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Charities Alert.
Which Charities SORP to apply?

In a nutshell

This Alert is for small charities who are small in accordance with Companies Act definitions.

Under current UK GAAP, small charities can choose whether to adopt the main suite of UK standards (FRSs, SSAPs and UITF Abstracts) or the FRSSE – the current Charities SORP contains a section for charities adopting the FRSSE.

From 2015, small charities will have a choice as to whether to adopt FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* – the replacement for current UK GAAP – or the FRSSE *Financial Reporting Standard for Smaller Entities*. The Charity Commission and OSCR have prepared two separate SORPs depending on which underlying standard is adopted– the FRSSE SORP and the FRS 102 SORP.

The FRSSE SORP has been designed to deliver minimal changes to charities currently adopting the FRSSE. The FRSSE is only subject to minor changes for 2015, with the FRC having announced their intention to withdraw the FRSSE in 2016 and ask small entities to apply FRS 102 with reduced disclosures.

Why pick the FRSSE and FRSSE SORP?

- Fewer changes in 2015 from current practice – allowing more time to consider the changes that may be necessary for 2016.
- FRS 102 does not contain the existing cash flow exemption in FRS 1 for small entities, so adopting the FRSSE is the only way for a small charity to avoid preparing a cash flow statement.
- No change for accounting for financial instruments.
- No change to the presentation of gains and losses on investment assets.
- No requirement to provide for additional contributions under multi-employer pension schemes.

Why pick FRS 102 and the FRS 102 SORP?

- If your charity is growing in size, change may be inevitable and best dealt with in one go, particularly if you are making other changes such as updating your accounting system.
- If your affairs are simpler (no complex financial instruments, no multi-employer pension schemes), there may be little difference in practice other than producing a cash flow statement.

This briefing covers firstly the key differences between the FRSSE SORP and the FRS 102 SORP and secondly the main changes for FRSSE adopters from SORP 2005.

The new SORPs will be applicable for periods beginning on or after 1 January 2015. Early adoption is not currently possible until the law is amended.

The Charities SORPs are available at http://www.charitysorp.org/

We encourage all charities that are eligible to apply the FRSSE to review the FRSSE SORP and consider which accounting framework and SORP is most appropriate.

Background

Charities Alert: July 2014 the FRS 102 SORP provides detail on the differences between SORP 2005 and the FRS 102 SORP www.deloitte.co.uk/charitiesandnotforprofit/

The Charity Commission and the Office of the Scottish Charity Regulator (OSCR) have issued two Charities SORPs. The SORPs are referred to as the FRS 102 SORP and the FRSSE SORP and each charity must use the appropriate SORP depending upon the choice of underlying accounting standard adopted. This briefing is directed at those charities who have a choice as to whether to follow the FRSSE or FRS 102 and the first part of the briefing covers some of the key differences (and similarities) between the FRS 102 SORP and the FRSSE SORP. There is a separate briefing on the FRS 102 SORP which covers the main changes from SORP 2005 Accounting and Reporting By Charities: Statement of Recommended Practice (revised 2005). Any UK charity is able to apply the FRS 102 SORP.

The FRSSE SORP cannot always be read as a standalone document as it includes references to the FRSSE for the basic accounting requirements and then expands on those areas of charity accounting where the FRSSE offers little or no guidance, including donated assets, non-exchange transactions and fund accounting. The FRSSE SORP adopts a modular approach which allows charities that have less complex operations to consider only the core modules which cover the fundamental principles. Additional modules cover more specific areas which may not apply to all charities. It also includes illustrative formats for the statement of financial activities, balance sheet, and selected notes.

As the FRSSE was changed very little when updated to the 2015 version, there are few changes to the accounting under the new FRSSE SORP, although income recognition criteria have been changed to reflect the FRS 102 SORP requirements. However, there are more changes to the trustees' report that will need to be considered by all charities including those applying the FRSSE SORP. These changes are covered in the second half of the briefing.

Terminology

Must, should and may

The SORPs are drafted to identify clearly 'must' requirements (those driven by law or the accounting framework and which are required for compliance with the FRSSE SORP/FRS 102 SORP); 'should' (which charities are encouraged to follow as a matter of good practice); and 'may' (which are options and illustrations which may be adopted at the discretion of the charity). A failure to follow a 'should' or a 'may' would not be seen as a departure from the relevant SORP. Larger charities (those with a gross income exceeding £500,000 or subject to audit under charity law in their jurisdictions of formation, registration or operation) are required to make more extensive disclosures to comply with the FRSSE SORP/FRS 102 SORP and these are clearly signposted within the text. Sentences introduced by the statement 'This SORP requires' are requirements that go beyond the requirements of the FRSSE/FRS 102.

Smaller charities will still have a choice

Thresholds

Size criteria	Gross income	Balance sheet	Employees
Two out of three limits to be met in two consecutive years to qualify as "small". Once small, two out of three limits need to be breached for two consecutive years to cease to qualify as small.	Gross income less than £6.5m (or £7.8m gross in the case of a small group).	Balance sheet total less than £3.26m (or £3.9m gross in the case of the parent of a small group).	Less than 50 employees on average.

Provided they meet the relevant size criteria set out above, charities will have the option of adopting the FRSSE, regardless of whether they had done so previously, unless they are a company limited by guarantee of a type set out in s384 Companies Act 2006 – in practice such exceptions are rare.

Key differences between the FRSSE SORP and the FRS 102 SORP

Investments/loans and other financial instruments

Complex financial instruments will be recognised on balance sheet under FRS 102

There are no changes to the accounting for financial instruments in the FRSSE SORP. Adopters of the FRS 102 SORP will need to consider the new guidance in the FRS 102 SORP and FRS 102. Under FRS 102, complex financial instruments, such as derivatives which may historically have been off balance sheet will now come on balance sheet and be measured at fair value through profit and loss.

Multi-employer defined benefit pension schemes

Additional liabilities for agreed contributions are recognised under FRS 102 SORP

Where a charity is part of a defined benefit multi-employer plan with external employers and it is not possible to apportion the scheme's assets or liabilities between the employers, charities can continue to be able to account for the scheme as a defined contribution scheme. However, unlike charities applying the FRS 102 SORP, a FRSSE charity will not need to recognise a liability for any agreement to make additional contributions.

For a group scheme, this exemption is also available under the FRSSE. However, under FRS 102 it must all be allocated to the sponsoring employer (normally the parent charity), and hence any surplus or deficit included in each entity's own balance sheet, unless another basis can be agreed.

Data capture costs may not be capitalised under FRS 102 SORP

The FRS 102 SORP also requires a description of the extent to which the charity can be liable to the plan for other entities' obligations; and an explanation of how any liability arising from an agreement to fund the plan has been determined.

Intangible assets

The FRSSE SORP permits charities with an existing accounting policy of capitalising the data capture costs of internally developed databases to continue to do so. This would not be permitted under the FRS 102 SORP.

Key management personnel and trustees

Total remuneration of key management personnel required by FRS 102 SORP

Only entities following FRS 102 are required to disclose the total remuneration of key management personnel. The FRSSE SORP states that information on the remuneration of the chief executive and/or other key management personnel may be given in the notes to the accounts.

Donations from the trustees and other related parties must be disclosed in aggregate (no individual disclosure is required) for those reporting under the FRS 102 SORP. There are exemptions for disclosure of individual trustees' donations which are not subject to signficant conditions over use.

Cash flow

Cash flow statement required by FRS 102 SORP

There is no exemption for small charities from preparing a cash flow statement, as is permitted under current UK GAAP. Therefore, unless the charity chooses to follow the FRSSE or is part of a larger charitable group, it will have to prepare a cash flow statement.

Other differences between the FRS 102 SORP and the FRSSE SORP to look out for

- There is a different treatment of **unrealised gains and losses** in the statement of financial activities. FRS102 requires all investment gains and losses to be included as part of net income/expenditure; the FRSSE SORP allows these to be reported in the Statement of Financial Activities (SOFA) below the "Net incoming/outgoing resources before transfers" line.

- **Comparatives** given for total funds only (FRS102 comparatives required for all SOFA fund columns).

- Both SORPs require the initial recognition of **unlisted investments** at cost, but subsequent valuation at fair value is required by FRS 102 whereas the FRSSE follows a simpler approach.

- FRSSE does not require some of the more **detailed disclosures** of FRS 102 such as disclosure of the stock expense during the year nor liabilities disclosures detailing the nature of the obligation and the expected amount and timing of resultant payments and an indication of the uncertainties surrounding the amount or timing of those outflows.

Key differences between the FRSSE SORP and SORP 2005

The Financial Statements

Income to be recognised when probable not virtually certain

Whilst the requirements of the standards and SORP are mostly unchanged, some of the changes may have a significant effect for some charities, for example income recognition criteria have changed to reflect the criteria in the FRS 102 SORP. The FRSSE SORP (as does the FRS 102 SORP) reduces the number of headings on the SOFA and uses plainer English. For example, "voluntary income" is now "donations and legacies" (which includes grants, donated goods, membership subscriptions and sponsorships that are in substance donations). "Resources expended" is now "expenditure", with three simplified headings: "raising funds"; "charitable expenditure"; and "other". Governance costs are only disclosed in the notes as part of support costs.

Income recognition

Income will need to be recognised when all of the following criteria 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 will flow to the charity; and
- Measurement – the monetary value or amount of the income and the costs to complete the transactions can be measured reliably.

This will be one of the most significant changes as one of the income recognition criteria will move from "virtually certain" to "probable". This may mean that some donated income is recognised at an earlier point in time where there is documentation of the promise that makes receipt more likely than not. This may have a significant impact on the recognition of legacy income for some smaller charities where legacy income has effectively been recognised on receipt rather than, for example, when probate has been granted. Specific guidance is given in the FRSSE SORP to assist charities in identifying the point of income recognition. If the impact of the change in accounting policy is material, in the year of transition to the FRSSE SORP this adjustment may lead to some income not previously recognised in prior periods being recognised directly in reserves. Income from insurance claims is still not recognised until receipt is virtually certain.

Donated goods and services, including volunteers

Donated items to be recognised on receipt at fair value wherever possible

The FRSSE SORP contains a separate core module for 'Donated goods, facilities and services, including volunteers'. This has not significantly changed from the exposure draft and will require donated items to be used in the course of the charity's work (e.g. tents and blankets received for a disaster appeal) to be valued and recognised in stock, unless it is impractical to assess the value at the time of receipt. This is a change from SORP 2005 where such items would be recognised only on distribution. Where valuation on receipt is impractical, the gift will be recognised in donations and as charitable expenditure when it is distributed.

In the same way donated goods for resale should be valued and included in stock. Where it is impractical to recognise donated goods on receipt the proceeds of sale will be recognised as 'income from other trading activities' in the SOFA.

Disclosures on volunteers required in the notes to the accounts

The contribution of general volunteers will not be included as income in the charity's financial statements. However, an indication of the scale of their contribution will be required in the trustees' report which may, include, for example, details of volunteer hours or staff equivalents. An indication of the nature and scale of their contribution must also be included in the notes to the accounts.

Higher paid staff

All charities to disclose pay over £60,000

As noted above FRSSE entities will not need to provide total remuneration disclosures but all charities must now include disclosure for any employees whose remuneration is over £60,000 in the £10,000 bandings, or state that there are none. This is a change from SORP 2005 which included an exemption for smaller charities.

Trustees' report

The trustees' report will include the same major headings as in SORP 2005 although there are changes in emphasis as noted below. The form and content requirements are the same as the FRS 102 SORP and are covered in more detail in the FRS 102 SORP briefing.

More disclosures on risk and key management personnel

Contents of the trustees' report

Smaller charities will still be required to provide the same basic information with very little change except that there is no longer an exemption to restrict the disclosure of trustees to 50 (where there are over 50 trustees) and where the reserves policy is not detailed, the absence of a reserves policy must be explained. For larger charities[1] increased disclosure is required:

- More detailed disclosure of risk including principle risks and mitigating actions.
- Explanation of the financial effect of significant events described in the trustees' report.
- Inclusion of both the positive and negative factors which have affected the achievement of the charity's objectives.
- More detailed disclosures on reserves including comparing the amount of reserves actually held against the reserves policy described in the trustees' report and explaining any actions required to bring the level of reserves into line with that policy.
- Disclosure of the arrangements for setting the pay and remuneration of the charity's key management personnel and any benchmarks, parameters or criteria used in setting their pay.
- Public benefit considerations will not be restricted to objectives and activities but will also be considered in respect of achievements and performance. All charities should 'identify the difference the charity's work has made to its beneficiaries and, if practicable, explain any wider benefits to society as a whole'.

Timing and resources

The FRSSE SORP applies for periods beginning on or after 1 January 2015. As comparative financial information will be required, the first relevant balance sheet for 31 December 2015 financial statements will be 1 January 2014, and therefore, consideration of the impact of the transition should begin as soon as possible. Early adoption is not permitted.

More resources on new UK GAAP and how Deloitte can help you are available in our resource centre at **www.deloitte.co.uk/futureofukgaap**.

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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1 Those charities subject to audit under charity law in their jurisdictions of formation, registration or operation, or charities with a gross income exceeding £500,000 (UK) or 500,000 euros (Republic of Ireland) in the reporting period.

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