The New Charities SORP

Following a long period of consultation the joint SORP making body today released two new Statements of Recommended Practice (SORPs):

- SORP 2015 for Charities applying FRS 102; and
- SORP 2015 for Charities applying FRSSE.

The new SORPs replace the previous edition (2005) and apply for accounting periods beginning on or after 1 January 2015. The SORPs are available to download from the charity SORP website (www.charitysorp.org) and are a joint project between the Charities Commission and Office of the Scottish Charity Regulator.

Why are there new SORPs?

The new SORPs have been produced as a result of the introduction of FRS 102, The Financial Reporting Standard Applicable in the UK and Republic of Ireland which will replace all current UK accounting standards with the exception of the Financial Reporting Standard for Smaller Entities (FRSSE) in 2015.

Whilst UK GAAP has been subject to a significant review, accounting for smaller entities (as defined by the Companies Act 2006) remains broadly unchanged and these entities can continue to use the FRSSE. The criteria are that a Charity must meet two of the following three criteria:

- Income less than £6.5m;
- Assets less than £3.26m; and
- Employees fewer than 50.

When will the new SORPs apply?

The SORPs apply for periods commencing on or after 1 January 2015. Many charities will have 31 March year ends. The implications of the new SORP for a charity with a 31 March year end are:

- Financial statements for the year ended 31 March 2016 will be the first under the new SORP / FRS 102;
- Comparative period will need translation (year ended 31 March 2015)
- Transition point is the opening balance sheet for that period, i.e. 1 August 2014.

A translation exercise effectively needs to be undertaken for three balance sheets.

What is the ‘Modular Format’?

The new SORPs are set out in a modular format and contain a number of core modules that are relevant to all charities and specialist modules that only apply to particular charities according to their constitution, structure and activities. Each module has an introduction which explains what the module is about and details, in bullet points, the contents of a particular module.
In addition to the modular format, requirements have been written so that they are placed into three categories – “must”, “should” and “may” so that mandatory requirements can be separately identified.

**What are the main implications for the Trustees’ Annual Report?**

The Trustees’ Annual Report will retain the headings set out in the previous SORP (2005), however there are a number of notable additional requirements.

The first of these is that the principal risk and uncertainties facing the charity, along with plans and strategies for mitigating the risks, will need to be disclosed. Many larger charities already do so, however it now becomes an explicit requirement for any charity requiring an audit.

There is also a greater emphasis on progress against objectives, identifying the results of the charity’s activities and their impact on beneficiaries and more detailed disclosure recommended about the charity’s reserves.

**What will the new SoFA look like?**

Possibly the most noticeable change as a result of the new SORP is that the SoFA has been simplified:

- Four incoming resources headings (donations, earned income split, between income earned from charitable activities and other activities, and investment and other income) replacing the six income analysis headings in the SORP (2005); and

- Three headings for expenditure (fundraising costs, expenditure on charitable activities and other expenditure) replacing the seven analysis headings of the SORP (2005);

- Governance costs are no longer shown on the face of the SoFA and must now be allocated to the other expenditure headings; and

- Investment gains/losses are shown ‘above the line’; i.e. as part of incoming resources (in line with FRS 102).

**Will the treatment of legacies change?**

The general rule for income recognition within the new SORP is that income should be recognised when the three criteria below are met:

- Entitlement – control over the rights or other access to the economic benefit has passed to the charity;
- Probable – it is more likely than not that the economic benefits associated with the transaction or gift will flow to the charity; and
- Measurement – the monetary value or amount of the income can be measured reliably and the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

This has been a controversial area for the new SORP. The change from recognising income when virtually certain under the previous accounting framework has now changed to ‘probable’ under the new SORP. This SORP states that receipt of a legacy is probable when following probate the executors have established there are sufficient assets in the estate and any conditions have either been met or in the control of the charity.
Holiday Pay

Under FRS 102 there is now an explicit requirement to account for ‘accumulated compensated absences’ (typically holiday pay) which are outstanding at the balance sheet date. For an entity with a holiday year that runs concurrently with the financial year and allows no carry over of holiday then this would be zero. However where the carry over of holiday is allowed or the holiday year and financial year are not the same then a figure will need to be calculated for the year end unused entitlement.

Related Parties and Key Management Personnel

There has been a significant extension to the definition of related parties under the new SORP – from two paragraphs to more than two pages. Most notable is that all employees (not just senior management) are now related parties. Transactions with related parties (including employees) will need to be disclosed unless they fall within a list of transactions outside the scope (e.g. donations).

Another area which has been met with some resistance is a new FRS 102 requirement to disclose an aggregate total for key management remuneration.

Fixed Asset Revaluations – Transitional Option

Under current UK GAAP / SORP (2005) there was an option to hold property at cost or at valuation, with unrealised surpluses being held in a revaluation reserve. Choosing to revalue buildings would commit a charity to periodic revaluations to ensure that the property remains at fair value. This process of revaluations would create additional on-going costs and may not seem an attractive option. These two choices are also available in FRS 102 and moving to revaluations would indeed still require periodic revaluations under FRS 102.

However there is a transitional option within FRS 102 (para 35.10c) that would allow a charity’s building to be valued at fair value on transition and then use that value as deemed cost going forward with no on going requirement to carry out further revaluations. This option was also present when FRS 15 was introduced in 1999. This will affect the transitional balance sheet and any valuations will need to be undertaken relatively soon to ensure they reflect the value at that date.

Heritage Assets

The SORPs create a very significant extension to the scope of heritage assets in comparison to FRS 30 and FRS 102. Previously the requirements would have only applied to entities who hold assets to further preservation or conservation purposes (e.g. museums). However the new SORPs recommend that charities who have assets whose preservation and contribution to culture are ancillary to faith or other purposes also account for them as heritage assets.

Heritage assets may be held at either cost or valuation. As many charities may have received such assets over a number of years, many will have not recorded these in the financial statements. This will not affect the balance sheet, but there are some additional disclosures that may be very tricky to draft.

Total Return Approach

Where a charity holds investments as permanent endowment and adopts a total return approach, the amount of the unapplied total return allocated to income must be identified separately in the SoFA as an allocation between endowment funds and income funds, either within the transfer row or within the “investment and other income” section of the SoFA. Also required is the disclosure of the date the value of the initial gift component of the permanent endowment and initial value of the unapplied total return was established, as well as the amount of unapplied total return carried forward.
Long term intercompany loans

Loans within a charitable group, typically from a charity to a trading subsidiary, are often interest free. Under FRS 102 and the new SORP charities may be required to discount the loans to present value using market rates. It may be worth considering whether market level interest rates should be applied to avoid a scenario where intercompany balances will not reconcile due to discounting. The obvious solution would be to ensure that intercompany loans are repayable on demand or to apply a commercial rate of interest to such loans. There is however, an exemption for intercompany loans to entities that undertake charitable activities (e.g. loans between two charities in a group).