HW Fisher
& Company

CHARTERED
ACCOUNTANTS

3 April 2018

By email to:
charities.sorp@cipfa.org

Our Ref: **NNS/MPC**

Dear Sirs

DRAFT UPDATE BULLETIN 2

We write to offer our comments on the draft of Update Bulletin 2 issued on 20 February 2018.

We set out our detailed comments on the consultation questions raised in an Appendix to this letter.

While the main reason for issuing Update Bulletin 2 is to apply the FRS 102 Triennial Review changes to charities, the area which causes us most concern is the amendment to the requirements for comparative figures, which we believe would be detrimental to charity accounting.

The existing provision of p4.2 of the SORP that "comparative information must be provided for all amounts presented in the SOFA" has generally been taken (not least in the Model Accounts prepared by the Charity Commission itself) to mean that comparatives need only been given to the level of detail given on the face of the SOFA itself. We believe that this gives a reasonable level of disclosure in the context of charity accounting.

Apparently at the behest of the FRC, the proposal is to add a further requirement to the SORP as p3.49 that comparative information must be provided for all amounts which appear in the accounts, including the notes. We believe that this would be detrimental because:

a) It will increase the length of charity accounts with what the FRC might reasonably in other contexts regard as "clutter".
b) In some cases, this requirement will discourage the disclosure of additional analysis in the current period which is useful.

One central purpose of charity accounting is to demonstrate how charitable funds have been spent during the year. While comparative information is of use we do not believe that it is useful for the reader to be presented with comparative information to the same level of detail as is given for the current period (more details of our proposal of how this might work are given in the Appendix).

FRS 102 does not require comparative figures to be given for <u>all</u> figures in a set of accounts, there are a number of notes, generally described in FRS 102 as presenting "reconciliations" (although we do not believe that the principle need to be tied specifically to the concept of "reconciliation") for which comparatives are not required, and these principles have been applied to charity accounts. In general, these reconciliations are given in relation to items disclosed in the balance sheet. In charity accounting there are number of additional analysis notes, applying to both balance sheet and SOFA items, which are in addition to anything which is required in FRS 102 itself. For the SORP to provide exemptions from the general requirement to give comparatives for these analyses would not be in conflict with FRS 102. It may be that the Charities SORP Committee should hold further discussions with the FRC on these issues to arrive at a practical solution.

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It is regrettable that revised Model Accounts to illustrate the operation of the SORP, which added comparatives to some of the notes which would be affected by the proposed rule change, were published in September 2016. This is regrettable because:

a) In principle this could be seen as a major change to the accounting requirements (it would certainly significantly increase the volume of charity accounts), but was issued with very little publicity and no consultation.
b) The amended Model Accounts did not apply the consequences of the proposed changes in full (for example the Arts Theatre Trust FRS 102 version accounts, amendments were made to notes 25 and 26 (although these could reasonably be regarded as "reconciliation" notes) but not to notes 8, 9 or 10 which, on the same argument, should also have been affected by the change.
c) The simplicity of these Model Accounts, masks the complexity of a full application of the proposed new rules.

It would be good idea to withdraw the September 2016 Model Accounts pending the resolution of these issues.

While the Model Accounts published on the SORP micro site are obviously authoritative, given that the guidance in the existing SORP, which was endorsed by the FRC, was well understood and that the issue of the September 2016 Model Accounts were not announced as a major change in the requirements, we do not believe that the proposed changes should be regarded as <u>already in place</u> as an interpretation of FRS 102. (There is some precedent for this in the original ICAEW Technical Release TECH 16/14BL (Revised) which is discussed in the Appendix, p7 of this guidance made clear that its interpretation of the existing requirements should only be applied from the date when former Charity Commission guidance giving an alternative view was withdrawn.) There is therefore an opportunity to present a more proportionate requirement in the Update Bulletin (see further detail in the Appendix), it would therefore be reasonable to regard this as a change in the underlying requirements which could have a future implementation date. This would require an amendment to proposed p18A in the Update Bulletin.

If it is not thought possible to include these changes with those for which the general implementation period of Update Bulletin 2 applies, we would suggest that the meaning of the words "effective immediately" in proposed p18A should be taken to apply from the publication of the final version of Update Bulletin 2. We would also urge the Charities SORP Committee to give an early indication of the likely outcome of the considerations raised above so as to give preparers time to implement the changes.

The FRC's ruling on the treatment of gift aid payments is unwelcome, but unlikely to be changed. In the Appendix we set out two main areas where we believe that the SORP could usefully include practical guidance. This guidance is required now in relation to accounts which are currently being finalised. We therefore urge the Charities SORP Committee to publish some provisional guidance in these areas as soon as possible.

We hope that you will find these comments helpful in the further development of Update Bulletin 2.

Yours faithfully

Michael Comeau

Michael Comeau
Technical Principal

DETAILED COMMENTS ON UPDATE BULLETIN 2

Our responses to the two consultation questions are set out below.

Question 1
Do you agreed with how the amendments to FRS 102 have been reflected in the proposed amendments to the Charities SORP (FRS 102) in draft Update Bulletin 2?
If not, which of the proposed changes do you not agree with, and why?

There are a number of different topics which are set up below. There is no specific question on the proposed changes which do not arise directly from the amendments made to FRS 102, so these have been included under this heading.

Comparative figures
As discussed in our covering letter, we are concerned that the proposed changes regarding the disclosure of comparative information will introduce unnecessary clutter into charity accounts, as well as potentially discouraging useful disclosures in some areas.

On balance, we agree that the proposed new paragraph p3.49 should be added to the SORP with the minor changes illustrated below:
FRS 102 requires that comparative information must be provided for all amounts presented in the current period's <u>*accounts*</u> *~~financial statements~~, which includes the notes. Therefore charities must provide comparative information for all amounts presented in the accounts and notes to the accounts unless otherwise stated in FRS 102* <u>*or*</u> *~~and~~ this SORP. This applies to both disclosures required by FRS 102 and those additionally required by this SORP.*

The change of the word "and" for "or" would enable the SORP to allow exemptions from presenting comparatives for disclosures that derive from its own requirements. Update Bulletin 2 would then need to add the relevant exemptions against the paragraphs which require the underlying analysis.

The change from "financial statements" to "accounts" is only for consistency. Although accounting standards favour the use of the term "financial statements" the simpler word "accounts", which derives from legislation, is often used in its place. Throughout the existing SORP the term "financial statements" is only used as an alternative to the term "accounts" which is used as the main term throughout (except in the FRC's endorsement statement). The SORP's glossary includes the definition "Financial statements is a term used in FRS 102 to describe the accounts". It may be that when a full revision is made to the SORP the term "financial statements" may be used throughout, but for the moment we would suggest that consistency is maintained.

A consequential change should also be made to p4.2 of the SORP which should be made more clearly consistent with the new paragraph as shown:
FRS 102 requires that comparative information must be provided for all amounts presented ~~in the SoFA~~. This SORP requires that the comparative information provided for the total funds of a charity must be presented on the face of the SoFA. Comparative information provided for the separate classes of funds, if any, held by a charity may be presented either on the face of the SoFA or prominently in the notes to the accounts.

In most accounts, comparative figures are presented beside the current year figures. The exemptions within FRS 102 may be seen as reflecting the difficulty of doing this for reconciliation notes which give a two dimensional analysis. The presentation in notes 25 and 26 of the revised Model Accounts give separate tables for the current and comparative amounts, one after the other. This makes the comparison between the years harder to make. We believe that in general it will be a clearer presentation of the comparative information to show comparatives against the <u>total</u> rows and columns of these two-dimensional displays, albeit that this would mean that the full matrix of information would not be given for the comparative year. In particular cases where the reader does require this additional analysis the prior accounts would normally be readily available, but we believe that such reference would rarely be required.

Although the Model Accounts which appear on the SORP micro site present quite simple accounts which do not necessarily cover all the issues involved, it is useful to use these as a starting point for a consideration of the further changes which we suggest should be made to Update Bulletin 2.

There are three main types of note to consider:

a) Notes which only analyse total funds into greater detail. An example of this is note 4 to the Arts Theatre Trust Model Accounts, although the same would apply to notes 5 and 7 except that in this particular example the amounts under these headings relate only to unrestricted funds. The analysis by category of the total funds is then supplemented by an analysis of the totals by fund for the current and comparative year by way of narrative note. Many charities currently give a fund by fund analysis of such information for each analysis line in a tabular form with comparatives given for the totals for each row and column. The strict application of new p3.49 would discourage charities from giving this additional analysis, which we do not think would be an improvement in the information given in charity accounts. The relevant notes largely relate to sources of charitable income and we believe that, while not made mandatory, the ability to give analysis of such information by fund is useful.

b) Notes which give a more detailed analysis of SOFA items. An example of this is note 8 to the Arts Theatre Trust Model Accounts. Similar issues arise with notes 9 and 10. Note 8 analyses the total charitable expenditure by type of expenditure for each charitable activity (i.e. these two factors form a two-dimensional display) with additional disclosures of the totals for each fund given for the current and comparative year in a narrative note. At present in the Model Accounts this note only gives an analysis of the comparatives by fund. Many charities give a similar basic analysis but add a total comparative column to analyse the comparative amounts by type and then add separate analysis by fund type under each column (representing charitable activity) for the current and comparative years (in effect giving a three dimensional analysis of the totals). We believe that this gives a clearer view of the comparative information then presenting a full analysis of the comparative information in a separate table.

c) Notes for which a full analysis has been given for each year. Examples of these are given in notes 25 and 26 of the Arts Theatre Trust Model Accounts. As noted in more general terms above, we believe that adding comparatives to the total rows and columns of these notes gives a clearer understanding of the comparative information. This particularly applies to the analyses given within note 25, the case is less clear in the case of note 26 and it may be that in this one case a separate note for each year could be accepted without greatly adding to the clutter in charity accounts.

In order to achieve these preferred layouts, the SORP could usefully be modified (initially via Update Bulletin 2) as follows:

The requirement to disclose the movements on material individual funds, which is the basis for note 25 in the Model Accounts is in the third bullet point of p2.29 of the SORP. This requirement is quite similar to the requirement to reconcile movements on fixed assets in p17.31 of FRS 102, for which comparative disclosures are not required. We would suggest the addition of a single sentence at the end of p2.29 of the SORP to say (see also reference to p4.67 below):
Details of the movements on material individual funds in the prior period need not be disclosed.

The requirements to disclose material components of income and expenditure in the notes derive from

a number of paragraphs in Section 4 of the SORP. Although there is no requirement to apply an additional fund analysis under these headings, many charities find it useful to apply such analysis to the income categories described in p4.42. We would suggest the addition of a single sentence at the end of p4.42 as:
Where analyses are given under any of the above headings by fund or by charitable activity, no analysis of equivalent information from the prior period need be disclosed.

Similar sentences could be added to the following paragraphs to achieve a similar effect:

p4.57
A comparative analysis is only required of the total expenses by type of expenditure and by charitable activity.

p4.58
A comparative analysis is only required of the totals under each heading of expenditure and of each charitable activity.

p4.67
This reconciliation need not be presented for prior periods.

Gift aid payment to parent charities
We share the view of many who work with charities that the FRC's ruling on the treatment of gift aid payments is a barrier to the presentation of a true and fair view in the subsidiary and parent charity's own accounts. Nonetheless, we recognise that the FRC's view cannot be changed in the short-term.

We also accept that for this change it is difficult to argue that the FRC's current view is a change from established principles. Although the focus of the ICAEW Technical Release 16/14 BL (Revised) was rather different from the way in which it is now being interpreted, the FRC is likely to argue that the current change should have been made in all accounting periods commencing on or after 1 April 2015, as stated in that Technical Release.

The changes proposed for Update Bulletin 2 are minimal. At the public discussion of the Update Bulletin hold at ICAEW on 2 March 2018, it was suggested that this is on the grounds that it is the charity's subsidiary, which is not itself a charity and therefore not subject to the SORP, which is most affected. In practice these issues do also affect the parent charity and it would be useful for the SORP to give guidance.

While there is guidance on this general issue in sections B29.10 - 15 of the "Basis for conclusion" section of FRS 102 (as reissued in March 2018), this gives little help to charities who wish to restore the position as previously understood by ensuring that the gift aid payment for the year is established as a "present legal obligation". We believe that it would greatly assist users of the SORP if guidance on this issue were to be given in the SORP.

The original version of what is now B29.13 of the "Basis for conclusion" section of FRS 102, which appeared in FRED 68 explicitly gave the existence of a deed of covenant as a way of establishing this liability. A further option would presumably be for the charity itself, normally being the sole member of the subsidiary, to approve the payment (which could be defined in terms of the available distributable profits of the subsidiary, rather than a specific sum) through a General Meeting or written resolution of the subsidiary before the end of the accounting period. It would be useful if the SORP could explain the issues involved in these two approaches.

A further area where additional guidance could usefully be given concerns how to reflect the change. The FRC is clear that the only changes in FRS 102 in this area concern the tax treatment and that the new understanding of the timing of the recognition of the gift aid payment reflects the position as already required by FRS 102. Therefore, the change cannot be seen as deriving from an amendment to an FRS (although the tax effect would complicate this conclusion). The change does not seem to fall within the description of a change in accounting policy, but rather would fit within the category of the correction of prior period errors. If this is the case, it does not seem fair that charities should be required to disclose these adjustments as the correction of an error when the treatment they had previously adopted was widely accepted in the sector. It may be that the solution is to describe this as an error made as a result of applying an accounting treatment "adopted by many charities before the FRC's most recent clarification of the issue". An agreed approach that can be adopted by all charities in this circumstance would be useful.

Charity accounts are currently being finalised which must reflect a conclusion on these issues, we would encourage the Charities SORP Committee (having discussed these issues with the FRC) to issue interim guidance as soon as possible, and in advance of the finalisation of Update Bulletin 2.

Reconciliation of net debt
New paragraphs 14.17A and 14.17B reflect the new requirements added to FRS 102, and we welcome the addition of an example table in the SORP.

However we have the following comments to make on Table 10A in the draft of the Update Bulletin:

a) There is a line headed "Current asset investments", but any amounts in this category which are properly included within the table would already be included under the heading "Cash equivalents". Was this heading intended to be "Derivatives relating to debt" which has been missed from the analysis?
b) The number of columns given in the example will be difficult for charities to easily include within their accounts and is overcomplicated. We would suggest combining the columns for:
   i) new finance leases
   ii) foreign exchange movements; and
   iii) other non-cash changes;

   into a single column under the "other non-cash changes" heading. This would not result in any loss of information as none of the rows affected have entries in more than one of these columns.

Other issues
We have no particular comment to make in relation to the other proposed changes, which implement the changes already made to FRS 102.

Question 2
Are there any other amendments to the Charities SORP (FRS 102) that you consider to be necessary based on the recent amendments to FRS 102?
If so, please state the amendment to FRS 102 and the relevant SORP paragraph(s).

We have no additional points to add.