SORP Committee

Minutes of the SORP Committee Meeting of 28 July 2011
(Approved at the September 2011 SORP Committee Meeting)

Contact: Nigel Davies, Secretary to the SORP Committee
01823 345470
Nigel.davies@charitycommission.gsi.gov.uk

Present:

Laura Anderson, Joint Chair of the SORP Committee
Tidi Diyan
Peter Gotham
Pesh Framjee
Chris Harris
Keith Hickey
Noel Hyndman
Tris Lumley
Ray Jones
Catriona Scrimgeour

In attendance:

Nigel Davies, Secretary to the SORP Committee
Joanna Spencer, Accounting Standards Board

Apologies:

Debra Allcock-Tyler
Frances McCandless, Chief Executive, Charity Commission Northern Ireland (observer member)
John Graham
Lynne Robb
Carol Rudge
Kate Sayer
Paul Spokes
Sam Younger, Joint Chair of the SORP Committee

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 7 June 2011 were considered and were approved with a number of corrections:

- Minute 2.3: the word 'first' should be 'second' so that the sentence reads 'the second matter was'
- Minute 2.4 change 'than in the work' to 'that in their work' so that the sentence reads 'The Committee noted that in their work'
- Minute 2.4 insert the word 'of' so that the sentence reads 'since there is a nil acquisition cost of stock'

- Minute 2.6 insert ‘a point for discussion where’ so that the sentence reads ‘the Committee noted a point for discussion where’
- Minute 2.6 delete the words ‘every’ and ‘necessarily’ and insert ‘an’ so that the sentence reads ‘it does not imply that an operational asset is a heritage asset’.

2.2 The matter arising was the draft submission to the Accounting Standards Board’s consultation on the draft Financial Reporting Standard for Public Benefit Entities (FRSPBE) also known as Financial Reporting Exposure Draft 45 (FRED 45). It was noted that the submission had been sent and that a copy had been circulated with the papers for the meeting.

Item 3 Update from the ASB

3.1 Joanna Spencer gave a verbal update of progress on FRED 43 (Application of Financial Reporting Standards) and FRED 44 (The Financial Reporting Standard for Medium-sized Entities - the FRSME) following the close of the consultation. She noted that the ASB’s Board had decided on 16 June that no entities which are not currently required to apply full International Financial Reporting Standards (IFRS) will be required to apply them.

3.2 It was likely that the FRSME would permit any accounting treatment to be adopted provided it is currently permitted by UK Generally Accepted Accounting Practice (UK GAAP) and is also permitted by IFRS. The revised FRSME is likely to be consulted upon. She also noted that the ASB had tentatively put back the implementation date to 1 January 2014.

3.3 The ASB Board are keen that SORPs be supplementary to and did not supplant the standard(s). Therefore SORPs should not attempt to be a ‘one-stop shop’. Regarding the future of the Financial Reporting Standard for Smaller Entities (FRSSE), the ASB Board had yet to consider its future but would consult upon its future at some stage. The FRSSE was not the current priority.

3.4 The Committee noted that the SORP had been a great success in raising the standard of reporting and that the SORP provided the opportunity to put UK GAAP in charity sector context and provide specific examples. If the ASB had the objective of raising the quality of financial reporting then the current SORP met that objective. The SORP research also clearly highlighted sector support for a SORP that adopted a ‘one-stop shop’ approach and was written with the smaller charities in mind. The new modular approach being adopted seeks to achieve these dual objectives through allowing the selection of relevant modules with drafting in an accessible style and a greater use of plain English. Accounting standards tended to be written in a very technical language with qualified accountants in mind.

3.5 The diverse nature of the sector with over 99% of charities below the FRSSE threshold and the sector’s reliance on volunteers meant that the SORP had to cater for a different audience to accounting standards. The SORP provided application guidance and it was noted that the application guidance in UK GAAP would be dropped with the new FRSME. The Committee felt that it was unrealistic to expect the majority of charities, usually run by volunteers, to read and understand both the FRSME and the SORP.

3.6 The Committee were keen that SORP met the needs of stakeholders, both preparers and the ASB's defining class of user, identified by the ASB as funders and financial supporters. If the SORP is not comprehensive and written in a way that assists the lay reader there is a danger that various 'guides' might be produced that would not have the same standing. This would lead to diversity of practice and a fall in the quality of reporting.

3.7 It was noted that the sector would expect the SORP to be ready well before the implementation date of 1 January 2014. Therefore the ASB needs to publish the final FRSME promptly so that that the SORP can be consulted upon and the necessary regulations put in place in both England & Wales and Scotland. The ASB's commitment to an 18 month period between the finalisation of the new framework and its implementation therefore remains important.

3.8 The Committee concluded that:

- **The combining of FRSPBE and FRSME would be a welcome development.**
- **The SORP modules should appropriately reference to the FRSME so that readers understood its context and were signposted to the FRSME's text appropriately.**
- **The SORP making body should meet with the ASB to ensure that the approach being taken in drafting the new SORP accords with the ASB's vision as to the role and content of SORPs.**

Item 4 Progress on developing the SORP

4.1 Nigel Davies introduced this paper. He noted that the process of developing the new SORP began in December 2009 with the convening of a sub group to look at making the text more accessible to smaller charities. There were 4 factors influencing the development of the next SORP: the SORP research conducted in 2008-09, the concerns expressed in the UK Parliament about SORP, the conclusions of the SORP Committee sub group and the ASB's proposals for UK GAAP.

4.2 The Committee noted the two concerns raised in the UK Parliament: that the existing SORP was too long and that it did not do enough to address the needs of smaller charities. It was noted that the new SORP expresses accounting standards in a way which is intended to be more accessible to users of the SORP and this was adding to length. That said the use of modules should enable most users of the SORP to select only those modules that applies to their charity and this should cut the number of pages they have to read.

4.3 The SORP has been a key driver for better reporting and so increasing public trust and confidence. The sector's support for SORP was the basis of its success. The sector did have a role in supporting SORP if it valued that framework and wished to see it have the backing of regulations.

4.4 The Committee then considered a number of detailed recommendations about the content of the SORP modules regarding: the annual review, summarised financial statements and financial information, details of items provided in an analysis of net movement in funds, and a discussion point on heritage assets.

4.5 The Committee noted that the research findings had indicated a desire for guidance on the form and content of the annual review. The annual review served a different purpose to the Trustees' Annual Report and the target audience, form and content differed between charities. Although good practice could be developed in this area, the sector was better placed to provide it.

4.6 The Committee noted that the origin of the recommendations on summarised financial statements and financial information was a concern that charities were presenting misleading information. However, it was not the role of SORP to set out requirements for audit of such statements or information. Also the presentation requirements originate in company law and need only apply to charitable companies in the UK. This specific requirement could be better signposted in the module on charitable companies.

4.7 The existing SORP made recommendations on disclosing additional items such as net expenditure on additions to functional fixed assets as part of an analysis of the net movement in funds. These recommendations are discretionary. Since trustees can provide additional information, the Committee concluded that there was no need to retain these recommendations in the SORP.

4.8 The Committee discussed the submission by Pesh Framjee that the draft text on heritage assets be amended to better distinguish between heritage assets and operational assets which are not heritage assets. The Committee agreed that this change was needed and that the text could also benefit from some illustrative examples.

4.9 The Committee agreed that:

- **There is a need for the SORP making body and SORP Committee members to engage with leading sector bodies and the UK Parliament to explain the value of SORP.**
- **The SORP should not make recommendations about the form and content of the annual review.**
- **The existing SORP recommendations on summarised financial information and summarised financial statements should be dropped with the requirement for companies signposted.**
- **The existing SORP recommendations on providing extra information on certain items involving the net movement of funds should be dropped.**
- **The text of the heritage assets module should distinguish more clearly between heritage assets and operational assets.**
- **To facilitate SORP Committee business the October meeting should be extended until 3.30pm**

Item 5: Accounting for programme related investments, mixed purpose investments, 'social impact bonds' and similar financing arrangements

5.1 Ray Jones introduced this draft module and he noted in the past that there had been a clear distinction between investment property and functional property, performance related investments and financial investments. However there was now a developing body of opinion that favoured the concept of 'mixed motive' or 'mixed purpose' investments. A key issue was whether this was a distinct class of investment and if it was how it should be recognised in the financial statements.

5.2 He noted that the latest Charity Commission guidance on investment was likely to reflect this new thinking and include a reference to mixed purpose or mixed motive investments. The Committee were invited to consider a number of questions in turn on the draft module.

5.3 The module began with a definition of programme related investments which built on the existing SORP 2005 definition. The Committee noted that a financial return is made up of the repayment of the principal of the loan plus any interest or the opportunity to realise the equity through sale of winding up of an entity plus any dividends. However there was no requirement for a programme related investment such as loan to bear interest or for an equity holding to yield a dividend.

5.4 The Committee noted that for advocacy purposes some charities chose to invest in companies to have a right to attend the Annual General Meeting to influence that company's environmental, ethical or other policies. These holdings could be material to the charity. There was a view that these were mission related and so should be categorised as programme related investments and not treated as financial investments. However the Committee noted that these traded investments yielded a market return and the companies in which they invested were not pursuing the charity's aims or objects. Neither was the investment intended to fund a service or activity that was charitable. These investments were therefore more a variation on ethical investment and were not programme related investments.

5.5 In considering the measurement of, and impairment of, programme related investments, the Committee debated whether service potential was a technique that could be applied. For operational assets which are not held for cash flow purposes, service potential is an accepted technique for assessing impairment as often the market value of these specialised assets may be below their acquisition cost. However no impairment arose provided they were utilised to the anticipated level in providing service delivery. Could the same approach be applied to programme related investments instead of, or in addition to: transaction cost, present cost (amortised cost) and fair value (market value)?

5.6 It was noted that there was a difference between owning and controlling an operational asset directly and providing funds via loan or equity for a third party to operate an asset. The programme related investment asset held by the investing charity was the loan or equity instrument and not the asset that it financed. It was therefore insufficient that the third party provides service potential through its work to the investing charity. For the programme related investment to be an investment and not a grant the loan principle had to be repayable or the equity interest potentially realisable. The service potential was the reason the investment was made in the first place to advance the investing charity's aims. A key feature of not-for-profit organisations is the emphasis on social return rather than an economic market return.

5.7 When considering the concept of 'mixed motive' investments, the Committee noted that whilst the motive may be mixed, the financial asset was not itself separable. An asset was a unified item and could not be arbitrarily split on a subjective basis between a portion held for an economic return and a portion held for social return since there was no reliable measurement basis that could be used and the asset itself cannot be sold as distinct portions with different valuations. The Committee noted a better approach was to treat it as a standard investment and explain its investment performance in the trustees' annual report. Where circumstances change the asset could be tested for impairment and/ or reclassified if it no longer yielded an economic return.

5.8 The Committee concluded their review by looking at property. The FRSPBE was clear that operational property owned by the entity which is let at below market rent for social purposes is part of property, plant and equipment and not investment property. However the Committee considered the example of a homeless charity which provides rental property and charges above market rates to the local authority for their difficult to place tenants. The purpose of the property is a social one and the surplus is used to further the charity's purposes in supporting the homeless. The definition must therefore be flexible and not rely on a simple market rent test.

5.9 The Committee agreed that a greater understanding of the use of property and the basis on which it is classed as programme related investment or investment property is needed. A sub group should be formed to research property investments and 'mixed motive' investments in liaison with sector Finance Directors to gain a grater understanding of what the distinguishing factors are.

5.10 The Committee agreed that:

- **The definition of programme related investments remain as drafted.**
- **If material, programme related investments should be shown on the face of the balance sheet or disclosed in the notes to the financial statements as a separate category.**
- **The impairment of programme related investments is a charge to charitable activities and a gain is classified as other income as it is analogous to a gain on the disposal of an operational asset.**
- **Due to difficulties in developing a sector wide approach to measurement, service potential cannot be applied as a measurement technique when measuring the value of a programme related investment. Service potential may also lead to the balance sheet including amounts for PRI which are irrecoverable and whilst service potential is recognised in accounting standards as applicable to fixed assets (plant, property and equipment), it had not been explicitly extended to investments.**
- **Where a programme related investment no longer yields a social return then it must be tested for impairment and reclassified.**

- **A separate category of 'mixed motive' or 'mixed purpose' investments should not be recognised instead it is tentatively viewed as a sub class of standard financial investment.**
- **A sub group be convened, including representation from sector Finance Directors, to consider further PRI/ mixed investments and the relationship with economic or market returns.**

Item 6: Accounting for charities pooling investments

6.1 Nigel Davies introduced this draft module and he noted that it covered three distinct investment activities: common investment funds (CIFs) and common deposit funds (CDFs) funds, investment funds with limited participants, and pooling arrangements where the investing charities and the management of the investment pool are under common trusteeship.

6.2 He noted that the ASB's tentative decision, not to extend tier 1 (EU-adopted IFRS) to entities not currently required to apply IFRS, meant that CIFs and CDFs and funds with limited participants would not be required to follow IFRS. He noted that the International Accounting Standards Board's Small and Medium Sized Entities Implementation Group considered investment funds with limited participants as not having public accountability and so they were not required to follow IFRS. However a framework for their financial reporting was still needed. Pooling arrangements however were internal to a charity or a charity group under common trusteeship and therefore were within the remit of the charities SORP.

6.3 The Committee concluded that:

- **Any observations on the module should be e-mailed to the Secretariat.**
- **The Secretariat should contact the ASB to gain an understanding of the future of the Investment Manager's Association SORP for authorised unit trusts and open ended investment companies.**

Item 7: Committee membership Update

7.1 Laura Anderson advised the Committee that Chris Harris was stepping down from the Committee. Chris had moved from a sector-based role into professional practice with MacIntyre Hudson. Following the combination of Gotham Erskine with MacIntyre Hudson this had resulted in two committee members being drawn from a single accountancy practice.

7.2 On behalf of the Committee, she thanked Chris for his input to the work of the Committee. She noted that he was one of the original members of the current SORP Committee having joined in 2006 and his contribution would be missed.

7.3 She expressed the Committee's thanks to MacIntyre Hudson, Peter and Chris for hosting the meeting.

Item 8: Any other business

8.1 There being no other business the meeting closed.