

SORP Committee

Minutes of the SORP Committee Meeting of April 12 2007 (Approved at the October 19 2007 SORP Committee Meeting)

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Present:

Andrew Hind, Chair of the SORP Committee
Kirsty Gray, Deputy Chair of the SORP Committee
Debra Allcock Tyler
Tidi Diyan
Pesh Framjee
Peter Gotham
John Graham
Chris Harris
Noel Hyndman
Ray Jones
Tristan Lumley
Claire Newton
Carol Rudge
Catriona Scrimgeour
Paul Spokes

In attendance:

Nigel Davies, Secretary to the SORP Committee
Alan O'Connor, Accounting Standards Board

Apologies:

Keith Hickey
Kate Sayer

Item 1: Chairman's opening remarks and matters arising

1.1 The Chair opened the meeting by welcoming Tristan Lumley. The Chair noted that input of Tristan Lumley and Debra Allcock Tyler will be of particular value in helping to ensure the development of an accessible and user-friendly SORP.

Item 2: Approval of the minutes and matters arising

2.1 The minutes (paper 1) of the meeting of the 17 January 2007 were considered and approved with one change to minute 3.2 to note that the ASB had introduced a collection by collection approach to the valuation of heritage assets in FRED 40.

2.2 There were no matters arising not covered by the agenda.

Item 3: Second Paper ‘Update on heritage assets’

3.1 The Chair introduced the paper providing feedback on the roundtable event on accounting for heritage assets held in London on 30 March, chaired by the Commission, and informed the meeting that a verbal update of the event held in Edinburgh, chaired by the Office of the Scottish Charity Regulator (OSCR) would also be provided.

3.2 Ray Jones advised that Alan O’Connor of the Accounting Standards Board (ASB) had opened the session giving a presentation on the background and proposals contained in the ASB’s Financial Reporting Exposure Draft 40 - Accounting for Heritage Assets (FRED 40). Ray Jones then provided a summary of the SORP Committee’s initial concerns. David Watkins of HM Treasury concluded the presentations by outlining a HM Treasury funded project being undertaken by the Royal Chartered Institute of Surveyors and Kingston University that would look at methodologies for valuing heritage assets. The workshop, attended by 33 delegates, including members of the SORP Committee, then considered six questions related to FRED 40.

3.3 The Committee, in considering the feedback set out in paper 2, noted that faith charities were perhaps anticipating that their exclusion from the heritage asset definition may enable them to continue not to recognise structures and artefacts used for worship. However, Financial Reporting Standard 15, Tangible Fixed Assets, would not necessarily allow a non-recognition approach and any revision of accounting standards resulting from FRED 40 would also necessitate the SORP committee considering existing accounting recommendations for such assets.

3.4 The outcome of the London roundtable event was considerable unanimity. All participants agreed that:

- the valuation of heritage assets should be considered at the level of the total holding and not collection by collection;
- a definition of a collection would prove to be subjective and open to manipulation;
- valuation of heritage assets itself was unlikely to improve stewardship;
- assets used operationally could not be heritage assets; and
- the narrative disclosures were of primary importance.

3.5 The Deputy Chair provided a verbal report on the roundtable convened by OSCR in Edinburgh on 4 April. Delegates included faith groups, museums, universities, Audit Scotland and the Institute of Chartered Accountants Scotland. The format of the event followed that of the London event with both the ASB and OSCR making presentations. Only one delegate agreed that the collection by collection approach to valuation was practical. The delegates also struggled to understand what valuation would actually mean and how it would help users to better understand the nature of heritage assets held. The collection by collection approach to valuation was

seen as open to manipulation and there were concerns that this approach would lead to inconsistency. The main value of FRED 40 lay in its enhanced disclosures contained in the notes to the accounts. The Church representatives favoured non-valuation and the existing approach of SORP.

3.6 The Committee then actively debated the conclusions of the paper and reflected upon the outcome of the two events. It was noted that the FRED 40 definition of heritage assets would include wetlands, bird sanctuaries, and even some zoos which may have been valued at cost under FRS15 and that these charities would now be faced with the cost of periodic valuations. However, the existing SORP's approach to the recognition of heritage assets, based on the date of acquisition was generally considered unsatisfactory.

3.7 Transparency was seen as the primary objective and the notes to the accounts would play a particularly important role in delivering this objective, whether or not heritage assets were valued in the balance sheet. The general consensus of the Committee was that FRED40 could, as currently drafted create a number of potential problems and that further consideration by the ASB was desirable.

Item 4: Response to the ASB consultation on FRED 40

4.1 The Committee considered the draft response to the ASB's heritage asset consultation (paper 2.1) and the appendix response to specific questions raised by that consultation (paper 2.2).

4.2. In the ensuing discussion, Committee members considered a number of issues that flowed from the valuation of heritage assets:

- the effect of balance sheet recognition on funding;
- the extent to which valuation policies in relation to heritage assets will affect the Pension Protection Fund levy for those charities with defined benefit pension schemes;
- even though heritage assets may not provide a positive income stream, they were acquired (or accepted as donations) by charities because of their service potential in relation to a charity's objectives or their value in use. Other benefits may also be derived, for example, attracting membership;
- the recognition of heritage assets at current value would create a further valuation basis but this was not seen as a particular issue. Balance sheets already contain assets recognised on different bases – some at historic cost and other at market value (eg investment properties) and often heritage assets are not valued. Overall, FRED 40 was seen as a better solution than capitalisation based on the date of acquisition; and
- periodic valuations will give rise to fluctuations in values depending upon market conditions and fashion but in principle the valuation of assets, where practicable, is the right approach.

4.3 In concluding the discussion, the Committee agreed that the response to FRED 40 should emphasise the importance of transparency.

4.4 **The Committee agreed:**

- **To amend the draft letter to note:**
 - **the wider impact of FRED 40 on the sector;**
 - **a flexible approach to the frequency of valuations also creates uncertainty;**
 - **disclosures in the notes are key to transparency and are likely to be of most benefit to users of the accounts.**
- **The revised letter to be circulated for e-mail for information, with the Chair and Deputy Chair to approve the final letter for release.**
- **The consultation response, contained in the appendix to the letter, was considered sufficient and reflected the roundtable events and was approved for submission to the ASB.**

Item 5: Third Paper ‘IFRSs for Small & Medium sized entities and SORP’

5.1 The Chair noted that the January meeting had considered a paper on the impact of convergence between UK Generally Accepted Accounting Practice (UK GAAP) and International Financial Reporting Standards (IFRSs) and the development of an IFRS for small and medium enterprises by the International Accounting Standards Board (IASB). The Committee had also considered a draft letter which sought to highlight the impact of convergence on the not-for-profit sector.

5.2 Reflecting the outcome of the January meeting, a revised letter was now considered. It was noted that the effect of the ASB convergence agenda is that for-profit IFRSs will apply to charities, unless these are interpreted either in alternative international standards designed for the not-for-profit sector or by the Charities SORP. Aside from consideration of the conceptual framework and not-for-profit entities, the IASB were not actively considering the not-for-profit sector in standard setting at all.

5.3 A view was expressed that the charity sector should seek to influence global accounting standards for not-for-profit entities at an early stage. However, it was agreed that the development of global accounting standards was not within the SORP Committee’s remit.

5.4 The Committee concluded that:

- **The revised letter, now addressed to the ASB, should be issued.**
- **Although outside the remit of the SORP Committee, volunteers who wished to work proactively to influence or encourage the development of a set of international accounting standards for not-for-profit entities could contact Chris Harris who is interested in exploring the possibilities for taking this issue forward.**

Item 6: Fourth Paper ‘Updating SORP 2005 for changes in law’

6.1 The Chair introduced the paper and indicated that the preamble still presumes too much of the reader in terms of technical awareness. Also, the update paper contained a number of small typographical errors. The Chair asked Debra and Tristan to convene a sub-group to help make the preamble more accessible to small charities and non-financial readers. Tidi and Paul also volunteered to assist this sub-group in its drafting work.

6.2 **The Committee concluded that:**

- **The preamble is still too technical in its style. A sub-group will review the text and suggest further changes to simplify the language used and redesign the structure of this section. The revised preamble should then be re-circulated to the Committee for approval.**
- **The changes in law identified were noted. These changes were agreed and will now be reviewed by the Commission’s legal team and OSCR.**
- **The preamble and update to be copied to the Chair of the ASB Committee for Public-Benefit Entities for information. The preamble and update will then be incorporated in a reprint of SORP 2005.**

Item 7 Fifth Paper ‘Draft Information Sheet’

7.1 At the January meeting, the content of the Information Sheet was approved except for the text relating to the SoFA treatment of grant income. It was agreed that two alternatives should be presented to the Committee for further consideration. The first option uses performance conditions to differentiate between income recognised as voluntary and income being derived from charitable activities. The second option is based on a broader interpretation that includes grants that fund the provision of services as being derived from charitable activities. The text for the two options was set out in paper 5 for consideration.

7.2 Prior to reviewing the options, a recap was given of the January meeting which had focussed on the distinction between voluntary income and income from activities from charitable activities and the link between restricted and unrestricted funds, and how a performance condition attaching to a grant might be the distinguishing feature between voluntary income and income from charitable activities.

7.3 The two options presented were discussed and third option of not providing additional guidance was also considered. Option 2 found favour as it offered a broader and more flexible commentary on the SORP that reflected actual sector practice. After a very full consideration of sector practice and the text, it was agreed that option 1 also offered some useful guidance on definitions which could be built into the text of option 2 as the basis for the Information Sheet.

7.4 **The Committee concluded that:**

- **The draft Information Sheet be further amended for the treatment of grant income based around option 2.**
- **The draft Information Sheet SORP will be re-circulated to the Committee for final comment before being sent to the Chair of the ASB Committee for Public-Benefit Entities for information. It is intended to include the Information Sheet as an annex when SORP 2005 is reprinted.**

Item 8 ‘Accounting for Financial Instruments’

8.1 Carol Rudge advised the Committee that the ICAEW Charities Technical Sub-Committee were actively considering whether the covenanting of profits could be regarded as an obligation that should be accounted for as a financial instrument. Whilst the focus of a forthcoming Grant Thornton UK LLP paper was on the issues surrounding covenants, it was noted that the effect of Financial Reporting Standards 25 and 26 may be much broader. A paper should be prepared drawing upon the work undertaken by the ICAEW Charities Technical Sub-Committee but also looking at other issues that may arise from the application of these standards.

8.2 **The Committee concluded that:**

- **The SORP Secretariat should convene a sub group to review the impact of FRS25 and FRS26 on charities and prepare a paper for further consideration by the Committee.**

Item 9: Any other business and date of next meeting.

9.1 The Chair invited the Committee to raise any other business.

9.2 The issue of funders requiring charities to adopted particular accounting treatments for funds provide, for example, requiring contract income to be disclosed as restricted funds, was raised. After some discussion it was agreed that this was not an issue for the SORP Committee but was primarily a matter concerning the negotiation of contract terms between charities and funders.

9.3 It was noted that with HM Treasury updating the Financial Reporting Manual (FReM) for Government, some non-departmental public bodies which are charities may have to adapt their accounts for the IFRS compliant FReM.

9.4 **The date of the next meeting to be confirmed. The date of the meeting was subsequently confirmed as 19 October 2007.**