



New accounting rules for Charities

On 16 July 2014 The Charity Commission published its long-awaited new guidance for accounting by charities. The guidance is outlined in two Statements Of Recommended Practice (SORPs) which apply to financial years beginning on or after 1 January 2015. This guidance was finalised after public consultation in 2013 due to significant changes in the UK accounting framework to harmonise it with international financial reporting standards.

This is the first major change in charity accounting since the 2005 SORP, and all charities need to work out how the changes apply to them. For many charities the new SORPs will not have a dramatic impact, although the position is complicated by the fact that there are two new SORPs.

James Cowper Kreston will be running some seminars on the SORPs in September - further details are provided later.

Why are there two SORPs?

Significant changes have taken place at European level in recent times, and there is now an increased focus on the size of charities. If the original SORP exposure draft had been published, it would have had a very limited life before it needed to be withdrawn. Therefore the SORP has been separated into two versions:

- Financial Reporting Standard 102 (FRS102) SORP
- Financial Reporting Standard for Smaller Entities (FRSSE) SORP.

The separation means that FRS102 users will not be disrupted when the rules for smaller entities change. The FRSSE SORP will have a very short shelf life - when it is revised there may be little difference between the two SORPs. Some users may therefore choose to follow the FRS102 SORP to avoid too many changes along the way. It is anticipated that the revised FRSSE SORP will be issued in 2016. The position is less than ideal and is bound to result in confusion!

Eligibility

Charities considering using the FRSSE SORP need to confirm that they are eligible to use it. The FRSSE SORP can be used by a charity that meets two of the following three criteria - total income of under £6.5m, a balance sheet (gross) total of not more than £3.26m and 50 employees or less. The limits in group situations are slightly different. To add to the confusion, these limits may change. There are reduced disclosure requirements for those applying the FRSSE SORP and a cash flow statement is optional.

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Key changes

The new SORPs are not as radical as previous revisions, but each charity's circumstances need to be considered individually. The bulk of the comments below relate to the FRS102 SORP, unless otherwise indicated.

The SORP uses specific terminology to distinguish what options charities have:

"Must": those matters where not adhering to them is a departure from the SORP, requiring disclosure and a probable audit report qualification

"Should": matters which should be followed as best practice

"May": matters which a charity may choose to adopt or where there may be alternatives.

Trustees' report

The requirements of the FRSSE SORP and the FRS102 SORP are identical. Both require more information to be provided by larger charities, currently defined as those subject to statutory audit. At the present time this limit is income of over £500,000.

The new rules retain the current focus on providing information relevant to a charity's stakeholders and the charity telling its story in a balanced manner. All charities must provide a baseline level of information, but more is required for larger charities.

Changes for all charities include:

- Charity must explain any policy it has for holding reserves and state the amount of reserves and why they are held.

Changes for larger charities include:

- Explanation of social investment policies
- Explanation of the financial effect of significant events
- Enhanced risk disclosures to include a description of the principal risks and uncertainties facing the charity and its subsidiaries, together with a summary of plans and strategies for managing these risks
- Disclosure of arrangements for setting pay for the charity's key management personnel and any benchmarks, parameters or criteria used in setting pay.

Statement Of Financial Activities (SOFA)

The basic structure of the SOFA, with its columnar presentation of unrestricted income, restricted income and endowment is retained.

The number of headings within the SOFA has been reduced to follow a more "plain English" style to describe income and expenditure.

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The five income headings are:

- Donations and legacies
- Charitable activities
- Other trading activities
- Investments
- Other

There are only three expenditure headings:

- Raising funds
- Charitable activities
- Other

Governance costs are no longer disclosed in the SOFA but are shown in the notes to the accounts.

The treatment of gains and losses on investment assets has changed. SORP 2005 presented both realised and unrealised investment gains and losses as an item within other gains and losses after striking a total for "net incoming/outgoing resources". In order to comply with the new accounting rules, in future gains and losses on investments need to be shown in the SOFA before striking a total for "net income/expenditure". These changes are unlikely to be popular as charities do not like showing movements in investment value above the line. It may be possible to insert another subheading "net income/expenditure before gains and losses" to reduce this problem.

Income recognition

SORP 2005 required three conditions to be met before income could be recognised in the accounts. One of the criteria was that income could only be recognised where there was a reasonable "certainty" of receipt. The word "certainty" has been replaced by "probable".

This is likely to mean that some charities will have to include income in their accounts at a slightly earlier stage. This is most likely to affect charities receiving legacy income, where there has been a degree of flexibility about when the income is recognised.

The new SORP clarifies that the probability test is likely to be satisfied where there has been grant of probate, there are sufficient assets in the estate to pay the legacy and any conditions relating to the legacy have been met.

Charities receiving regular legacy income should consider how these rules affect them.

Another income change in the SORP relates to donated goods. Income from the receipt of donated goods for sale needs to be recognised at the date of receipt. Under SORP 2005 income is only recognised once sold.

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However if it is impractical to assess the value of donated stock at the date of receipt, or if the costs of undertaking a valuation outweigh the benefit, charities can continue with the existing practice.

Other changes

There are a variety of other changes, including:

- Clarification that internally generated databases cannot be capitalised
- Enhanced disclosures of trustee and staff remuneration, related party and other transactions
- Potential discounting for the time value of money where income and expenditure settlement will be delayed by more than 12 months.

Action required

Charities need to consider:

- which SORP is to be used
- the date the new rules apply
- the impact of changes, and what information needs to be obtained and at what dates. Changes may be required to prior year figures
- if there are any opportunities arising from the new rules
- if additional information is required in the trustees' report.

It is important for charities to plan in advance rather than waiting until the preparation of the accounts sometime after December 2015. This may also be a good time to consider how you communicate information to your stakeholders. The annual accounts may not be the most effective or engaging way of doing this, and an additional "glossy" report may also be useful. Sadly, even if you choose to do this, there is still a requirement to prepare annual accounts!

James Cowper Kreston seminars

James Cowper Kreston will be holding seminars on the new accounting rules for charities on **12 September** in our Oxford office and **19 September** in the Newbury office. If you normally receive our charity emails, you will receive an invite in due course. If not please contact Ellie Nicholls at enicholls@jamescowper.co.uk or call on 0118 959 0261.

Other resources

As well as your James Cowper Kreston contacts, there is much useful information on the Charity Commission's SORP website - www.charitySORP.org.

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This includes 3 helpsheets:

Helpsheet 1: this maps the SORP 2005 into the FRS102 SORP

Helpsheet 2: this sets out the main differences between SORP 2005 and the FRS102 SORP

Helpsheet 3: This sets out the differences between the FRSSE SORP and FRS102 SORP.

If you require further information about these new rules for charities, please feel free to contact us.

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