CFG INSPIRING FINANCIAL LEADERSHIP

Charites SORP Update Bulletin 2 Consultation

Consultation response

April 2018

About Charity Finance Group

Charity Finance Group (CFG) was founded in 1987. It is the charity that works to improve the financial leadership of charities, promote best practice, inspire change and help organisations to make the most out of their money so they can deliver the biggest possible impact for beneficiaries. CFG has over 1450 members and our members manage over £21 billion in charitable income. Our members work at the heart of the strategic development of their organisations, and are at the forefront of delivering a sustainable and efficient charity sector. CFG's CEO, Caron Bradshaw, is currently a member of the SORP Committee, providing her expertise and insight.

CFG hosts a regular Technical Accounting Forum that brings together charity experts, auditors and charities to discuss the impact of accounting legislation – as well as other accounting policy and regulatory changes – on their organisations.

We also held a special meeting with members and the wider charity sector about this update on the 7th March 2018.

Our response is based on our understanding of the challenges facing charities and feedback from charities.

For more information on this response please contact Andrew O'Brien, Director of Policy and Engagement, on 02078715477 or andrew.o'brien@cfg.org.uk

Executive summary

Overall, we are comfortable with the way that changes that have been put forward in the proposed Update Bulletin 2. We recognise that these changes have been forced into effect through changes proposed by the Financial Reporting Council and that there relatively little scope for change. We do recognise the efforts that have been made to engage with charities and we hope that our efforts to connect the Charities SORP-making bodies with the sector have been useful.

Our analysis of the consultation and feedback from members indicate that the changes in this Update Bulletin will make the SORP much more burdensome for many charities.

A key area is the change in comparatives made in the Annual Report and Accounts which will create much more work for charity preparers. It also opens up larger questions about whether some disclosures are necessary. It is important that in building up to the next revision of the SORP, we take into account the burden of complexity that is being placed on charities. We are similarly concerned about the burden and complexity of intangible assets which have not been an area which the charity sector has much experience in accounting for.

We are also concerned that there is a lack of clarity in the Charities SORP about financial institutions and that this could create confusion for many charities. This must be urgently addressed given the impact that it could have on a large part of the charitable sector, namely charitable foundations.

All this could see charities spend less time effective narrative and building understanding of the work and financial position of the charity and having to invest more resource into just complying with the rules. This is not in the interests of charities or readers and undermines the stated purpose of the accounts.

We raised similar concerns in our response to the SORP research consultation in 2016. There is a consensus in the charity sector that the SORP has become too long and burdensome. More effort is being expended on understanding the rules and preparing compliant accounts than considering how they can do their job of effectively explaining and educating stakeholders on the work of the charity. Although we know that this change has not come from the SORP-making bodies or SORP Committee, we would urge both to consider how steps can be taken in future revisions to readjust the balance.

Comparative information

We understand that this change has been made necessary due to the position of the Financial Reporting Council that comparative information should always be provided unless otherwise stated in the SORP and FRS 102.

We would urge the SORP-making bodies and SORP Committee to reconsider whether this change is necessary as the changes to FRS 102 were in the context of reduced disclosure requirements for companies. Some respondents to the consultation have proposed that this change is qualified by reference to “disclosures required under FRS 102” which we believe would narrow the amount of information that would be provided. This is important given that previous rules stated that comparatives were not necessary if they were “impractical or involving undue cost or effort” this change, by its very nature, will create significant cost and effort for the charity sector. We are also not clear whether sufficient attention has been given by the Financial Reporting Council to the cost-benefit of introducing this change.

Although we have had not had evidence of specific challenges in relation to the calculation of comparatives, this will no doubt emerge as charities have to prepare this information. We believe that this should be kept under review and there may be need for further advice and support for charity preparers.

We believe that the SORP Committee should also consider ways to make this as simple to implement as possible. This could be through avoiding tabular analysis of totals and movements and limiting comparative figures to prior year totals.

Balance sheet – depreciating assets

We are concerned that the change in Update Bulletin 2 will create significant challenges for many charities which work with heritage or unique assets which may create confusion around whether they contain two or more components, and if so, how to identify individual components. Guidance and support will need to be given to charities so that they are able to implement this change effectively. We believe that there are similar challenges for the componentisation of investment property.

As a consequence, it is important that functional properties are excluded from this change in accounting for depreciating assets. Not only has functional property been traditionally separated from investment property or other assets in the SORP, but we are also concerned that if functional property is included, this will add to the complexity and challenge in implementing these proposals.

Events after the end of the reporting period

Overall we believe that the amendments are clear, but there is a need for further clarification and guidance from the FRC or the Charities SORP-making bodies about the implementation of the changes.

Previous revision to the SORP on the recognition of legacy income led to significant variations in advice from different audit firms. This created uncertainty for charities and made preparing accounts more challenging. We are concerned that without appropriate guidance, that adjustments on the basis that an estate is “no longer probable” could lead to similarly differing advice and confusion.

On the matter of Gift Aid payments, there is a similar need for guidance from the FRC about how an obligation has been created and how adjustments should be made if there have been any errors in the level of Gift Aid in the previous years’ accounts. We would welcome the opportunity to work with the FRC or Charities SORP-making bodies on providing this guidance and certainty to the charity sector following this change.

Investment property – balance sheet

We are supportive of the changes put forward in the Update Bulletin which will enable charities that have property investments to calculate them on either through its individual financial statements, on the basis of fair value through the SoFA or to measure them using the cost model.

Statement of cash flows – net debt

We are supportive of changes in the Update Bulletin in relation to reconciliation of net debt. We believe that the amendment is clear and Table 10A provides useful support for charity preparers.

Accounting for financial assets and financial liabilities

We are concerned about the impact of the extra disclosures being proposed for financial instruments which are “particularly significant”. The definition of financial institution for the purposes of the SORP could catch a wide variety of charities, including some foundations, whose “principal activity is to generate wealth or manage risk through financial instruments.” We are concerned that there is a lack of clarity in the Charities SORP about financial institutions and that this could create confusion for many charities. This must be urgently addressed.

As noted by the Association of Charitable Foundations, the definition of financial instruments will be challenging to implement and could deter organisations from using financial instruments put forward in the SORP.

The financial instruments defined in this change could capture a range of instruments such as repayable grants, social investments or mixed motive investments. There is a need for guidance to ensure that charities are not needlessly concerned about this change and those charities which are affected can understand how to comply with Section 33/34 FRS 102 in relation to the wider Charities SORP.

As with other parts of this update, we believe that the SORP Committee should keep under review the implementation of this section and ensure that there is appropriate support given to preparers.

We also believe that it may be worthwhile for SORP Committee to make representations to the FRC in the future about whether repayable grants, social investments or mixed motive investments may need to be explicitly removed from future changes to FRS 102, given the difficulty in many cases in evaluating their significance because many investments are unique and providing context or useful information can be challenging.

Heritage assets and social investments – fair value

We welcome the changes to the Update Bulletin on accounting for fair value in heritage assets and social investments as this will provide more flexibility to charities in preparing the accounts. We believe that the increased flexibility will increase the chances of information provided being useful for readers and giving a better perspective on the financial position of the charity.

Accounting for groups and the preparation of consolidated accounts

We welcome the change to allow for subsidiaries to be excluded from consolidation when they are not material for the purpose of giving a true or fair view of the charity’s financial position.

Intangible assets

We are concerned about changes to the way that intangible assets are stated in the proposed Update Bulletin. Although we appreciate that the changes in the Update Bulletin signpost to the relevant FRS 102 sections, we are concerned that many charities will not have experience in identifying and accounting for the assets. As in other sections outlined above, we are concerned that there will be significant variations in the advice given by auditors about when an item becomes an intangible asset.

Charities are increasing engaging in commercial partnerships which use intangible assets such as brand and reputation in order to generate income, we are concerned that there is a lack of sufficient detail in the proposed Update will not give charities confidence in identifying these assets and accounting for them. We believe that it may be useful for the Charities SORP-making bodies and SORP Committee to engage further with charity finance professionals and auditors about how clarity can be provided through the Charities SORP.