors at the ASB and had a very useful explaining the particular concerns that the SORP making body and SORP Committee had.

Item 3: Update from the ASB

3.1 Joanna Spencer advised that over 100 responses had been received to the ASB consultation on Financial Reporting Exposure Drafts 46, 47 and 48. Some of these submissions were quite detailed with one running to over 80 pages.

3.2 There were a number of suggestions for changes or amendments relating to public benefit entities and these needed to be carefully considered. When making any changes the ASB is mindful of any consequential impacts on other types of entity. The process of carefully considering all the submissions and making changes was likely to take some time. Where it would be useful to this process, the ASB may take the opportunity to informally seek comment on particular changes it was considering.

Item 4: Statement of Financial Activities (SoFA) module

4.1 Nigel Davies introduced this item. He noted that when the Committee had previously considered the SoFA, a single solution that could be used by preparers using the Financial Reporting Standard for Smaller Entities (FRSSE) and the proposed Financial Reporting Standard for Medium-sized Entities (FRSME) was not possible. However with the new Financial Reporting Standard 102 and FRSSE based on company law a single solution was now possible.

4.2 Paper 2 made extensive reference to the available research evidence about what users of general purpose financial statements (the trustees' annual report and accounts) were looking for and the changes that stakeholders had been seeking in the SoFA. He noted that the feedback from the SORP research conducted in 2008-09 was that only necessary changes should be made. However the SoFA's terminology needed changing but the distinction between different types of fund must be kept. Whilst Foundations and other funding organisations wanted to know who provided funding for a charity, the general public were most concerned with how their donations had been spent. The public wanted to know whether a charity had excessive administrative costs but the SoFA did not provide this information.

4.3 The Committee considered the income section of the SoFA. Making the distinction between contracts and performance related grants was proving difficult in practice due to the contract style format and terminology now frequently used in grant agreements. What mattered was the user having an appreciation of how sustainable the charity's funding steams were and arguably who was providing the funding was key to making this judgement. The example discussed was that of a school where the split of income might be between user fees, public funds and donations.

4.4 The current SoFA encouraged charities to link the activities undertaken and the income funding those activities. This was an important link and should not be lost. However it was impractical to attempt to analyse who is funding the charity and to provide an analysis of funding across activities both on the face of the SoFA. If a change is made to show who is funding the charity on the face of the SoFA, then the linked activity analysis would have to be a required note in the accounts.

4.5 The treatment of gains from investments differed from that of for-profit companies. Due to the legal requirement not to make a distribution from unrealised gains, commercial accounting included recognised gains within profit and loss (income) but unrecognised gains were not included. Charities do not make distributions and so it was important to show the overall investment gain or loss whether realised or unrealised and its affect on total funds. The current approach was simpler and by showing the net result after net incoming resources, the effect of volatility in investment valuations was kept separate to the operational performance of the charity.

4.6 The Committee noted that these headings would need to distinguish fundraising and non-charitable trading activities from expenditure on charitable activities. They welcomed the suggested plain English headings suggested in paper 2.1 but recommended further thought be given to making them even more intuitive to general readers of the accounts.

4.7 The Committee considered the expenditure section of the SoFA. The research evidence shows that the public are keenly interested in the management and administration costs of charities. It was noted that SORP 1995 and 2000 had attempted to classify management and administration costs but due to criticism of that definition and a desire to focus on the work of the charity and its impact, SORP 2005 had dropped this heading in favour of allocating support costs. Instead SORP 2005 required the separate disclosure of a narrowly defined category of governance costs.

4.8 The value of governance costs tended to be immaterial and arguably immaterial items should be disclosed rather than shown on the face of the SoFA. The problem appeared twofold, if management and administration costs are identified this encourages gaming behaviour to try and reclassify costs but in replacing this category with support costs there had been a loss of transparency. Not all charities disclosed how they analysed support costs to activities. Also this analysis requires judgements to been made. Arguably an inconsistency in sector practice in classifying management and administration costs had been replaced with an inconsistency in how support costs were allocated or apportioned.

4.9 The Committee debated alternative approaches involving: making a distinction between direct, indirect and overhead costs, or a classification based on central costs or back office costs and field, programme or activity related costs. However the problem remained that whatever boundary was drawn or distinction made there would be anomalies such as a management team member in the UK might be classed as back office but doing the same job for an international relief charity operating overseas, the person could be classified as an activity cost. Also charities in their management accounts adopt different approaches to buildings related costs and coding back office and management staff costs.

4.10 The preparer makes a judgment in classifying costs whichever approach is taken. The key was ensuring that these judgements are transparent so that the reader of the accounts can make an informed judgement about the charity. The SORP might usefully ensure the support cost allocation note is a requirement, a must rather than a should, and set out default categories and apportionment bases to be used. Charities would report using this approach or if they departed from it would have to explain how and why they had changed the approach to support costs.

4.11 SORP 2005 contained useful guidance on cost allocation and this should be retained in the relevant module(s).

4.12 The Committee, in advising the SORP making body, recommended that:

The analysis of income on the face of the SoFA be changes to show who is funding the charity. The analysis should distinguish public funding from different types of private funding such as donations, interest and dividends and user fees.

The analysis of income in the notes should require those charities reporting on an activity basis to analyse income across the types of activity which generated it such as fundraising and non-charitable trading, charitable activities, and investments.

The current approach for reporting of the net gain or loss should be retained and shown as a separate row in the section 'changes in funds due to revaluations' and this section should be renamed 'changes in funds due to investments and revaluations'.

The sub total for total income should be described as 'total income and endowments'.

The current definition of governance costs should be retained but governance costs should be reported as a separate component of support costs in the notes to the accounts rather than on the face of the SoFA.

Where charities report on an activity basis the SORP should identify a default basis for allocation and categorisation and that analysis must be provided.

The existing SORP paragraphs 172, 173, and 179 regarding the allocation of costs including the reporting of costs relating to obtaining grants and contracts and performance reacted grants should be retained.

The revised draft SoFA be circulated for comment before the draft module is further amended.

Item 5: Outline plans for consultation on the E-SORP

5.1 Nigel Davies introduced this paper. He noted that the SORP is developed in accordance with the ASB's 'SORPs: Policy Code of Practice'. The code sets out an expectation of a minimum of 3 month public consultation unless there are exceptional circumstances that justifies a shorter consultation period. The consultation on SORP 2005 attracted more than 500 responses and the SORP research conducted in 2008-09 had over 1,000 participants. Therefore it was reasonable to assume that the consultation on the next SORP was likely to attract significant interest.

5.2 It was intended that the next SORP be primarily accessed via the internet and so the consultation was likely to be web based. The consultation would provide an opportunity to test this new format.

5.3 The Committee encouraged the SORP making body to consider investing in a solution that allows a high level of functionality and customisation for each of the jurisdictions covered by UK-Irish Generally Accepted Accounting Practice (GAAP). For example a ‘white label’ solution provides for the front facing web pages to be customised whilst keeping much of the content unchanged. Similarly a micro-site could be hosted which is common to all jurisdictions to which each regulator could then signpost.

5.4 The committee noted to outline timetable relied on the ASB producing the final suite of standards by September. Were that to be the case then the consultation on the SORP would be in the summer of 2013 and the launch of the SORP would be in mid 2014. It was noted that any delay in the ASB publishing the final standards would push back both the consultation and the final launch.

5.5 It was now unlikely that the ASB would produce the final standards until the end of 2012. In Scotland no charities could apply the new SORP until regulations permitted it and in England and Wales no non-company charities could apply the new SORP until the regulations permitted it. The making of those regulations was a matter for devolved governments in Scotland and Northern Ireland and the UK Parliament in England and Wales.

5.6 Past experience had shown that making the regulations was not a straight forward matter and relied on collaboration from government and time being and available in the legislative programme. The regulations could not be made to have retrospective application.

5.7 Protocol required that the SORP be published in its final form and therefore the regulations cannot be drafted until the SORP is published. Also the regulations must be tabled whilst a legislature is in session and it is not a foregone conclusion that the regulations will be approved.

5.8 The Committee expressed:

A desire that the SORP making body consider granting the licence or contract to produce the printed version and an alternative paid for E-version of the new SORP to a sector umbrella body rather than a commercial supplier.

Concern that the final standard is not available until Christmas 2012 it may mean that the necessary Regulations cannot be made in time to permit a 1 January 2015 application date. This would create a conflict between GAAP and the charity regulatory framework where charities would be unable to comply with GAAP.

Item 6: Balance sheet module

6.1 Nigel Davies introduced this paper. He noted that when the Committee had previously considered the balance sheet, a single solution that could be used by preparers using the Financial Reporting Standard for Smaller Entities (FRSSE) and the proposed Financial Reporting Standard for Medium-sized Entities (FRSME) was not possible. However with the new Financial reporting Standard and FRSSE based on company law a single solution was now possible. He noted that the proposed balance sheet was largely unchanged from SORP 2005.

6.2 The Committee considered that further guidance on cash and cash equivalents would be helpful in both the section on fixed asset investments and current asset investments. The existing SORP guidance on valuations of property might usefully be restated.

6.3 The Committee debated the issue of 'free reserves'. The SORP research had shown a desire for a clear definition of what free reserves are and how they should be calculated. The amount of free reserves was not on the balance sheet and often the figure that was calculated for reserves could not be readily tied back to the balance sheet. Yet it was an important figure on interest to many readers of the accounts.

6.4 The definition was not straight forward since trustees had a choice as to whether to include or exclude some or all of unrestricted funds that were designated for a particular use. The current definition also focussed on unrestricted funds whereas other factors such as restricted funds with very broad objects and the availability of expendable endowment reduced or perhaps removed the need for unrestricted funds to be held in reserve.

6.5 The Committee in advising the SORP making body, recommended that:

The option to have a two column balance sheet or an analysis across each type of fund on the balance sheet be retained.

Fixed asset investments section be amended to state 'however those investments not intended to be held on a continuing basis (taken to be twelve months of the financial year end) are recognised as current assets'.

Current asset investments section be amended to state: 'current assets are investments including cash on deposit and cash equivalents which are not intended for use on a continuing basis (more than one year). Also that a description of cash and cash equivalents be added that states: 'cash equivalents are short term, highly liquid funds held to meet short term cash commitments rather than for investment or other purposes'.

The existing SOPRP paragraphs 265 and 266 should be retained and a reference to using an insurance valuation as a proxy for valuing buildings should be added.

The figure for free reserves if not shown on the balance sheet must be shown in the notes to the accounts along with details of how it is calculated.

Item 7: Scheduling meetings for 2013

7.1 The Committee agreed that it would be wise to plan for the contingency that the final suite of standards is not published by the ASB in September and so dates should be scheduled for 2013.

Item 8: Any other business

8.1 There being no other business the meeting closed