



**Research exercise on the Charities Statement of Recommended
Practice (SORP) FRS 102**

RESPONSE FROM ICAS TO CIPFA, THE CHARITY COMMISSION
AND OSCR

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Introduction

The ICAS Charities Committee welcomes the opportunity to comment on the research exercise on the Charities Statement of Recommended Practice (SORP) FRS 102.

Our CA qualification is internationally recognised and respected. We are a professional body for over 20,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public and charity sectors.

Our Charter requires ICAS committees to act primarily in the public interest and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Overall comments

We continue to believe that the Charities SORP is still required and we continue to support the modular approach to the SORP.

We are also supportive of further work being undertaken on the development of a three-tiered approach to the application of new UK GAAP by charities. Charities implementing FRS 102 for periods commencing on or after 1 January 2015 have indicated that the length of their accounts has increased considerably without delivering a corresponding increase in value to users. Making concessions available to charities below the company law definition of a small entity could address this concern. Alongside the development of a two or even three-tiered approach to the Charities SORP (FRS 102), work would need to be undertaken in co-operation with the Financial Reporting Council (FRC) and relevant part of government to ensure that each element of the accounting framework for charities in each charity law jurisdiction of the UK is cohesive. The accounting framework for charities comprises: the Charities SORP; accounting standards; and legal requirements and we believe work is still required to ensure that the exiting framework is cohesive.

In our response to the consultation questions we highlight a number of issues which need to be resolved in relation to the drafting for the Charities SORP (FRS 102). Given the importance of ensuring that the requirements of the SORP are clear and the possibility of introducing different tiers, we would caution against making any further major changes to the next edition of the Charities SORP (FRS 102) which is anticipated for periods commencing on or after 1 January 2019.

We would also ask that OSCR and the Charity Commission make an explicit statement about the application of Section 1A of FRS 102 by charities. We believe that it is not possible for charities to take advantage of the concessions available in Section 1A. However, the legal position is currently unclear.

We set out our detailed comments on the consultation questions in Appendix A and in Appendix B we include our comments to the FRC on charity accounts and FRS 102 which were included in the FRC's request for feedback. Our comments to the FRC, set out a number of anomalies in the accounting framework for charities which need to be resolved.

Any enquiries should be addressed to Christine Scott, Assistant Director, Charities and Pensions, at cscott@icas.com.

Specific comments on the consultation questions

Question 1. Do you agree that the new format of the SORP meets the needs of all those preparing accounts using the SORP, including smaller charities? If not, what improvements should be made and why?

Response. We support the conclusions from the SORP Research exercise conducted in 2008-09 that: the Charities SORP should be retained; that it should be written in an accessible style for smaller charities; and that additional reporting requirements applicable to larger charities should be separately identified. We also support the modular approach taken to the Charities SORP (FRS 102).

Question 2. Is more assistance required to help smaller charities? If so, please explain what is needed and why.

Response. We do not believe that additional application material is needed specifically for smaller charities within the Charities SORP (FRS 102). However, we believe it is appropriate to consider making further concessions available to smaller charities. We comment on this further in our response to question 6.

Question 3. Is the use of the terms 'must', 'should' and 'may' successful in distinguishing between those requirements that have to be followed to comply with the relevant accounting standard and the SORP from those recommendations which are good practice and those that simply offer advice on how a particular disclosure or other requirement might be met? If not, what alternative format should be adopted and why?

Response. We broadly support the drafting convention of 'must', 'should' and 'may'. However, it is essential that charities and their professional advisers can clearly distinguish the requirements of FRS 102 and the SORP from other material. This means that the drafting convention should be strictly applied to each SORP module. There are examples throughout the SORP where this is not the case.

A specific example of this is paragraph 5.47 on income generation which states that "...the amount receivable should be discounted by the time value of money at a rate of interest that reflects the financing transaction involved." This should probably be worded as follows "...the amount receivable must be discounted by the time value of money at a rate of interest that reflects the financing transaction involved except where.....normal credit terms are offered etc." In this paragraph the word 'should' seems a more natural form of expression than 'must' so extra care needs to be taken when applying the drafting convention to use 'must' appropriately.

There are also instances where 'should' should arguably be a 'must' and where its use appears to be a straightforward error as opposed to being just a more natural form of expression. A specific example of this is paragraph 5.7 on income recognition where 'should' is used in the midst of a paragraph which is dealing entirely with requirements. 'Should' is used to link the introductory sentences with more specific bullets containing requirements.

We recommend that the Charities SORP (FRS 102) is reviewed to check that 'must' and 'should' are used as intended and changes are made to the wording where this is not the case. In addition to making the requirements clearer, this approach may also reduce the length of the SORP. Given that 'should' is a commonly used auxiliary verb, it may be challenging to draft parts of the SORP so that 'should' is only used to denote good practice.

Another drafting convention issue arises in paragraph 5.57 on income recognition which states that "This SORP requires that headings used to analyse income in the SoFA must follow those required by the SORP module 'Statement of financial activities'. The use of 'requires' is just another way of denoting a 'must'. This paragraph could just as easily state "Headings used to analyse income in the SoFA must follow the headings specified by the SORP module 'Statement of Financial Activities.'" We understand that this convention distinguishes between a SORP requirement and a FRS 102 requirement but it may be worth considering drafting convention changes which would reduce the length of the SORP without detriment to its content.

Question 4. Given the requirements for financial reporting that are now explained in FRS 102, is the retention of a SORP still necessary in the charity sector? Please give reasons for your answer.

Response. We support the retention of a Statement of Recommended Practice for Charities. This is valued by charities and their advisors alike, including the module on the preparation of the trustees' annual report. This module is often used by charity staff and advisers to prompt the trustees to give a proper account of their charity's activities.

Question 5. Do you have any suggestions as to the changes needed to address issues on implementation or in meeting the SORPs requirements? If so, please explain what are they are and where possible please give examples.

In addition to our response to question 3, we set out other drafting/ implementation issues which have come to light:

Statement of cash flow requirements

The difficulty with the statement of cash flow requirement has been largely resolved. There was a great deal of uncertainty around whether or not some charities applying FRS 102 for the first time were exempt from this requirement. Update Bulletin 1 was intended to give clarity on this matter but it did not provide explicit information on the position in each charity law jurisdiction. OSCR provided clarification at a later date that the statement of cash flow exemption was not available to Scottish charities until periods commencing on or after 1 January 2016. The lack of initial clarity was a cause for concern and charities did spend additional time that should not have been necessary to arrive at an answer. It would therefore be helpful if future Update Bulletin's provide jurisdiction specific guidance.

Part of the confusion over the application of the exemption arose due to drafting within SORP (FRS 102). Paragraph 26 of the SORP, under the heading 'How to use the modular SORP', states that all charities applying the SORP must prepare a statement of cash flows. However, some poor drafting in module 14 on the statement of cash flows did suggest that exemptions were permitted in certain circumstances. However, these circumstances were not made clear. We recommend that module 14 is revised to make it clear any circumstances where an exemption is available.

Mixed groups

As a general point there are differences between FRS 102 and the Charities SORP (FRS 102) which we are aware has caused challenges for the trustees of charities that head mixed groups. This highlights that it is important that the Charities SORP (FRS 102) follows the recognition and measurement requirements of FRS 102 unless there is a clearly justifiable sector specific reason for a departure. With the first major review of FRS 102 currently underway this is an important issue to bear in mind.

Transactions with related parties

Paragraph 9.18 deals with transactions with trustees which do not need to be disclosed. However, the last sentence of the first bullet states that "... charities must provide an aggregate disclosure of the total amount of donations received without conditions." We recommend that as a minimum the requirement to make this disclosure is not included in a paragraph on transactions which do not need to be disclosed.

We also question whether it is really necessary for this disclosure to be made and whether this really strikes the correct balance between transparency and the privacy of trustees. We are aware that some churches have found it challenging to provide accurate information on donations from trustees where cash donations are collected.

Question 6. Do you agree that there needs to be a third tier of reporting by only the largest charities and if so at what level of income should that reporting requirement apply?

Response. For periods commencing on or after 1 January 2016, we believe that the withdrawal of the Financial Reporting Standard for Smaller Entities (FRSSE) and the concurrent withdrawal of the Charities SORP (FRSSE) alongside the application of FRS 102 and the Charities SORP (FRS 102) by all charities preparing true and fair accounts will mean that the majority of charities will be complying with requirements which are unnecessarily onerous. There is anecdotal evidence that the accounts of charities applying FRS 102 for the first time are now excessively long with some of the additional disclosures not viewed as providing value to users.

There is also an absence of clarity around whether or not Section 1A of FRS 102 can be applied by charities and there are flaws in the accounting framework which mean that it does not seem possible to claim that a charity's accounts give a true and fair view unless they follow full FRS 102. We set out in Appendix B to this response the concerns we have shared with the FRC about the accounting framework for UK charities.

We agree therefore that there could be three levels of reporting for charities preparing true and fair accounts. Broadly speaking, we support consideration being given to the following three levels of reporting:

- Charities above the company law definition of a small entity should apply full FRS 102.
- Charities with a gross income above £500,000 (the threshold for existing concessions within the SORP) and below the company law definition of a small entity, should broadly follow the recognition and measurement requirements of full FRS 102 but with additional disclosure concessions.
- Charities with a gross income of £500,000 or less should continue to receive the concessions currently available within the SORP plus the additional disclosure concessions available in the new middle tier.

The introduction of a three-tier approach would require extensive consultation with the sector and their advisers and should cover:

- Consideration of how the tiers should be determined.
- Consideration of the disclosure concessions to be made available to the middle and lower tiers, for example, in relation to financial instruments and executive pay.
- Consideration of any further narrative or presentation concession to be made available to the middle or lower tiers, for example, in relation to prior year comparatives.
- In terms of presentation, we would specifically request that the statement of cash flow requirement is revisited for the higher and middle tiers. There is a question mark over how meaningful a statement of cash flows is for a charity without a requirement to distinguish between different categories of reserve.
- Consideration of whether the recognition and measurement requirements of the micro-entity regime are suitable for the charities which would be caught by tier three.
- A review of the charity accounting framework to ensure it is compatible with the introduction of a three-tiered approach. This would require the support of the FRC and a number of areas of government.

Question 7. If you agree that there should be a third tier of largest charities, what items in the existing SORP that apply to larger charities should be restricted to just these largest charities?

Response. We envisage that the largest charities would comply in full with FRS 102 and the Charities SORP (FRS 102).

Question 8. Do you agree with one or more of the four suggested areas for review of the trustees' annual report recommended by the SORP Committee? If so, which ones do you support and if you do not support any of these suggestions, please give your reasons as to why not?

Response. We believe that the issues which we have raised already in relation to the drafting of the SORP and the potential to have three tiers of reporting mean that we would not be looking for further changes to be made to the trustees' annual report requirements at this point in time. This does not mean we do not think the ideas have merit and should not be revisited in future.

Question 9. Do you agree with either of the two suggested areas for the review of the accounts recommended by the SORP Committee? If so, which ones do you support and if you do not support any of these suggestions, please give your reasons as to why not?

Response. We do not believe that there should be any additional developments over and above those we mention elsewhere in our response in the interests of giving charities as much stability as possible.

Question 10. Do you agree with one or more of the six themes for review of the SORP suggested by the charity regulators? If so, which themes do you support, and if you do not support any of these suggested themes, please give your reasons as to why not?

Response. We would support the inclusion of executive pay disclosures as part of any future consultation on the introduction of a three-tiered approach to reporting by charities.

Question 11. If you do support one or more of the suggested themes, which, if any, of the specific issues identified within each theme do you agree needs attention in the next SORP? Alternatively, if you support none of these suggested issues, please identify the issues that need to be addressed and explain your reasons why?

Response. We have no additional themes to suggest.

Question 12. Are there any items in the report or accounts which could be removed. If so, what are they and what are your reasons for removing them?

Response. We have no further specific suggestions for any items to be removed.

Question 13. Are there any items in the report or accounts which could be changed to improve the information provided to the user? If so, which items would you change, what would the change be, and how would it improve the information to users of the report and accounts?

Response. We have no additional changes to mention at this time other than those referred to elsewhere in our response.

Question 14. Are there any items you would like to add in to the report or accounts? If so, what are these items and how would their inclusion help the user of the report and accounts?

Response. We have no items we would like to see added to the report or the accounts.

Question 15. Are there any disclosures in the notes to the accounts that you believe can simply be removed altogether? If so please state the disclosure, the relevant SORP paragraph(s) and give your reasons as to why this disclosure is not useful to the user of the report and accounts?

Response. We have no additional suggestions on the removal of specific disclosures which have not been raised elsewhere in our response. Any consultation on the introduction of a three-tiered approach would involve a comprehensive review of disclosure requirements.

ICAS response to FRC request for feedback on FRS 102 (extract)

Specific comments on charity accounts and FRS 102

The accounting framework for charities is particularly complex, for example, there are three charity law jurisdictions in the UK and charitable companies must comply with company law and with charity law, in certain circumstances. While the requirements under the various bodies of charity law and company law are broadly similar, there are sufficient differences to cause a high degree of complexity.

The implementation of FRS 102 and the subsequent introduction of Section 1A have both created challenges for charities. These challenges highlight the need for the FRC to be mindful of how changes to accounting standards impact on entities which are not companies or which may be companies but which also have to comply with other legislation in relation to their accounts. It is therefore vital that the FRC engages with a wider range of stakeholders in government and not just BIS (now succeeded by BEIS) when major changes to UK GAAP are made to ensure that the law is updated as necessary.

There are outstanding challenges for charities which do require to be resolved to provide greater certainty as to the requirements:

- In England and Wales, non-company charities preparing 'true and fair' accounts and parent company charities preparing **group accounts** are required to prepare their accounts in accordance with the Charities (Accounts and Reports) Regulations 2008. [N.B. In England and Wales, the individual accounts of charitable companies must be prepared in accordance with the Companies Act 2006 only and the 2008 Regulations do not apply]. The 2008 Regulations require accounts to be prepared in accordance with the Charities SORP 2005 which is based on old UK GAAP. This places charities applying the 2008 Regulations in the awkward position of not being able to comply with the law and the most up to date accounting requirements. The position is even more awkward for charitable companies preparing **group accounts** where compliance with charity law means non-compliance with company law. This is an undesirable situation for charity finance staff, trustees, independent examiners and auditors. While the FRC is not responsible for the 2008 Regulations, it should take a similar approach to liaising with the relevant government department as it did with BIS over the implementation of new UK GAAP. Responsibility for charities has recently moved from the Cabinet Office to DCMS and we would urge the FRC to seek an amendment to the 2008 Regulations as soon as possible.
- Section 1A of FRS 102 has been introduced to bring accounting requirements placed on companies into line with the new EU Accounting Directive. Although the Accounting Directive doesn't apply to non-companies or to not-for-profit companies, it has been implemented within UK accounting standards as though it does. While on the surface this make sense, there are practical difficulties with this:
 - Charitable companies across the UK comply with the Charities SORP either as the most appropriate means of complying with the requirements of company law or because they are required to by charity law. However, Section 1A makes presentation and disclosure concessions available to companies and there is no mechanism through which UK accounting standards can impose additional requirements on companies which are otherwise eligible to apply Section 1A. This places UK accounting standards directly at odds with the normal practice and legal requirements for charitable companies to apply the Charities SORP. This could have been avoided by scoping not-for-profit companies out of Section 1A and this is perhaps something the FRC, in conjunction with BIES, may need to consider in order to provide clarity. In practice, the overriding requirement for the accounts to give a 'true and fair' view would seem to point charitable companies towards compliance with full FRS 102.
 - Non-company charities preparing 'true and fair' accounts appear to be able to apply Section 1A, although this is not entirely clear from any of the new FRSS which form the new UK GAAP. However, it is unlikely that compliance with Section 1A can also achieve compliance with the Charities SORP (FRS 102) or result in accounts which give a 'true and fair' view. It is legitimate for the Charities SORP-making body (OSCR and the Charity Commission for England and Wales), through the Charities SORP, to impose additional requirements on non-company charities as there is no legal barrier to doing so. However, new UK GAAP should include an explicit statement that non-company charities cannot apply Section 1A of FRS 102. This should reinforce charity law requirements that non-company charities must comply with the Charities SORP.

In summary, ICAS takes the view that charities preparing 'true and fair' accounts must comply with the Charities SORP in order to do so and therefore cannot apply Section 1A. However, we believe there is scope for a category of 'super large' charity to be introduced through the Charities SORP. Such charities would be required to comply in full with the disclosure requirements of FRS 102.

The 'super large' category could be defined, for example, as any charity which exceeds the company law size criteria for a small entity. For charities which are not 'super large', which are the vast majority, the Charities SORP making-body could then consider what disclosure requirements would be appropriate. We envisage such disclosures would lie somewhere between the concessions available in Section 1A and full FRS 102. The level of disclosures required would need to balance transparency with proportionality. We believe that FRS 102 has led to charities having to make disclosures which are disproportionate and, following the withdrawal of the FRSSSE, for accounting periods commencing on or after 1 January 2016, more charities will be in the position of having to make disclosures, which in our view, are excessive.