Technical research agenda

1 Background

1.1 Following the publication by the Accounting Standards Board (ASB) of a review of the four public-benefit SORPs, Andrew Lennard the Chair of the ASB's Committee on Accounting for Public- benefit Entities wrote to the Chair and Deputy Chair of the SORP Committee in April 2008. The letter drew attention to the publication of the report, prepared by PwC, and highlighted a number of areas where different accounting treatments are prescribed by different SORPs. The letter recognised there may be valid reasons for some of these differences, reflecting the differing circumstances of the sectors to which the SORPs are addressed.

1.2 The Chair and Deputy Chair of the SORP Committee responded pointing out that the SORP Committee were now "entering a period of research that will inform the development of our next SORP which we hope will be set within the framework provided by IFRSs. We plan to take forward a number of issues through a series of stakeholder roundtables starting in the autumn and we suspect that this would also provide a good opportunity to consider the issues identified within the PwC report. Clearly, we would like to obtain the views of the SORP Committee before committing to this way forward."

1.3 At the SORP Committee's June 2008 meeting it was agreed that certain key technical issues identified in research commissioned by CAPE should be initially delegated to technical working groups for consideration. The role of the technical working groups would be to act as working groups to considering particular technical issues and to develop a preferred approach to them for subsequent consideration by the full SORP Committee.

1.4 A separate technical working group would be set up for each key issue identified by the CAPE research and the membership of each group would be drawn from membership of the SORP Committee with particular interests or expertise in the issue being considered. It was envisaged that each working group would have up to five members and would commence their work in late autumn. The October 2008 SORP Committee meeting agreed that the technical working groups should develop an initial response to the ASB and caveat that response so that additional feedback can be given where applicable once the roundtables have concluded.

2 Progress to date

2.1 The three technical working group meetings have taken place to date have discussed Designated Funds, Capital Grants and Consolidations and Combinations. Three more meetings are scheduled to discuss the Structure of Primary Statements, Narrative and non-financial reporting in the Annual Report and the Recognition of Multi-period Funding Commitments.

2.2 The annex (Paper 4.1) to this paper sets out the membership of each group and a minute of the group's conclusions. Copies of the briefing papers for each working group meetings should have been circulated to all members of the SORP Committee but copies are available on request from the SORP Committee Secretariat.

2.3 The conclusions of each working party will be compared to the evidence of sector views on each of these issues obtained from roundtable events. A paper will then be put to the main SORP Committee for their consideration and approval following the completion of the roundtable events series and analysis of the views obtained. The outcome of these discussions will then provide the basis for the response that we have promised the ASB and will also form the basis of the approach we would propose to take in the initial drafting of the next SORP. As highlighted in Paper 2 the series of roundtable events end in June and it is anticipated that the research findings will be available in autumn 2009.

2.4 At this stage it may be helpful to briefly compare the conclusion of the working parties on the 3 issues considered to date and make a tentative comparison with the feedback received through the questionnaires completed by those attending roundtable events.

3 Designated Funds

3.1 The working group agreed that an explanation of designations should primarily form part of a charities reserves policy. Designations should not be presented as part of income or expenditure within the SoFA or presented in the balance sheet as a liability.

3.2 The working group recognised that concerns existed that designations were being used as 'window dressing' although it was accepted these concerns were based on anecdotal evidence rather than empirical evidence. The identification of designations for future projects or expenditure can create a presumption that expenditure was committed which may not be the case.

3.3 Designations did however have value in helping the reader of accounts understand that certain tangible fixed assets were utilised for the provision of charitable services/activities. The usefulness of this information to users of accounts, primarily funders, is particularly important.

3.4 The initial recommendation of the working group is that designations should be limited to identify assets used for provision of charitable services/activity. A minority view was that in the absence of a legal prohibition as to the use of designations they should be allowed in charity accounts. The determination of this issue should however give very high weighting to the views of funders.

3.5 Feedback from roundtable events has been very mixed with comments being received both about the use of designations for window dressing purposes and others emphasising their value in understanding a charity's financial position. Questionnaire returns from Roundtables at present show support (but not strong support) for the retention of designations within charity accounts.

Question:

Does the SORP Committee wish to comment on these early findings in relation to designations?

4 Capital Grants

4.1 The working group view was that funders and charities do not generally perceive a capital grant as a long term subsidy of revenue costs associated with an asset but rather focus on any restrictions over the future use of the asset. In commercial accounting where government funding, in normal circumstances, is less usual the treatment of a capital grant as effectively a revenue subsidy can be more readily understood.

4.2 Also the direct application of SSAP 4 creates issues for readers of accounts in understanding the nature of the liability created by income deferral. If funding conditions created a 'performance related grant' dependent, for example, on the stages of a construction project then such conditions would be relevant to initial recognition of the grant. It is important to have internal consistency between accounting for donations to fund a capital project (eg. an appeal) and grant funding for the whole or part of a capital project.

4.3 The working party concluded that within the context of the SoFA and fund accounting, the Charity SORP's approach to the recognition of capital grants provides the most appropriate accounting treatment reflecting the legal framework and business model within which charities operate. Only if SoFA was to be replaced by a single column 'income and expenditure' account model might the balance of the argument support a 'matching approach'.

4.4 Again, there was no clear consensus in the roundtable questionnaires analysed to date. Preparers as a group supported matching, auditors were neutral with funders supporting the current approach within the SORP. Some of the feedback suggests that those supporting matching include those that prefer a more orthodox 'income and expenditure' approach to accounting. However, no firm conclusion can be drawn on this hypothesis until the responses and discussion comments are analysed in more detail.

Question:

Does the SORP Committee wish to comment on these early findings in relation to accounting for capital grants?

5 Consolidation and combinations

5.1 The working party welcomed the recognition given in the Interpretation for Public Benefit Entities of Statement of Principles that mergers do arise. Ideally this accounting treatment should be preserved (if compatible with the standards framework on which SORP is based). The SORP should identify the criteria that can be used to differentiate mergers from acquisitions.

5.2 SORP should continue to provide recommendations on accounting for associates and joint ventures. Equity accounting was favoured in both cases. The criteria by which significant influenced was assessed in the case of an associate charity required particular consideration - the criteria put forward in IPSAS 7 provided some ideas but may not work unless adapted for charities. A particular issue was Board representation by charity funders.

5.3 SORP needs to address accounting requirements where a subsidiary is acquired or disposed of in a financial year. In particular, any goodwill on the acquisition of a charitable subsidiary should be recognised as a gain. The transfer of trusteeship of an endowment or restricted fund should similarly be recognised as a gain. (Different accounting treatment for the transfer of endowments and restricted funds was not supported).

5.4 The next SORP should clarify the accounting responsibilities of corporate trustees. Some still assume that corporate trustee should prepare consolidated accounts to include the charities where they act as corporate trustee.

5.5 Moves within government accounting which assume charity trusteeship should create a presumption for consolidation remain a concern. There should be no automatic assumption that trustees exercise control to obtain economic benefit for an appointing entity. The nature of trusteeship needs to be understood and the next SORP should set out criteria by which control can be assessed in the context of a charitable subsidiary. Power of appointment and a general concurrence of purpose should not be taken as meeting the ‘benefit test’ inherent in consolidation. There needs to be evidence that trusteeship is used to create a ‘managed’ benefit for the parent entity before consolidation criteria are considered met. Consideration should also be given to whether charitable trusts created a ‘long term restriction’ which would prohibit consolidation of a charity by a non-charitable parent.

5.6 The working group concluded that the next SORP primarily needed to address the criteria by which control is assessed in the context of a charity. It should also provide further guidance on accounting treatments resulting from mergers or acquisitions within the financial year.

5.7 The conclusion reach by the working party that the option for merger accounting needed to be preserved within standards applying to charities has been supported by roundtable questionnaire responses to date. The importance of differentiating between a merger and the ‘take-over’ of one charity by another appears to be understood.

5.8 In a supplementary email to the working party Pesh Framjee has recently raised some issues concerning the difficulties in distinguishing between branches and subsidiaries in the context of overseas activities. Often in substance, nothing has changed but overseas work may often now be carried out through separate entities and these changes to legal structures can have very significant impact on the accounting treatment adopted. Further consideration is needed in relation to the treatment of overseas activities and when the activities form part of the UK reporting entity accounts, the consolidated accounts or remains off-balance sheet. There is a risk that legal form could be dictating accounting treatment in this area. A copy of Pesh Framjee’s email is available on request to all SORP Committee members. The issues raised are likely to warrant further consideration by the technical working group.

Question:

Does the SORP Committee wish to comment on these early findings in relation to accounting for consolidation and combination by charities?

Membership of Technical Working Groups and note of main conclusions

Technical Working Group DRAFT MEMBERSHIP		
Issue	**SORP Committee members**	**Dates those expressing interest can attend**
Designated funds **-** consistency IPB-SoP and other SORPs; disclosure in primary statements or notes/TAR; 'window dressing' or conveying 'relevant information'.	Chris Harris Debra Tyler John Graham	17 Nov PM
Capital grants and funding **-** recognition points; deferral; conditions preventing recognition; consistency with IPB-SoP, SSAP4 and other SORPs.	Pesh Framjee Keith Hickey Carol Rudge Kate Sayer John Graham	15 Dec PM
Consolidations and Combinations **-** what does control mean in context of a 'trust interest'; what is meant by 'benefit' in the context of a 'trust interest'; what is an acquisition or merger in the context of charities; consistency with FRS2 and FRS6.	Pesh Framjee Carol Rudge Kate Sayer Catriona Scrimgeour	12 Jan PM
The structure of primary statements **-** Consistency of SoFA with FRS2; disclosure of restricted and endowment funds; complexity (clutter); approaches adopted by other public-benefit SORPs.	Pesh Framjee Keith Hickey Carol Rudge Kate Sayer Catriona Scrimgeour Tris Lumley Peter Gotham Lynne Robb	9 Mar PM
Narrative and non-financial reporting including annual report/OFR **-** role of TAR, what do users of accounts want, annual reporting and small charities?	Tidi Dyan Keith Hickey Tris Lumley Debra Tyler Noel Hyndman Peter Gotham	20 Apr PM
Recognition of multi-period funding arrangements asset/liability test or matching; implied conditions; entitlement; what are unavoidable commitments; what is entitlement in absence of legal redress; performance related grants; consistency with FRS 12, FRS 5, IPB-SoP and other SORPs.	Tidi Dyan Pesh Framjee Keith Hickey Kate Sayer Paul Spokes Lynne Robb	22 May PM

Membership of Technical Working Groups and note of main conclusions

Meeting date: 17 November 2008

Issue: Designated funds - consistency IPB-SoP and other SORPs; disclosure in primary statements or notes/TAR; 'window dressing' or conveying 'relevant information'.

Present: John Graham; Chris Harris; Ray Jones; Debra Tyler

The group agreed that:

- An explanation of designations should primarily form part of a charities reserves policy.
- Designations should not be presented as part of income or expenditure within the SoFA or presented in the balance sheet as a liability.
- The identification of designations for future projects or expenditure can create a presumption that expenditure was committed which may not be the case.
- Concerns existed that designations were being used as 'window dressing' although it was accepted these concerns were based on anecdotal evidence rather than empirical evidence.
- Designations did have value in helping the reader of accounts understand that certain tangible fixed assets were utilised for the provision of charitable services/activities.
- The usefulness of this information to users of accounts, primarily funders, is particularly important.

The majority view

- Designations should be limited to identify assets used for provision of charitable services/activity.
- The determination of this issue should however give very high weighting to the views of funders.

The minority view

- There was no legal impediment or prohibition in standards that prevented the reporting of designations.
- Commercial companies were not prohibited from use of designations - so a prohibition for charities would be inequitable.
- If there was 'window dressing' then SORP rules could be tightened.
- Decision should be informed by research on use/abuse of designations.

Membership of Technical Working Groups and note of main conclusions

Meeting date: 15 December 2008

Issue: Capital grants and funding - recognition points; deferral; conditions preventing recognition; consistency with IPB-SoP, SSAP4 and other SORPs.

Present: John Graham; Keith Hickey; Ray Jones; Carol Rudge; Kate Sayer.

The group agreed:

- The different approaches to capital grants adopted by the four public benefits SORP's reflect the business models under which these sub-sectors operate. Charities do not operate on a 'subsidy model' rather they seek funding for the objectives they seek to carry forward.

- Income recognition and presentation within charity accounts is determined by both the restrictions on the use of funding and the conditions that determine entitlement. Capital grants are only recognised when conditions relating to the grant are met and are presented as a restricted fund until relevant restrictions/ trusts relating to the grant are met or 'extinguished'.

- The identification of capital grants as a restricted fund ensures such income is differentiated from contractual or unrestricted income.

- Restrictions as to future use of an asset are recognised through fund accounting (restricted income, ongoing restriction or endowment). Funders and charities do not generally perceive a capital grant as a long term subsidy of revenue costs associated with an asset but rather focus on any restrictions over the future use of the asset.

- Restrictions as to future use of asset do not affect recognition but will result in ongoing recognition as a restricted fund.

- The nature of ongoing restrictions should be explained in notes that help the reader of accounts understand what the balance on the restricted fund represents.

- SSAP 4 creates issues for readers of accounts in understanding the nature of the liability created by income deferral.

- If funding conditions created a 'performance related grant' dependent, for example, on the stages of a construction project then such conditions would be relevant to initial recognition of the grant.

- It is important to have internal consistency between accounting for donations to fund a capital project (eg. an appeal) and grant funding for the whole or part of a capital project.

Conclusion:
Within the context of the SoFA and fund accounting, the Charity SORP's approach to the recognition of capital grants provides the most appropriate accounting treatment reflecting the legal framework and business model within which charities operate. Only if SoFA was to be replaced by a single column 'income and expenditure' account model might the balance of the argument support a 'matching approach'.

Membership of Technical Working Groups and note of main conclusions

Meeting date: 12 January 2009

Present:
Laura Anderson; Nigel Davies; Ray Jones; Pesh Framjee; Carol Rudge; Kate Sayer; Catriona Scrimgeour

The group agreed:

- Consolidation of subsidiaries was relevant to charity accounting notwithstanding the absence of traded debt and equity. Further consideration of the threshold at which consolidation was required was desirable as part of the post implementation review of the Charities Act 2006.

- The recognition given with the Interpretation for Public Benefit Entities of Statement of Principles that mergers do arise was welcomed. Ideally this accounting treatment should be preserved (if compatible with the standards framework on which SORP is based). The SORP should identify the criteria that can be used to differentiate mergers from acquisitions.

- SORP should continue to provide recommendations on accounting for associates and joint ventures. Equity accounting was favoured in both cases. The criteria by which significant influenced was assessed in the case of an associate charity required particular consideration - the criteria put forward in IPSAS 7 provided some ideas but may not work unless adapted for charities. A particular issue was Board representation by charity funders.

- SORP needs to address accounting requirements where a subsidiary is acquired or disposed of in a financial year. In particular, any goodwill on the acquisition of a charitable subsidiary should be recognised as a gain. The transfer of trusteeship of an endowment or restricted fund should similarly be recognised as a gain. (Different accounting treatment for the transfer of endowments and restricted funds was not supported).

- The next SORP should clarify the accounting responsibilities of corporate trustees. Some still assume that corporate trustee should prepare consolidated accounts to include the charities where they act as corporate trustee.

- Moves within government accounting to assume charity trusteeship should create a presumption for consolidation was a concern. There should be no automatic assumption that trustees exercise control to obtain economic benefit for an appointing entity. The nature of trusteeship needs to be understood and the next SORP should set out criteria by which control can be assessed in the context of a charitable subsidiary. Power of appointment and a general concurrence of purpose should not be taken as meeting the ‘benefit test’ inherent in consolidation. There needs to be evidence that trusteeship is used to create a ‘managed’ benefit for the parent entity before consolidation criteria are considered met. Consideration should also be given to whether charitable trusts created a ‘long term restriction’ which would prohibit consolidation of a charity by a non-charitable parent.

- A number of minor points should also be considered in drafting including:

    - Differentiating between branches and subsidiaries.

Membership of Technical Working Groups and note of main conclusions

- Drafting in paragraph 383 of the SORP should be reviewed as paragraph 383(b) repeats earlier text.

- Paragraph 397 of the SORP needs greater clarity as to the presentation of parent entity SoFA/results.

- Paragraph 405 of the SORP needs greater clarity as to expectations in relation to the presentation of segmented information.

- Requirements for intermediate subsidiaries should be addressed.

Conclusion

The next SORP primarily needed to address the criteria by which control is assessed in the context of a charity. It should also provide further guidance on accounting treatments resulting from mergers or acquisitions within the financial year.