CHARITIES SORP (FRS 102)

Amendments to Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland

Update Bulletin 2

Updating the Charities SORP (FRS 102) issued in July 2014 for amendments to FRS 102 issued by the Financial Reporting Council in December 2017: *Amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Triennial review 2017 – Incremental improvements and clarifications.*

Publication date: 20 February 2018

CHARITY COMMISSION FOR ENGLAND AND WALES
CIPFA The Chartered Institute of Public Finance & Accountancy
OSCR Scottish Charity Regulator

Background

All Statements of Recommended Practice (SORPs) are developed within the context of law and accounting standards. This is made explicit in paragraph 3 of the Charities SORP (FRS 102) which states that:

> "This SORP provides guidance on how to apply FRS 102 to charity accounts and it should be noted that in the hierarchy established in accounting standards, FRS 102 requirements and legal requirements take precedence over the SORP. Therefore, should an update to FRS 102 or a change in relevant legislation be made after the publication of this SORP, any of the provisions of this SORP that conflict with the updated FRS 102 or relevant legislation cease to have effect."

Purpose

The purpose of SORP Update Bulletins is to amend the text of the underlying SORP for changes in Accounting Standards and legislation subsequent to the SORP's issue.

The amendments set out in this Update Bulletin apply to all charities in the United Kingdom and Republic of Ireland that follow this SORP for reporting periods beginning on or after 1 January 2019.

1. Introduction

1.1 This Update Bulletin sets out amendments to the text of the Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS 102) (Charities SORP (FRS 102)) issued in July 2014.

1.2 These changes are due to the amendments and clarifications set out in *Amendments to FRS 102 – Triennial review 2017 – Incremental improvements and clarifications* issued in December 2017. There are no other changes other than those set out in this Update Bulletin to the Charities SORP (FRS 102).

1.3 The amendments have been split into three categories and are presented in separate sections of this Update Bulletin.

1.4 Section 3 sets out amendments to the Charities SORP (FRS 102) which are based on clarifications made by the FRC in relation to FRS 102. The amendments to the Charities SORP (FRS 102) ensure that it is consistent with the original drafting intention of FRS 102. As these amendments clarify how the requirements of FRS 102 must be applied, they must be applied immediately by charities.

1.5 The following clarifying amendments are set out in Section 3:

- **Module 3: Accounting standards, policies, concepts and principles, including adjustment of estimates and errors:** clarifying the requirement to provide comparative information;
- **Module 10: Balance Sheet:** removes the undue cost or effort exemption for depreciating assets comprising of two or more major components which have substantially different useful economic lives;
- **Module 13: Events after the end of the reporting period:** clarifying when payments by subsidiaries to their charitable parents that qualify for gift aid are adjusting events occurring after the end of the reporting period;

1.6 Those amendments which are considered to be more significant and likely to have an impact on the accounts of charities, are set out in Section 4. Those amendments which are editorial in nature or considered to be less significant and likely to have an impact on the accounts of a limited number of charity accounts, are set out in Section 5. The significant amendments are presented separately from the other proposed amendments in order to assist stakeholders' consideration of them.

1.7 As the amendments in Sections 4 and 5 relate to amendments to FRS 102, the effective date for these amendments is for reporting periods beginning on or after 1 January 2019, with early application permitted provided all amendments are applied at the same time.

1.8 The following significant amendments are set out in Section 4:

- **Accounting and Reporting by Charities: The Statement of Recommended Practice (SORP) - Scope and Application module:** inserting the date from when the amendments in this draft Update Bulletin would be effective;
- **Module 10: Balance Sheet:**
  - permitting charities that rent investment property to another group entity to measure the investment property either at cost (less depreciation and impairment) or at fair value;
  - removing the undue cost or effort exemption for the investment property component of mixed use property to require measurement at fair value;
  - removing the disclosure of stocks recognised as an expense;
- **Module 14: Statement of cash flows:** requiring charities to prepare a reconciliation of net debt as a note to the statement of cash flows;
- **Module 27: Charity mergers:** including the transfer of activities to a subsidiary undertaking as an example of a charity reconstruction that should be accounted for as a merger; and
- **Appendix 1: Glossary:** inserting a definition of the term service potential.

1.9 Amendments to the Charities SORP (FRS 102) are indicated as follows:

- deleted text is struck through; and
- inserted text is underlined.

2. Financial Reporting Council's statement on Update Bulletin 2 to the Charities SORP (FRS 102)

In accordance with the FRC's *Policy on Developing SORPs* the FRC carried out a review of the proposed Update Bulletin focusing on those aspects relevant to the financial statements but also including aspects relevant to the FRC's broader responsibilities where appropriate.

15 February 2018
Financial Reporting Council

3. Clarifying amendments

Module 3: Accounting standards, policies, concepts and principles, including the adjustment of estimates and errors

3.1 Charities SORP (FRS 102) is amended to clarify the requirement for comparative information to be provided for all amounts presented in the financial statements, which includes the notes. .

3.2 The following paragraph is inserted:

Comparative information

3.49 FRS 102 requires that comparative information must be provided for all amounts presented in the current period's financial statements, which includes the notes. Therefore charities must provide comparative information for all amounts presented in the accounts and notes to the accounts unless otherwise stated in FRS 102 and this SORP. This applies to both disclosures required by FRS 102 and those additionally required by this SORP.

Module 10: Balance sheet

3.3 Charities SORP (FRS 102) is amended to remove the undue cost or effort exemption for depreciating assets comprising of two or more major components which have substantially different useful economic lives. This is required to align the accounting treatment for these assets in the SORP with that in FRS 102.

3.4 The following paragraph sets out the amendments to Module 10: Balance sheet:

10.31. Where an asset comprises two or more major components which have substantially different useful economic lives, each component must~~, unless impractical or involving undue cost or effort,~~ be depreciated separately over its useful economic life.

Module 13: Events after the end of the reporting period

3.5 Charities SORP (FRS 102) is amended to clarify when payments by subsidiaries to their charitable parents that qualify for gift aid are adjusting events which occur after the end of the reporting period. As an expected gift aid payment is accounted for as a distribution to owners, FRS 102 does not allow these payments to be recognised as a liability at the end of the reporting period unless a legal obligation for the subsidiary to make the payment exists at the reporting date. FRS 102 requires a legal obligation for the subsidiary to make a payment to the parent to exist, for example by entering into a deed of covenant, in order for the expected gift aid payment to be recognised at the reporting date. Therefore the reference to 'constructive obligation' is this context is contradictory with the required accounting treatment.

3.6 The following paragraph sets out the amendments to Module 13: Events after the end of the reporting period:

13.5. Examples of events occurring after the end of the reporting period that require adjustment include:

- settlement of a court case that confirms that the charity had a liability at the end of the reporting period and not a contingent liability;
- notification that the payment of a legacy from an estate is no longer probable as a result of the will being contested;
- the determination of the amount of a Gift Aid payment to a parent charity by a subsidiary undertaking, when the subsidiary had a present legal (for example, a deed) ~~or constructive~~ obligation to make the payment at the reporting date;

…

4. Significant amendments

Accounting and Reporting by Charities: The Statement of Recommended Practice (SORP) - Scope and Application module

4.1 Paragraph 18A is inserted in the Scope and Application Module of the Charities SORP to clarify from when the amendments are effective from.

4.2 The following paragraph is inserted:

> 18A. In **[insert month]** 2018 amendments were made to this SORP to incorporate amendments necessary to maintain consistency with accounting standards. The changes made by Update Bulletin 2 are applicable for accounts of relevant charities for reporting periods beginning on or after 1 January 2019. Except where prohibited by regulations or charity or company law, the early application of the amendments made to this SORP is permitted provided that all of the amendments are applied at the same time. It should be noted that the insertion of paragraph 3.49 and amendment to paragraphs 10.31 and 13.5 represent amendments which clarify how charities should apply FRS 102. These amendments to the SORP are effective immediately. If applying the amendments to the SORP for the first time, section 1 of FRS 102 sets out a number of exemptions to retrospective application.

Module 10: Balance Sheet

4.3 Charities SORP (FRS 102) is amended to introduce an accounting policy choice which allows charities that rent investment properties to other group entities to measure those investment properties either at cost (less deprecation and impairment) or at fair value.

4.4 The following paragraph sets out the amendments:

> 10.36A The disclosures in paragraph 10.37 are relevant to a charity that chooses to measure investment property rented to another group entity under the cost model, as permitted by paragraph 10.48A.
>
> …
>
> 10.48A A charity that rents investment properties to another group entity may choose to account for those properties in its individual financial statements either: at fair value with any gain or loss taken through the SoFA; or transfer them to tangible fixed assets, and measure them using the cost model.
>
> 10.48B When only part of a property is rented to another group entity, paragraph 10.48A only applies to the component of that property that is rented to another group entity.

10.56. Charities holding investment property must also disclose:

- the methods and significant assumptions applied in determining the fair value of investment property;
- the extent to which the fair value of investment property is based on a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and class of the property being valued (or if there has been no such valuation this fact must be disclosed);
- the existence and amounts of any restrictions on the ability to realise investments property or on the remittance of income and proceeds of disposal;
- any contractual obligations for the purchase, construction, or development of investment property or for repairs, maintenance or enhancements;~~ and~~
- in the analysis (see paragraph 10.15) the additions resulting from acquisitions through business combinations, if any~~.~~; and
- the carrying amount at the end of the reporting period of investment property rented to another group entity, where the charity has chosen to account for such property using the cost model.

4.5 Charities SORP (FRS 102) is amended to remove the undue cost or effort exemption for measuring the investment property component of a mixed use property at fair value. It is also amended to include additional guidance on when the different components of a mixed use property should be separated.

4.6 The following paragraphs set out the amendments:

10.47. Mixed use property should be separated between investment property and property held for operational use as a tangible fixed asset if the resulting portions could be sold separately (or leased out separately under a finance lease). However, if the fair value of the investment property component cannot be measured reliably~~ without undue cost or effort~~, the entire property should be accounted for as property within tangible fixed assets.

10.48. Investment properties must be measured initially at cost and subsequently at fair value at the reporting date. ~~This SORP does not permit charities using FRS 102 to subsequently measure investment properties at their cost less accumulated depreciation and any accumulated impairment losses.~~ Depreciation is not provided on investment property.

4.7 Charities SORP (FRS 102) is amended remove the requirement to disclose the amount of stock recognised as an expense in the notes to the accounts.

4.8 The following paragraph sets out the amendments:

10.63. The notes to the accounts must disclose:

- the accounting policies adopted in measuring the value of stocks and, if applicable, work in progress and any cost formulae used;
- the carrying amount of stocks and, if applicable, work in progress analysed between activities;
- ~~the amount of stock recognised as an expense;~~
- any charges for impairment or reversal of impairment losses; and
- the carrying amount of any stocks pledged as security for liabilities.

Module 14: Statement of cash flows

4.9 Charities SORP (FRS 102) is amended to introduce the requirement for a reconciliation of net debt to be prepared as a note to the statement of cash flows.

4.10 The following paragraphs and table are inserted:

14.17A A reconciliation of net debt must also be provided. Net debt consists of the borrowings of a charity, together with any related derivatives and obligations under finance leases, less any cash and cash equivalents. When several balances (or parts thereof) from the balance sheet have been combined to form the components of opening and closing net debt, sufficient detail shall be shown to ensure users can identify these balances. The analysis need not be presented for prior periods.

14.17B An example of how this reconciliation may be set out is given in Table 10A, which should be adapted as necessary for the reporting purposes of the charity. For example, a layout may be adopted which distinguishes between debt used to finance tangible fixed assets, and debt used to finance operational costs. A layout may also be adopted which distinguishes between the timing of the cash flows associated with debt financing and purpose for which those cash flows were applied.

Table 10A: Analysis of changes in net debt

	At start of year	Cash-flows	Acquisition/disposal of subsidiaries	New finance leases	Fair value movements	Foreign exchange movements	Other non-cash changes	At end of year
	£	£	£	£	£	£	£	£
Cash	x	(x)	-	-	-	-	-	x
Cash equivalents	x	(x)	-	-	-	x	-	x
Overdraft facility repayable on demand	(x)	(x)						(x)
		(x)						
Bank loans falling due within one year	(x)	(x)	(x)	-	-	-	x	(x)
Bank loans falling due after more than one year	(x)	(x)	(x)				(x)	(x)
Finance lease obligations	(x)	x	(x)	(x)	-	-	-	(x)
Current asset investments	x	(x)	-	-	x	x	-	x
TOTAL	**(x)**	**(x)**	**(x)**	**(x)**	**x**	**x**	**-**	**(x)**

Module 27: Charity mergers

4.11 Charities SORP (FRS 102) is amended to include the transfer of activities to a subsidiary undertaking as an example of a charity reconstruction that may be accounted for as a merger. The amendments to FRS 102 expanded the definition of a group reconstruction to incorporate the transfer of a business in certain circumstances. These reconstructions can be accounted for using merger accounting, provided the use of this method is not prohibited by company law or other relevant legislation. The examples of charity reconstructions which may be accounted for as mergers in the SORP has therefore been amended to reflect the revision and include an example of one such reconstruction common to the sector.

4.12 The following paragraph sets out the amendments to Module 27: Charity mergers:

> 27.12. In some cases, a charity may change its legal form but its purposes and beneficiary class remain unchanged. The most common examples are the decision by trustees of an unincorporated trust to establish a charitable company or charitable incorporated organisation to take forward the charity's work and the conversion of a charitable company to a charitable incorporated organisation. Another common example is the transfer of activities to a subsidiary undertaking. A subsidiary entity may be established to undertake non-charitable trading activities previously undertaken by the parent charity.

Appendix 1: Glossary of Terms

4.13 Charities SORP (FRS 102) is amended to introduce a definition of the term 'service potential'.

4.14 The following definition is inserted into the glossary of the Charities SORP (FRS 102):

> **Service potential** is the capacity to provide services that contribute to achieving a charity's objectives. Service potential enable a charity to achieve its objectives without necessarily generating net cash inflows.

5. Other amendments

Accounting and Reporting by Charities: The Statement of Recommended Practice (SORP) - Scope and Application module

5.1 Charities SORP (FRS 102) is amended to change the reference to those charities which meet the definition of a financial institution. The FRS 102 glossary definition of a financial institution was amended to remove references to 'generate wealth' and 'manage risk'. This potentially widens which charities will meet this revised definition beyond only being charitable incorporated friendly societies.

5.2 The following paragraph sets out the amendments to the Scope and Application module:

> 20. Charities~~able incorporated friendly societies that fall within the~~ with a principal activity similar to those listed in the FRS 102 definition of a financial institution~~, as set out in the glossary to FRS 102~~ must make the additional disclosures required by section 34 of FRS 102. This is likely to include charitable incorporated friendly societies and charities that undertake lending at a market rate or to achieve an element of market return (mixed motive investments). It excludes those charities which provide concessionary rate finance in the form of programme related investments unless such lending is the charity's only principal or sole charitable activity.

Module 11: Accounting for financial assets and financial liabilities

5.3 Charities SORP (FRS 102) is amended to replace a reference to investments in non-convertible preference shares and non-puttable ordinary shares, to non-derivatives instruments that are equity of the issuer. This reflects drafting changes to FRS 102 which aim to improve the accounting for those instruments that are liabilities of the issuer by requiring measurement at amortised cost (if the instrument is classified as 'basic') and ensure consistency with the accounting treatment of the issuer.

5.4 The following paragraph sets out the amendments to Table 7: Common basic financial instruments:

> Investment in ordinary shares or types of preference share that are free of any derivative or conditional element which could affect their market value or the charity's right to the shareholding i.e. a non-derivative instrument that is equity of the issuer~~- non-puttable (i.e. without an option to sell the shares at a later date at an agreed price) ordinary and preference shares or non-convertible preference shares.~~

5.5 Charities SORP (FRS 102) is amended to change those paragraphs which cover the initial measurement of basic financial instruments.

5.6 The following paragraphs set out the amendments:

> 11.7. Charities preparing accounts normally measure a basic financial asset or basic financial liability on its initial recognition at the amount receivable or payable ~~including~~ adjusted for any related transaction costs. However, if initially measured at fair value, transaction costs are not included in the measurement of financial assets or liabilities, instead, the transaction costs are treated as an expense. If extended credit is offered, the accounting treatment depends on those extended credit terms.
>
> 11.12. The financing element is the difference between the settlement amount and the present value of that amount. The calculation of the present value of the settlement amount requires the identification of the timing and amount of future payment(s) due and then discounting these amounts at a market rate of interest for a similar debt instrument as determined at initial recognition adjusted for transaction costs. A similar debt instrument may be an unsecured loan of an amount equivalent to the settlement value over a comparable time period. The unwinding of the discount is shown as a financing transaction (interest receivable or interest payable as appropriate).

5.7 Charities SORP (FRS102) is amended to encourage charities to make additional disclosures where they hold financial instruments and the risks arising from these are particularly significant. FRS 102 encourages entities to provide information to enable users of financial statements to evaluate the significance of financial instruments held.

5.8 The following paragraph is inserted:

> 11.35A When the risks arising from financial instruments are particularly significant to the charity (for example because they are principal financial risks for the charity) additional disclosure may be required. Reference should be made to section 34 of FRS 102 for examples of disclosure requirements for risks arising from financial instruments that may be relevant in such cases.

5.9 Charities SORP (FRS102) is amended to remove the requirement to disclose the carrying amounts of financial assets and liabilities measured at amortised cost and at cost less impairment. Entities are only required to disclose separately the carrying amounts of financial assets and liabilities measured at fair value through profit and loss.

5.10 The following paragraph sets out the amendments:

11.35. Charities with basic financial instruments must disclose:

- the measurement bases and the accounting policies used for financial instruments;
- the carrying amount of financial assets measured at fair value through income and expenditure (termed profit and loss in FRS 102);
- ~~the carrying amount of financial assets measured at amortised cost;~~
- the carrying amount of financial liabilities measured at fair value through income and expenditure (termed profit or loss in FRS 102);
- ~~the carrying amount of financial liabilities measured at amortised cost;~~
- ~~the carrying amount of financial liabilities measured at cost less impairment;~~

…

Module 18: Accounting for heritage assets

5.11 Charities SORP (FRS 102) is amended to change those paragraphs which cover the initial measurement of assets at fair value.

5.12 The following paragraph sets out the amendments to Module 18: Accounting for heritage assets:

18.17. Heritage assets donated to the charity should be recognised initially at their fair value where practicable. Fair value can often be estimated by reference to recent market transactions or binding sale agreements in identical assets or in assets that are substantially the same as the asset being measured, and between knowledgeable, willing parties in an arm's length transaction. Fair value may be determined by the appraisal of market-based evidence by trustees or staff who have relevant skills, knowledge and experience or by a professionally qualified valuer. Where no market-based evidence exists, depreciated replacement cost may be used to estimate the fair value of certain properties held as heritage assets. If a reliable estimate cannot be made of the asset's fair value or the cost of valuation is likely to exceed the benefits provided by the information, the asset is not recognised in the accounts and the relevant note disclosures concerning the nature of asset and its accounting treatment must be provided.

Module 21: Accounting for social investments

5.13 Charities SORP (FRS102) is amended to change those paragraphs which cover the measurement of assets at fair value.

5.14 The following paragraph sets out the amendments to Module 21: Accounting for social investments:

> 21.29. The bid price must be used to measure fair value for accounting purposes of shares that are traded in an active market. When quoted prices are unavailable, the price of recent transactions of identical (or similar) investments in an arm's length transaction between knowledgeable, willing parties may provide evidence of their fair value, provided that there has not been a significant change in economic circumstances since those transactions. Prices may need to be adjusted if the last transaction price is not a good estimate of fair value, for example if the transaction was as a result of a forced sale.

Module 24: Accounting for groups and the preparation of consolidated accounts

5.15 Charities SORP (FRS102) is amended to cover the exclusion of immaterial subsidiaries from consolidated financial statements.

5.16 The following paragraph is inserted as follows:

> 24.13A A subsidiary may be excluded from consolidation when its inclusion is not material for the purpose of giving a true and fair view (but two or more subsidiaries may be excluded only if they are not material when taken together).

5.17 Charities SORP (FRS102) is amended to include the accounting treatment of intangible assets acquired in a business combination.

5.18 The following paragraphs are inserted as follows:

Intangible assets acquired in the acquisition of non-charitable subsidiaries

24.34A An intangible asset is recognised as an asset if, and only if:

- it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and
- the cost or value of the asset can be measured reliably.

24.34B Where a parent charity purchases a non-charitable subsidiary and acquires intangible assets, these assets must be recognised separately from goodwill when:

- the recognition criteria set out in paragraph 24.34A is met entirely;
- the intangible asset arises from contractual or other legal rights; and
- the intangible asset is separable (i.e. capable of being separated or divided form the entity and sold, transferred, licensed, rented or exchanged either individually or together with a related contract, asset or liability).

24.34C A charity may additionally choose to recognise any or all intangible assets separately from goodwill when the recognition criteria set out in paragraph 24.4A is met, and when either of the following conditions are satisfied:

- the intangible asset arises from contractual or other legal rights; or
- the intangible asset is separable.

Where a charity chooses to recognise such additional intangible assets, this policy must be applied to all intangible assets in the same class (i.e. having a similar nature, function or use in the charity), and must be applied consistently to all non-charitable subsidiaries acquired. The charity must also disclose the nature of those intangible assets and the reason why they have been separated from goodwill. For more information refer to section 18 of FRS 102.

5.19 Charities SORP (FRS102) is amended to include the requirement for unconsolidated interests in special purpose entities to be disclosed where consolidated accounts are prepared.

5.20 The following paragraph sets out the amendments:

24.35. The following disclosures must be made in the group's accounting policies note when consolidated accounts are prepared:

- a statement that the accounts are consolidated;
- the basis for concluding that control exists when the parent charity does not own, directly or indirectly through subsidiaries, more than half of the voting power;
- any difference in the reporting date of the accounts of the reporting charity parent and its subsidiaries in the preparation of the consolidated accounts;
- the nature and extent of any significant restrictions on the ability of subsidiaries to transfer funds to the parent charity in the form of cash dividends or to repay loans;
- the value of any non-controlling interest as a separate item, after the 'Funds of the charity' heading, on the balance sheet; and
- the name of any subsidiary excluded from consolidation, and the reason for its exclusion~~.~~; and
- the nature and extent of any interests in unconsolidated special purpose entities, and the risks associated with those interests.

5.21 Charities SORP (FRS102) is amended to introduce the requirement for the disclosure of intangible assets which are acquired in a business combination and not separately recognised.

5.22 The following paragraph sets out the amendments:

24.39 Where the reporting charity acquires a material subsidiary in the reporting period, it must disclose:

- the date of acquisition;
- the cost of acquisition and how it was settled, for example by cash or debt instrument;
- the useful life of goodwill, and if this cannot be reliably estimated, supporting reasons for the period chosen;
- the periods in which any negative goodwill will be recognised;~~ and~~
- the amounts recognised for each class of assets, liabilities and contingent liabilities at acquisition; and
- a qualitative description of the nature of intangible assets included in goodwill.

Appendix 1: Glossary of Terms

5.23 Charities SORP (FRS 102) is amended to align the glossary definition of an intangible asset with that in FRS 102.

5.24 The following paragraph sets out the amendments to the definition of an intangible asset in the glossary to the Charities SORP (FRS 102):

Intangible asset is an accounting term for an identifiable non-monetary asset without physical substance. Such an asset is ~~recognised~~ identifiable when:

- it is separable, i.e. is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; or
- it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.