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Charities Alert
SORP Bulletin 2 – consultation

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SORP Bulletin 2 is available at http://charitiessorp.org/about-the-sorp/sorp-consultations/

In a nutshell

SORP Bulletin 2[1] consultation updates the Charities SORP (FRS 102) (the "SORP") for the amendments and clarifications set out in the Triennial Review 2017 issued by the Financial Reporting Council in December 2017[2]. This second SORP bulletin sets out the proposed amendments in three sections:

- those changes which are required to ensure that the SORP is consistent with the original drafting intention of the FRS 102 – to be applied immediately;
- those changes which are significant and likely to have an impact on the accounts; and
- those amendments which are considered less significant and editorial in nature.

As the points noted in the latter two sections relate to amendments to FRS 102, the effective dates for these changes are reporting periods beginning on or after 1 January 2019 with early adoption permitted provided all amendments are applied at the same time.

The key changes that would be applied immediately relate to:

- the disclosure of comparative information;
- removal of undue cost or effort exemption for depreciating assets with major components with significantly different lives; and
- providing more clarity on the treatment of gift aid payments and the impact on the tax treatment.

The last change means that only gift aid payments which are legal obligations should be accrued for at the year end – constructive obligations are no longer included in the list of examples of adjusting events occurring after the end of the reporting period.

Other significant proposals, with the 2019 effective date, include:

- Permitting charities that rent investment property to another group entity to measure the investment property either at cost (less depreciation and impairment) or at fair value;
- Removing the undue cost or effort exemption for the investment property component of mixed use property hence changing the requirement to measurement at fair value;
- Removing the disclosure of stock recognised as an expense;
- Including a description of a basic financial instrument, as well as conditions for classification, which may result in a small number of additional financial instruments being considered basic;
- Requiring a reconciliation of net debt as a note to the statement of cash flows; and
- Including the transfer of activities to a subsidiary undertaking as an example of charity reconstruction that should be accounted for as a merger.

1. Amendments to Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland. Update Bulletin 2 – 20 February 2018

2. Amendments to FRS 102 the Financial Reporting Standard applicable in the UK and Republic of Ireland – Triennial Review 2017 – Incremental Improvements and Clarifications – December 2017

Background

The Charity Commission published in February a consultation on Amendments to Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland Update Bulletin 2. This updates the Charites SORP (FRS 102) for the amendments issued by the Financial Reporting Council in December 2017 as part of its Triennial Review 2017. The bulletin has been set out in three sections, covering the proposed amendments to be applied immediately as they are clarifications in the SORP to bring it in line with the original drafting of FRS 102; changes that may have a significant impact on the accounts; and changes that are considered less significant and are mainly editorial in nature.

Proposed amendments to be applied immediately – clarifying amendments

Comparative Information

The SORP is amended to clarify the requirement for comparative information to be provided for those disclosures required only by a SORP. Therefore, charities must provide comparative information for all amounts presented in the accounts or notes to the accounts unless otherwise stated in FRS 102 or the SORP. This therefore means that comparatives are required not only for the reserves notes and net asset by fund analyses, which were already covered in *Information Sheet 1*[3], but also the support cost allocation and other expenditure notes, where for some charities the comparative is often given by a total column only. Although the bulletin is not yet issued, this should be applied immediately since it simply clarifies the existing SORP.

Comparative information required for all notes unless otherwise stated.

Undue cost or effort exemption for component depreciation

The SORP previously offered an undue cost or effort exemption where charities held an asset which comprised two or more components with significantly different useful economic lives, which allowed one depreciation rate to be established. The proposal is to remove this as it is considered inconsistent with FRS 102. As a result, each component must be depreciated over its useful economic life.

Major components and separate useful lives must be identified for depreciation.

Accounting for gift aid payments and tax effects

In the original drafting of the SORP, the list of events occurring after the end of the reporting period that require adjusting currently includes a gift aid payment when the subsidiary has a legal or constructive obligation to make the payment to the parent. In the sector there has been a diversity of practice, some of this was reduced by the ICAEW guidance[4] which clarified that the expected gift aid payment was a distribution. However, the further clarifications in FRS 102 should promote greater consistency. As an expected gift aid payment is accounted for as a distribution to owners, FRS 102 does not allow these payments to be recognised as a liability at the end of the reporting period unless there is a legal obligation to make the payment (typically through a deed of covenant) at the reporting date. Consequently the SORP has been amended to remove the word 'constructive'.

Gift aid payments can only be accrued where there is a legal obligation.

> SORP 13.5 Examples of events occurring after the end of the reporting period that require adjustment include:
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> The determination of the amounts of a Gift Aid payment to a parent charity by a subsidiary undertaking, when the subsidiary had a present legal (for example, a deed) obligation to make the payment at the reporting date.

Charities who do not currently have a deed of covenant in place who wish to show the liability to make the gift aid payment will need to consider whether a deed should be put in place prior to their year end.

The SORP bulletin does not consider the tax effects of the gift aid payment which would be accounted for in the subsidiary. However, these are covered by the FRC Triennial Review 2017. Amendments have been made to FRS 102 section 29[5] to allow the tax effects of a distribution by a subsidiary to its charitable parent to be recognised in the reporting period so the accounting is consistent with the tax treatment planned to be used in the entity's tax filings. This applies where it is probable that the gift aid payment will be made within nine months of the reporting date and the payment will qualify to be set against profits for tax purposes. These amendments to the tax treatment set out in the triennial review 2017 are effective for periods beginning on or after 1 January 2019 and may be adopted separately from the other amendments.

The tax effects of a probable gift aid payment can be recognised in the reporting period.

3. Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland. Information Sheet 1: Implementation Issues – April 2017
4. ICAEW technical release TECH 16/14BL REVISED – February 2016
5. FRS 102 section 29.14A

As a result a charitable subsidiary without a deed of covenant will be able to recognise the tax effects of a probable gift aid payment but will not be able to accrue for the gift aid payment itself.

Amendments that may have an impact on the financial statements effective 2019 – significant amendments

Changes to investment property

The SORP Bulletin 2 proposal replicates the accounting treatments permitted by FRS 102 for investment properties rented to other group entities and will allow charities an accounting policy choice. Charities that rent investment properties to other group entities can measure those investment properties either at cost (less depreciation and impairment) or at fair value. Where the property is only rented in part to another group entity this only applies to the component of the property that is rented to the other group entity. If a charity takes the option to report at cost, the property (or element of that property) must be transferred to property, plant and equipment.

New accounting policy choice for investment properties rented to other group entities.

The amendments also remove the undue cost or effort exemption for measuring the investment property component of a mixed use property at fair value in line with FRS 102 changes. As a result, where the resulting portions could be sold separately (or leased under a finance lease) the fair value should be used. However, if the fair value cannot be measured reliably the entire property should be accounted for as a property within property, plant and equipment, i.e. no longer included within investments as an investment property.

Undue cost or effort exemption removed for mixed use property.

Stock disclosures

The SORP would be amended to remove the requirement to disclose the amount of stock recognised as an expense in the notes to the accounts.

Statement of cash flows

A reconciliation, similar to that required under old UK GAAP, of the movement on net debt must also be provided. This replicates the disclosures required by FRS 102. An example of the analysis required is given in a new table template[6], the reconciliation is not required for the prior period.

Net debt reconciliation required

Charity mergers

SORP section 27.12 detailing examples of charity mergers would be extended to give another common example which is the transfer of activities to a subsidiary undertaking, such that a subsidiary entity may be established to undertake non-charitable trading activities previously undertaken by the parent charity. These reconstructions can be accounted for using merger accounting, provided the use of this method is not prohibited by company law or other relevant legislation.

New definition of service potential

Service potential is the capacity to provide services that contribute to achieving a charity's objectives. Service potential enables a charity to achieve its objectives without necessarily generating net cash inflows.

Service potential should be considered when valuing stocks, particularly those held for distribution, and impairments of assets.

Other proposed amendments effective 2019

- The definition of a financial institution in the FRS 102 glossary has been amended to remove references to 'generate wealth' and 'manage risk'. This potentially widens which charities will meet this revised definition beyond only being charitable incorporated friendly societies. This may now include those charities that undertake lending at a market rate or to achieve an element of market return (mixed motive investments). It would not include those charities which provide concessionary rate finance in the form of programme related investments.
- Changes to section 11 on financial instruments include a description of a basic financial instrument, as well as conditions for classification, which may result in a small number of additional financial instruments being considered basic. Other changes are mainly editorial, but they do include a recommendation that charities provide additional disclosure when the risks arising from financial instruments are particularly significant.
- Minor changes have been made to the guidance on valuing heritage assets and social investments to indicate that arm's length transactions between knowledgeable, willing participants may be a good basis for a fair valuation.

6. SORP 102 section 14, Table 10A: Analysis of changes in net debt.

- The SORP clarifies that where more than one subsidiary is excluded from consolidation on grounds of materiality, the subsidiaries should be considered collectively to determine whether they are material or not.
- Additional guidance has been inserted on intangible assets acquired in the acquisition of non-charitable subsidiaries to reflect the changes made to FRS 102 to make clear when intangible assets should be recognised separately from goodwill, and additional disclose is required regarding the nature of intangible assets included in goodwill.
- Additional disclosures are required in consolidated accounts regarding the nature and extent of any interests in unconsolidated special purpose entities and the risks associated with those interests.

Next steps

The consultation period finishes on the 4 April 2018 and we would encourage charities to respond.

We would recommend that clarifications relating to additional comparative information, separate estimated useful lives of major components of an asset, and the recognition of gift aid payments should be adopted immediately. All other amendments are for periods beginning on or after 1 January 2019, but may be adopted early provided all amendments are adopted together.

Contacts

If you would like further, more detailed information or advice and to discuss how this will affect you, please contact your local Deloitte partner or:

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