

SORP Committee

Minutes of the SORP Committee Meeting of 14 March 2012 (Approved at the May 2012 SORP Committee Meeting)

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Present:

Laura Anderson, Joint Chair of the SORP Committee
Sam Younger, Joint Chair of the SORP Committee
Debra Allcock-Tyler
Tidi Diyan
Peter Gotham
Pesh Framjee
Noel Hyndman
Ray Jones
Carol Rudge
Kate Sayer

In attendance:

Nigel Davies, Secretary to the SORP Committee
Caron Bradshaw, Charity Finance Directors' Group (observer member)
Joanna Spencer, Accounting Standards Board (observer member)

Apologies:

John Graham
Keith Hickey
Tris Lumley
Jennifer McMahon (observer member)
Lynne Robb
Catriona Scrimgeour
Paul Spokes

Item 1: Opening remarks and declarations of interest

1.1 Laura Anderson opened the meeting and invited any declarations of interest to be declared. No declarations of interest were noted.

Item 2: Approval of the minutes and matters arising

2.1 The minutes of the meeting of the 8 December 2011 were considered and three typographical errors were identified for correction:

- Last sentence of minute 3.2 the duplicate reference to 2012 should be removed.
- First sentence of minute 4.3 the word 'accounting' to be inserted so that the reference is to the Committee for Accounting for Public benefit Entities.
- Second bullet point of minute 5.5 the word 'context' should be substituted for the word 'contest'.

2.2 The amended minutes were approved.

2.3 Nigel Davies advised that the submission to the Financial Reporting Council on the future of the Accounting Standards Board (ASB) was included with the Committee papers.

Item 3: Consultation on the Financial Reporting Standard and draft response

3.1 Ray Jones introduced this item. He noted that Paper 2 gave an overview of the proposed new accounting framework. The ASB proposals contained a new suite of standards - FRS 100 (Application of Financial Reporting Requirements), FRS 101 (Reduced Disclosure Framework) and FRS 102 (the Financial Reporting Standard) together with the FRSSE (Financial Reporting Standard for Smaller Entities) - which would form UK-Irish Generally Accepted Accounting Practice (GAAP).

3.2 There were a number of important developments in the proposals:

- The three tiered approach based on public accountability was dropped. Full International Financial Reporting Standards (IFRS) would not be extended to those entities not currently required to use them.
- FRS 100 provided for the SORPs to specify if and how the FRSSE can be followed.
- A single standard FRS 102 now combined the public benefit entity (PBE) specific treatments with the general accounting framework. The earlier proposal for a Financial Reporting Standard for Public Benefit Entities (FRSPBE) had been dropped.

3.3 There were also developments in company accounting that could affect the FRSSE. A proposed European Union (EU) Accounting Directive for small companies promises to cut down radically the information provided in the notes to the financial statements (accounts). Member States would also have the option of more radical simplification of the accounts required of micro entities. The timing of when these proposals might come into effect was unclear but it may be as early as 2014.

3.4 It was anticipated that the Accounting Directive would apply to for-profit companies and so impact on the requirements of the FRSSE. However, the Accounting Directive would not necessarily be mandatory for not-for-profit companies including PBEs. If this was the case then the SORP could still require additional information to be provided where this was in the public interest. In discussion, it was agreed that public confidence and donor and user information needs may justify certain additional disclosures by charities.

3.5 Ray Jones introduced Paper 2.1 that set out the SORP Secretariat's view as to those key issues from the SORP making body's submission to the ASB's previous proposals in 2011 which had not been reflected in the draft FRS 102. He also drew the Committee's attention to Paper 2.2 that reviewed point by point the earlier submission and how far those points had been accepted by the ASB and reflected in the revised consultation proposals.

3.6 The Committee's discussion was then focussed on the draft letter to the ASB (Paper 2.3) and annex to the letter (Paper 2.4) which addressed each of the ASB's consultation questions. On reflection, the past practice of a simple submission of a letter might not be the most helpful approach and he wondered if the Committee would agree that it would be more constructive to share specific drafting points informally with the ASB before making the formal submission.

3.7 In considering the proposed response the Committee noted that certain issues were more critical than others. The danger of a lengthy response is that the critical issues will get lost in the detail. At this late stage, the ASB may be seeking to settle the new GAAP quickly and be reluctant to consider a long list of drafting points some of which are 'nice to haves' rather than essential changes.

3.8 The Committee were concerned that without significant amendment, the effect of the ASB's proposals for grant income recognition rather than preserving the current practice across the PBE SORPs would instead fundamentally change accounting practice for charities in favour of a form of matching. The effect would be to mandate a form of cash accounting for grants.

3.9 The issue about whether a grant or gift might become repayable was a separate matter assessed subsequent to the initial recognition of the income. The presence or absence of a repayment clause or term was not relevant to either the initial income or expenditure recognition of grants and gifts. Trust law is clear that a restriction is to do with the purpose for which a grant or gift is given. Restricted funds are those funds received on specific trusts that are narrower than the overall charitable trusts of the recipient charity.

3.10 It was noted that in the registered social housing sector (RSLs) the practice was to defer income from government grants in the balance sheet and only recognise that income when housing assets are acquired or constructed with the income netted off against the asset. The effect was a form of reserve accounting as the income was not shown in the performance statement. The grant income was repayable if it was not applied for that purpose. Rather than mandating this approach to all PBEs the Committee considered that this specific issue for RSLs was dealt with in their SORP.

3.11 By their nature grants are non-exchange transactions which are not contractual and so not enforceable under contract law. The PBE specific guidance in section 34 on recognising grant commitments was not fully consistent with the general guidance given in section 21 on recognising provisions. The three recognition criteria of: obligation, probable transfer of economic benefits and reliable estimation given in section 21 accorded with current accounting practice in the sector.

- 3.12 The critical issues that need addressing that were agreed in discussion were:
- The definition of a restriction should be limited to purpose.
 - The definition of a performance condition should follow the existing sector practice in SORP 2005 and the ASB's Interpretation of the Statement of Principles for Public Benefit Entities and be linked to specified level of services or other similar performance criteria rather than the presence of a repayment clause or term.
 - The reference to repayment clause and reference to a term that states that a grant offer is reliant on future income elevates legal form over substance and is contrary to the concepts and pervasive principles set out in FRS 102 and existing sector practice.

3.13 Turning to the draft annex to the letter (paper 2.4), The Committee considered the response to the ASB's specific consultation questions prepared by the SORP Secretariat. The Committee observed that:

- The second bullet point in the response to question 1 was not required.
- The response to question 3 should simply note that we have no comment.
- The response to question 4 is that we have no comment.
- The response to question 5 simply note that we have no comment on the ASB's specific points and cross refer to the letter setting out the critical changes that need to be made to FRS 102.
- The response to question 8 should more prominently flag the implications of the new EU Accounting Directive and the importance of aligning the effective date of the new FRSSE with the effective date for FRS 102.
- The response to question 9 be amended to support the recommendation of the 'alternative view' that pension disclosures are simplified.

- 3.14 **The Committee, in advising the SORP making body, recommended that:**
- **The response note that ideally changes to the FRSSE would take effect at the same time as the new GAAP came into effect.**
 - **Were the EU Accounting Directive mandatory for all small companies to apply then to maintain high quality financial reporting by the charity sector the SORP should continue to make recommendations as to best reporting practice.**
 - **The SORP making body should share specific drafting points with recommended solutions informally with the ASB before submitting a formal response.**
 - **Two separate responses should be considered. A letter should advise the ASB of those critical changes that need to be made to preserve the integrity of current charity accounting practice. A separate letter with an annex should identify those changes that are 'nice to have' together with the response to the ASB's specific consultation questions.**
 - **The critical issues to be circulated to the Committee prior to drafting the revised letter.**
 - **The annex containing the response to the ASB's specific consultation questions is amended to reflect the observations of the Committee.**

Item 4: Treatment of cash as an investment

4.1 Ray Jones introduced this paper. This item had originally been raised under any other business in the November 2011 meeting but the relevant minute had been deleted pending a fuller discussion. He noted that Paper 3 set out a proposal from the SORP Secretariat to codify practice for the next SORP.

4.2 When considering cash as a component of current assets there was currently some divergence in practice with different approaches to the analysis of cash and cash equivalents within current assets. Many charities based their analysis of cash and cash equivalents within current assets on whether or not the holding formed part of a charity's working capital whilst others based the analysis on the liquidity of the holdings. Although both of these approaches were considered acceptable because they are not inconsistent with current accounting standards and the SORP, the development of the new SORP provided an opportunity to settle on a single accounting treatment.

4.3 In discussion, the Committee noted how these two approaches led to categorisations of cash and cash equivalents as one or more components of current assets. It was noted that charities often adopted a 'working capital' approach to the analysis of cash with holdings over and above operational requirements being disclosed within investments. However, as neither approach was considered inconsistent with the SORP or accounting standards neither approach should be specifically ruled out by the SORP.

4.4 The Committee concluded that:

- **There was no need to codify the treatment of cash and cash equivalents at this time.**

Item 5: Any other business

5.1 There being no other business the meeting closed.