

## Steering the way forward: challenges and options

**1. The issue for consideration**

- 1.1. The Accounting Standards Board's (ASB) code of practice requires the SORP to be reviewed annually. This paper sets out the drivers for change, key issues that require consideration and provides a recap of resources available to us together with an indicative timescale for each option available for the review.
- 1.2. The Committee, having considered the issues set out below, is asked to advise on the preferred option for the SORP review. Key questions are posed at the end of each section of the paper.

**2. The drivers for change  
Criticisms of the new SORP**

- 2.1. Whilst, we believe, that the SORP has generally be well received and provides a technically accurate "one-stop shop" for charity accounting and reporting, it is not without it critics. The passage of the Charities Bill through Parliament provided a focus for those who criticise its length and complexity. Our recent meetings with representatives of umbrella groups and the CCAB bodies to explain the new SORP arrangements also provided an opportunity to explore some of these issues.
- 2.2. We have set out below a summary of the criticisms, the contrary view and asked some questions, marked in *italics*, to help focus thinking:
  - **The SORP goes beyond 'true and fair'**. The SORP has expanded to include additional information, for example, Appendix 3 defines and explains the types of charitable fund; the text of the SORP includes more illustrative examples, for example, Table 4 provides a suggested analysis for support costs and practical tips on cost allocations. *Does the Committee believe that this type additional information is helpful to smaller charities and practitioners, or is it a burden or source of potential confusion?*
  - **The SORP, including appendices, is 121 pages with 451 paragraphs and is far too long.** This is a similar point to the SORP going beyond true and fair, however, the SORP also summarises aspects of accounting standards in its appendices, and provides example formats for notes, for example, Table 8 provides the analysis of movement in fixed assets and additional information about the general application and requirements of FRS 15 to fixed assets held by charities. *Does the Committee consider it appropriate to try and provide a comprehensive treatment or is it better to concentrate solely on the areas of difference and assume that the reader has full knowledge and understanding of UK GAAP (3071 pages)?*

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- **The SORP is not designed with the needs of the smaller charity in mind.** The current approach sets out recommended practice based on the adoption of a full Trustees Annual Return and deals with all key aspects of accounting recognition and disclosure that may arise. The exemptions for smaller charities are then stated subsequently and summarised in Appendix 5. Given that the majority of charities are below the audit threshold, some question the prudence of this approach. *How could this approach be modified, bearing in mind the SORP's broad constituency and that the "true and fair" requirements for accruals accounts means adherence to accounting standards?*
- **The level of disclosure required is too burdensome and may discourage philanthropy.** The contents of the Trustees' Annual Report (TAR) and the level of disclosures in the notes to the accounts do contain an element of discretion; however the majority of disclosures are required, or in the case of the TAR is best practice, under UK GAAP. *Does the Committee consider the SORP has achieved the right balance between the needs of the users of the accounts and the degree of transparency and disclosure imposed upon reporting charities?*
- **The SORP recommendations are a costly burden to charities.** The SORP, in so far as it summaries legal and accounting requirements, should reduce compliance costs. *Does the Committee agree that there is sufficient difference between charities and for-profit commercial organisations that a SORP continues to be justified?*
- **The terminology used in the SORP, particularly the Statement of Financial Activities (SOFA), is misleading to the interested lay reader and trustee alike.** *Does the Committee consider that it would serve charities better to have complete freedom in the use of terms and categories used when preparing their SoFAs, or, would this result in unacceptable inconsistencies and lack of comparability? We also need to bear in mind that the initial impetus to develop the SORP came from a lack of standardised accounting and reporting by the sector which also led to considerable criticism and concern.*
- **The accruals accounting requirements are too complicated.** The Commission and OSCR are seeking to promote receipts and payments accounts for eligible charities and the Commission also produces pro-forma accruals and receipts and payments packs. *Does the Committee agree that by producing accruals accounts under UK GAAP, there is little scope for radical simplification of accounting and disclosure requirements?*

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- **Charity accounts are getting too complex.** Many of the SORP's recent developments, for example, FRS17 and pensions accounting, or performance related grants and contracts, Application Note G, are driven by developments in UK GAAP. The shape of future accounting and reporting will continue to be influenced by developments in UK GAAP, for example, the Operating and Financial Review and indeed by the international accounting agenda as we move towards convergence. *Does the Committee agree that the SORP has achieved the right balance between complexity and transparency and comprehensiveness on the one side and minimising the reporting burden on the other?*

2.3. These issues are clearly complex and raise some fundamental issues that need to be set against the desired role and remit of the SORP. The SORP, at present, can be seen as:

- An aid to the sector helping it to meet the legal requirement for accounts to give a 'true and fair' view. Accounting standards apply to all accrual based accounts that seek to give a 'true and fair view'. The SORP does not invent accounting standards but interprets them to help the sector apply them. Without the SORP each individual charity would need to consider how these commercially set standards should be applied in the context of charity accounting and their particular circumstances.
- Providing a "one-stop" shop, giving recommendations on accounting, format of accounts, annual reporting and addressing the separate legal and jurisdictional regimes that UK charities may operate within.
- Dealing with the particular impact of trust law on charity accounting.
- Providing comprehensive recommended practice thereby limiting the need for detailed law and regulation.
- Applying in each of the three separate legal jurisdictions of the UK and thereby providing a consistent accounting framework specific to needs of charities across the UK.
- Applying to both company and non-company charities again giving consistency against a backdrop of separate legal frameworks.

2.4. The length of SORP can also be exaggerated by some, for example of the 121 pages, 19 pages are devoted to a detailed and user friendly index; 7 pages are contents and required "sign-off statements"; 10 pages deal with special situations and 18 pages are devoted to an appendix cross reference and summary of all accounting standards, setting out their application to charities. The accountancy

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recommendations applying to the generality of charities are contained in less than 50 pages.

- 2.5. We are grateful to the Directory of Social Change for conducting an internet poll looking at the role of the SORP as a “one-stop” shop. The findings provide a useful sector perspective on the issues of completeness and complexity. The poll’s findings have been circulated in conjunction with this paper.

**What is the SORP Committee’s view on these criticisms and how might we address them?**

**In particular:**

- **Do we want SORP to be a “one stop shop”?**
- **Do we want to deal only with key charity specific issues and let charities find their own way to other accounting guidance?**
- **Can the SORP be present the same information in a more accessible and concise way?**
- **Can we use IT solutions that allow charities to call up only those parts of SORP relevant to their own particular affairs?**

- 2.6. In looking at the options for change, we also need to bear in mind that the next two years may be a period of changes. The following sections look at changes that are anticipated and would need to be addressed in any revision of the SORP.

### **3. The drivers for change** **Changes in law and regulation**

3.1. The Companies Act 1985, sections 234(1) (b) and 234ZZB, applies to company charities above the small company thresholds, and requires them to provide a business review as part their Director’s Report. The SORP arguably addresses the key requirements, however, sector practice is often to limit risk disclosures to those specifically required by paragraph 45 of the SORP. This practice may be insufficient for those company charities affected because the business review requires ‘a description of the principal risks and uncertainties facing the company’. SORP paragraph 419 draws attention to the need to ensure compliance with company law.

3.2. Since SORP 2005 was published, the accounting provisions of the Charities and Trustee Investment (Scotland) Act 2005 and the Charities Accounts (Scotland) Regulations 2006 have come into effect,

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superseding references in Table 1 of the SORP to the Law Reform (Miscellaneous Provisions) (Scotland) Act 1990 and the Charities Accounts (Scotland) Regulations 1992.

- 3.3. At the time of drafting, the Charities Bill had not completed its passage through Parliament. Should this legislation and associated future regulations, or future legislation or regulations in Scotland or Northern Ireland come into effect, elements of the SORP 2005 narrative which cross refers to the law will become out of date and require amendment.
- 3.4. These issues do not affect the “method and principles” of the SORP or its key recommendations. These issues could perhaps be dealt with through the publication of an “Information Sheet, or, in the case of changes in the legal framework by the insertion of an amendment slip into the SORP with legislative references being updated with the next reprint of the SORP.

**Does the Committee agree that the additional requirements in relation to the reporting of risk resulting from Business Review requirements could be addressed by way of an Information Sheet?**

**Does the Committee agree that changes to the legal framework could be dealt with by way of a SORP insert pending reprinting of the SORP?**

#### 4. The drivers for change Developments in UK GAAP

- 4.1. The ASB issued a Statement of Recommended Practice in January 2006 entitled Reporting Statement: Operating and Financial Review. This standard is advisory and sets out, with illustrative examples, the recommended contents for an OFR. Whilst SORP 2005 addresses much of the required content, the SORP does not address all relevant disclosures, for example, liquidity, environmental, employee, social/community issues and specific key performance indicator disclosures are not required by the SORP. The RSL SORP Exposure Draft 2006 incorporates an OFR and CIPFA has been consulting on a public benefit OFR aimed at government bodies.

**Does the SORP committee believe these issues should be addressed, or, do we need to wait at least until the new requirements for the Trustees’ Annual Report has bedded in?**

**Should we take the view that the implication of an extended OFR is only an issue for the very largest charities and then a matter of best practice rather than a specific SORP requirement?**

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4.2. The ASB have drafted a proposed amendment to FRS15 following on from its earlier discussion paper Heritage Assets - Can Accounting Do Better? published in January 2006. A separate paper is tabled for the SORP Committee's consideration identifying the consequential changes that would be required to the SORP should FRS 15 be amended.

4.3. The ASB have also consulted on an exposure draft of their Statement of Principles for Financial Reporting: Proposed Interpretation for Public Benefit Entities published in August 2005. The outcome of this consultation exercise is still awaited. Publication of this interpretation is likely early next year. Any revision to the SORP would need to be consistent with this interpretation of principles. Whilst it is anticipated that the SORP will be consistent with the interpretation in most respects, there are a number of interpretation which may have an impact on the SORP as currently drafted. These issues include:

- Accounting for liabilities and commitments which may impact on the SORP's treatment of multi-year grants and the boundaries currently used to define performance related grants;
- Use of designations;
- Use of merger accounting;
- Recognition of donated goods and services.

Current indications are that our current recommended treatment of grant liabilities and commitments will require further consideration.

**Does the SORP Committee agree that it would be necessary for any revision of the SORP to be fully consistency with the ASB's Proposed Interpretation of the Statement of Principles, and that it would be imprudent to amend the SORP's recommendations in relation to grant liabilities until the ASB's work in this area is completed?**

## 5. The drivers for change

### The convergence agenda between UK GAAP and IFRS

5.1. The ASB bullet, Inside Track, Issue 48, published in July 2006, advises that the final timetable for converging UK GAAP with International Financial Reporting Standards issued by the IASB is contingent on confirmation of the proposed IFRS for Small and Medium Sized Entities. Subject to this SME IFRS standard being issued, the SORP secretariat have been planning for a 2009 convergence date, implying a requirement for a new SORP in 2009 (or soon after) to reflect the changes required to comply with IFRS for SMEs. It is anticipated that the SME thresholds will be set at such a

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level that 99.9% of registered charities will fall within the SME standard. ***Convergence will inevitably require a new SORP.***

**Does the Committee agree that one of our primary objectives should be to produce a SORP fully compliant with IFRS soon after UK GAAP achieves convergence?**

**Does the Committee favour a SORP based around an SME standard, if this is practicable, with additional recommendations, perhaps in an appendix, dealing with the largest charities where full compliance may be necessary?**

## **6. The drivers for change Interpretational issues**

- 6.1. Although a significant number of charities adopted SORP 2005 in their accounts for the year to 31 March 2005, many also deferred adoption until the following year. Accounts for 31 March 2006 do not have to be filed until January 2007 and therefore whilst there are encouraging signs that the new SORP has enhanced the relevance of charity reporting, it remains too early to undertake a detailed review of compliance levels.
- 6.2. Helpline and other contacts with charities suggest that whilst some interpretation issues have arisen, these are not of such significance, on their own, to warrant the SORP's revision, although there may well be issues that could usefully be dealt with by the publication of an information sheet. A number of examples of such items are set out in the following paragraphs.
- 6.3. The analysis of grants income within the SoFA categories has given rise to some difficulties, in particular, when grants should be identified as voluntary income and when as income derived from charitable activities. The inference in the SORP is that quasi-contractual arrangements, such as performance related grants, should be regarded as income from charitable activities, whilst grants, as enabling payments, whether restricted or not should be regarded as voluntary income. However, the SORP's drafting (see paragraphs 121(b), 143 and Appendix 1 – GL 29, GL 30 and GL45) does not give this message as explicitly as it could.
- 6.4. In drafting example accounts, it was also noted that disclosure recommendations concerning intentions to spend (paragraphs 328 to 329) were potentially confusing as they were located within the section headed "provisions for liabilities and charges". By definition a provision under FRS12 would be a liability, whilst the intention on the drafting was to encourage disclosure of both trustee intentions, i.e.

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designations, and designations associated with contingent liabilities, the location in the text of SORP of this advice has caused some confusion.

6.5. The recognition of grant liabilities, particularly in the context of multi-year awards, continues to be debated within the sector, unfortunately, with no clear consensus developing. This issue is referred to in paragraph 4.3 above. It will be problematic to take this issue forward until the ASB publish its Proposed Interpretation of the Statement of Principles for Public Benefit Entities.

6.6. With the possible exception of vexed issue of grant recognition, no interpretational issues have been identified that would require a change to the SORP's "methods and principles" or key recommendations. Further clarification could be provided on the issues identified through the publication of an Information Sheet explaining the SORP's recommendations in more detail.

**Does the Committee agree that the interpretations issues identified could be addressed through the publication of an Information Sheet?**

**Can the Committee identify any other interpretational issues that could be clarified in this manner?**

## 7. Other considerations

7.1. In the past, SORPs have coincidentally been produced every 5 years, 1995, 2000 and 2005. Each new SORP brings certain implementation costs and non-essential change is not likely to be welcomed by the sector unless it offered significant advantages.

7.2. The internet poll conducted by the Directory of Social Change is also informative in helping us assess the sector's appetite for immediate change.

**Would the sector be able to cope with a new SORP in 2007 and a new SORP in 2009?**

7.3. Through our help line facility, we are aware of charity's sensitivities over changes in audit fee increases coincidental with a new SORP.

**Would the likely additional expense from an increase in audit fees of a new SORP in 2007 and a new SORP in 2009 be a reasonable call on charity resources?**

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**8. Resources**

- 8.1. To assist the SORP Committee, aside from the available time and resources volunteered by members, OSCR and the Commission can put in place a combined resource of up to circa 1 full time equivalent accountant at times of peak demand for resources and provide access to legal advice. The Committee are also asked to bear in mind that our accountancy resource will often face competing demand for their time which will need to be reflected when planning our work.
- 8.2. In planning our approach to the review the Committee will be aware that the SORP's development has in the past been marked by radical review and change at intervals of 5 years. This approach has added to the complexity and time spent with each new SORP adopting a different style, format and presentational layout as well as addressing essential technical developments. This approach may have advantages but also results in a longer development period before publication.

**9. Timescales*****A new SORP (between 16 and 19 months)***

- 9.1. The Commission's experience is that a new SORP involves at least a 6 to 9 month drafting period and a regular series of SORP Committee meetings. The requirement to research UITFs, UK GAAP and potentially IFRS is necessarily time consuming and obtaining a consensus within the Committee to the SORP's interpretational recommendations will also require a series of meetings over the same 6 to 9 month period.
- 9.2. The proposed SORP, subsequent to its approved by the SORP Committee, is then subject to review and clearance by CAPE and ASB prior to typesetting (up to 2 month). It is then subject to a 3 month consultation period and a post consultation review, leading to redrafting as necessary (3 months). The final text is then subject to approval by CAPE and ASB prior to typesetting and release (2 months). The total time required for the development of a new SORP is therefore estimated as at least 16 to 19 months, more time may be need if particularly contentious issues arise.
- 9.3. Following approval by the ASB, there is still a subsequent requirement for a separate 3 month consultation on any amendments to regulations. Parliamentary time would also need to be made available in Scotland and England for laying regulations before a new SORP could be effective in law.

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***A rewrite of SORP 2005 (between 12 and 15 months)***

9.4. A full redrafting of SORP for style and layout (without significant amendment its recommendations) would require 3 to 6 months of drafting time. Subsequent to SORP Committee approval, the proposed SORP is then subject to CAPE and ASB review prior to typesetting (up to 2 month). It is then subject to a 3 month consultation period and post consultation a review prior to final approval by the SORP Committee, a process requiring at least 2 months. The final draft is then subject to CAPE and ASB approval prior to typesetting (2 months). The total time for a redraft is estimated at between 12 to 15 months.

9.5. Following approval by the ASB, there is still a subsequent requirement for a separate 3 month consultation on any amendments to regulations. Parliamentary time would also need to be made available in Scotland and England for laying regulations before a new SORP could be effective in law. Whilst it could be argued that a redraft of the SORP was not a new SORP, without new regulations there could be tensions between legal requirements applying to the old SORP and a new SORP setting out recommended practice in a redrafted style.

***An Update Bulletin (less than 9 months)***

9.6. In contrast to a redraft or new SORP, an Update Bulletin, being restricted to a specific topic or topics, requires 1 to 2 months of drafting time and approval by the SORP Committee prior to CAPE and ASB clearance (2 months). The standard 3 months consultation period would apply with subsequent approval of the post consultation draft by the SORP Committee and CAPE and ASB (2 months). The process could be undertaken in less than 9 months. With ASB willingness to “fast-track” their clearance procedures an Update Bulletin could, if necessary, be developed and issued electronically within 6 months.

9.7. Were the Update Bulletin to include material changes to the current recommendations or material changes to key disclosures, then it may be desirable to amend supporting regulations. This decision would be based on the perceived need to give legal force to the new recommendations.

***An Information Sheet (less than 4 months)***

9.8. An Information Sheet requires drafting and approval by the SORP Committee only and so is comparatively quick to implement, depending upon the number of topics or paragraphs covered. It would be usual to allow CAPE to consider the text prior to its release. An Information Sheet is applicable where it is considered that an aspect of

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the existing SORP requires further clarification or guidance as to its interpretation or application. An Information Sheet cannot be used to make an amendment or change to the SORP's recommendations.

**10. Options for decision**

***In view of available resources, timescales, and the drivers for change, which option does the SORP Committee approve from the following?***

- 1) A rewrite of SORP 2005 and a new SORP in 2009;**
- 2) A new SORP in 2007, incorporating drafting changes and developments in UK GAAP and ASB Best Practise, and a new SORP in 2009;**
- 3) An Update Bulletin only, with a new SORP in 2009;**
- 4) An Update Bulletin, and supplementary Information Sheet, with a new SORP in 2009.**

It should be noted that we should update the ASB with our key decisions and plans as part of our commitment to report to them at least annually.

**Paper origination:**

Prepared by SORP Secretariat October 2006

Approved by OSCR (yet to receive)

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