SORP Committee

Minutes of the SORP Committee Meeting of 8 November 2011
(Approved at the December 2011 SORP Committee Meeting)

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Present:

Laura Anderson, Joint Chair of the SORP Committee
Debra Allcock-Tyler
Tidi Diyan
John Graham
Pesh Framjee
Keith Hickey
Noel Hyndman
Ray Jones
Carol Rudge
Kate Sayer
Catriona Scrimgeour

In attendance:

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

Apologies:

Peter Gotham
Tris Lumley
Frances McCandless, Chief Executive, Charity Commission Northern Ireland (observer member)
Lynne Robb
Sam Younger, Joint Chair of the SORP Committee
Paul Spokes

Item 1: Opening remarks and declarations of interest

1.1 Laura Anderson opened the meeting by thanking Carol Rudge and Grant Thornton for hosting the meeting. She then welcomed Caron Bradshaw to her first meeting as an observer member. It was noted that in addition to being Chief Executive of the Charity Finance Directors' Group, Caron was also a Trustee for the Directory of Social Change.

1.2 The disclosure of declarations of interest was invited. No declarations of interest were noted.

Item 2: Approval of the minutes and matters arising

2.1 The minutes of the meeting of the 12 October 2011 were considered and were approved.

2.2 Laura Anderson reported that the launching of a ‘micro-site’ to host the finished SORP text had been delayed. This was due to problems with the sign-on process. It was hoped that these technical problems could be resolved and members would be kept updated as to progress.

2.3 Nigel Davies, SORP Secretariat, reminded members that the Committee’s views were sought at the last meeting on whether the differences in producing consolidated financial statements under the Financial Reporting Standard for Smaller Entities (FRSSE) option warranted a separate module. In discussion it was noted that the differences in approach, as compared to the Financial Reporting Standard for Medium-sized Entities (FRSME) option, were not significant.

2.4 The Committee agreed that the SORP module on the preparation of consolidated financial statements could be amended to encompass the FRSSE option.

Item 3 Update from the ASB

3.1 Joanna Spencer advised the Committee that the Accounting Standards Board (ASB) had approved revised proposals for accounting for non-exchange transactions. They had agreed that a restriction would not of itself prohibit income recognition. In the context of gifted goods and services, the general principle was that income would be recognised where it could be measured reliably and the benefits outweighed the costs, otherwise on grounds of practicality income would be recognised on sale or distribution. An example of where recognition may be impractical is the sale of high volume low value donated goods for resale.

3.2 In terms of valuing donated goods, in the absence of a purchase cost, the ASB considered the deemed cost to be the fair value of the donated goods on acquisition. The valuation of stock at the balance sheet date being the lower of deemed cost or estimated selling price less costs to complete or sell.

3.3 For inventory held for distribution at nominal or no cost there is no estimated selling price, therefore such inventories would be measured at the lower of (deemed) cost and current replacement cost adjusted when applicable for any loss of service potential.

3.4 In recognition of the application of gift aid rules in the UK to the sale of donated goods, the ASB’s Committee of Accounting for Public Benefit Entities (CAPE) considered this situation as analogous to consignment stock. The Committee noted that the SORP would need to consider the recognition point, whether on receipt, sale or 21 days after sale when the donor loses the right to claim the proceeds of sale.

3.5 CAPE was also recommending that the ASB Board make the default accounting treatment for concessionary loans that of initial recognition at fair value. The option of initial measurement at the amount received or paid only permitted where recognition at fair value would cause undue cost or effort.

3.6 In closing, she noted that the Financial Reporting Council (FRC) was consulting on the future arrangements for its work, including the oversight of UK accounting and auditing.

3.7 The Committee agreed that it would be useful to discuss the FRC's proposals and the implications for the approval of the SORP.

Item 4: IASB Agenda Consultation 2011

4.1 Nigel Davies introduced this item. He noted that the Committee had had a presentation about the International Accounting Standards Board's (IASB) Agenda Consultation at the October meeting from Mr Paul Pacter, IASB Board member. There were two main themes for the response. Firstly that it is desirable that an application of international accounting standards is developed for not-for profit. Secondly the IASB should simplify, as far as practicable, the disclosure requirements of international accounting standards.

4.2 The Committee noted that International Federation of Accountants (IFAC) had established the International Public Sector Accounting Standards Board (IPSASB) to adapt the IASB's international financial reporting standards (IFRS) for use by government entities. Although there was much more in common between the not-for profit sector and government, IPSASB's remit did not extend to not-for profit. However the IASB had been considering an application of its conceptual framework for not-for profit.

4.3 To distinguish not-for profit from government the Committee advised that the phrase 'private not-for profit' should be used in the response to avoid any confusion.

4.4 The Committee agreed that:

- **They had no additional recommendations to make concerning the SORP making body's response to the IASB's Agenda Consultation.**

Item 5: Financial Instruments module

5.1 Nigel Davies introduced this paper. He noted that there was nothing charity specific about this topic. However a module could be justified for two reasons. Firstly, practitioners and Honorary Treasurers of smaller charities used to thinking in terms of a debtor, creditor, loan or investment might be unfamiliar with the classification of these items as financials instruments and the use of the terms financial asset and financial liability. Secondly, although the measurement basis for basic financial instruments meant in practice little changed, practitioners may benefit from that reassurance. Also practitioners may be unfamiliar with the new terms used for measurement including: present value, fair value and the effective interest method.

5.2 The Committee noted that a good start had been made but the text could be further improved to assist readers new to the topic of financial instruments. This module, along with the rest of the SORP, needs to reflect the finding of the SORP research exercise that the new SORP should think of the needs of smaller charities first.

5.3 In particular the material in the module could be re-ordered to assist the reader. It was important that those charities involved in basic financial instruments could understand if they needed to read beyond the introduction or not. Further explanation of new terms was needed to help the reader unfamiliar with the terminology surrounding financial instruments.

5.4 It was noted that the FRSSE was a simplified standard that reflected current Financial Reporting Standards. Current standards already made reference to financial instruments and so the only difference for FRSSE users was a reminder that where a new accounting policy was needed they need to refer to the FRSME.

5.5 The Committee noted that the Secretariat intended to liaise with some sector Finance Directors about mixed motive investments and that the module on programme related investments had yet to be finalised. Investments were a form of financial instrument.

5.6 The signposting of the FRSME and the free guidance produced by the IASB as a training module for the IFRS for SMEs was appropriate. The SORP need not elaborate on complex financial instruments since those charities involved in complex financial instruments could obtain the necessary expert assistance to account for them correctly.

5.7 The Committee agreed that where arrangement fees are material their treatment as a financing charge over the life of the loan was the correct treatment. Indeed it reflected current practice. However where the arrangement fees are not material they could be treated as an expense in the year, provided such a treatment does not lead to the financial statements presenting a misleading financial position.

5.8 From the perspective of for-profit commerce a concessionary loan is an inducement to the customer to buy goods and services. International accounting standards consider that the value of sales would be overstated unless the implicit financing component of such a sale related arrangement is not separately identified. Therefore the practice is to discount the value of the sale at the rate at which financing would have been advanced on commercial terms over the period of the arrangement so as to identify the financing component.

5.9 The difference between the nominal value of the sale and the present value of the sale is treated as a cost of sales adjustment in the period, thereby reflecting the financing cost of making the concessionary loan (debit cost of sales, credit customer account). Notional interest income is then credited over the term of the arrangement to the profit and loss account (the debit being to the customer account). Where a charity is furthering its charitable aims this approach implies that when making a concessionary loan, as opposed to a grant, there should be a notional charge in year 1 for making the loan. This appears counterintuitive as there is no equivalent notional charge for making a grant.

5.10 The suggested alternate treatment for concessionary loans furthering a charitable aim was to initially recognised it at fair value but defer the notional financing cost (debit deferred charge for notional cost of concessionary loan financing, credit loan account). The notional financing cost is then charged to the Statement of Financial Activities (SoFA) over the term of the arrangement over which charitable benefit is being received (debit SoFA, credit deferred charge) to match the notional interest income (credit SoFA, debit loan account). The notional cost of concessionary financing being the difference between the market rate of interest that would have been charged and the actual rate of interest, if any, that is charged as a term of the loan.

5.11 The Committee considered that the accounting policy for measuring concessionary loans at the amount or received or advanced better reflected the substance or primary purpose of charitable activities such as micro-financing schemes in developing countries. However if the purpose of the concessionary loan was primarily sales related then the fair value approach would better reflect the purpose of the loan.

5.12 The Committee was wary of the FRSME placing undue reliance on cost benefit grounds for not following a particular treatment. Cost benefit was in practice a difficult test to apply and is more subjective than having specified accounting treatments that can be followed.

5.13 Since tier 1 (full European Union adopted IFRS) would not be extended as a requirement beyond those entities currently having to follow it, the reference to IFRS can be dropped. In discussion it was noted that the wide variety of complex financial instruments meant it was impractical for the SORP to go into detail. However it would be useful to illustrate what was involved with two of the more common examples: advance fee schemes and the option to buy foreign exchange.

5.14 The Committee agreed that:

- **The module was needed and reflected the objective to meet the needs of smaller charities. It could be improved to be even clearer about basic financial assets and liabilities to help practitioners.**
- **It was important to reassure preparers and practitioners that were not involved in more complex financial instruments that little had effectively changed from current practice.**
- **Constructive obligations and non-exchange transactions can fall within the scope of financial instruments, for example a promise to make a grant.**
- **More explanatory material was needed about the new terminology used and where possible new terms should be avoided when discussing basic financial instruments. The module should also be renamed.**
- **The treatment of arrangement fees as proposed was approved.**
- **Where settlement was due within 12 months of the balance sheet date the sum receivable or payable need not be discounted.**
- **The treatment of concessionary loans was approved subject to the final ASB standard.**
- **Where the aim is to further the charity's charitable objectives the accounting treatment for a concessionary loan recognised at fair value is to match over the term of the loan the notional interest expense and notional interest receipt.**
- **Signposting to other guidance for more complex financial instruments was appropriate.**
- **The module could usefully set out the accounting treatment for two of the more common arrangements. These were advance fee payment schemes and the option to buy foreign exchange at an agreed rate.**
- **A general drafting point for all modules was whether the existing SORP 2005 approach of referring to the charity is more appropriate than the alternative of preparer, practitioner or user.**

Item 6: Charitable Companies module

6.1 Nigel Davies introduced this paper. He noted that the module was intended to encompass company law in the UK and the Republic of Ireland. The module followed the same approach as SORP 2005 by signposting relevant requirements rather than trying to summarise the company law framework in its entirety as it affected company charity accounting and reporting. He noted that the department of Business Innovation and Skills were currently consulting on changes to the Directors' Report.

6.2 The Committee noted that the Regulations made under UK company law permitted the directors' to adapt the financial statements of the entity for the nature of its business. Whereas the balance sheet format was mostly prescribed, the format for the Profit and Loss Account was much more flexible.

6.3 The exclusion of the receipt of endowment from income followed the distinction set out in trust law and was appropriate. However restricted income is appropriately included within income for the purposes of the Income and Expenditure account. The proposal for a combined Statement of Financial Activities (SoFA) and summary Income and Expenditure Account reflected common sector practice.

6.4 The proposal not to give guidance on the preparation of a separate Income and Expenditure account was not helpful. The existing SORP 2005 text was also not a helpful guide. Instead a simple table setting out the minimum requirements is needed.

6.5 In practice most charities preparing consolidated financial statements did not prepare a separate parent SoFA on the grounds that it did not offer much in additional information to users of the financial statements. Excluding it reduced clutter. The draft module noted that the option not to file the Income and Expenditure Account for the parent was permitted by UK company law. The SORP making body was invited to consider whether this option under company law can continue to be extended on an administrative basis to the filing of consolidated financial statements by non-company charities.

6.6 The time available precluded further consideration of the draft module.

6.7 The Committee agreed that:

- **It would be useful to replicate the format of the existing Information Sheet comparing the requirements of the business review with the SORP as a comparison of the Directors' Report and the SORP.**
- **The flexibility of the Companies Act framework does permit the equivalent headings of interest receivable and payable, extraordinary income and depreciation not to be shown on the face of the summary Income and Expenditure Account**
- **The receipt of endowment funds does not form part of reported income.**
- **There was a need for some guidance on the contents of a separate summary Income and Expenditure account, where one is required, and a table should be inserted providing this information.**
- **Committee members would advise the SORP Secretariat of any further observations on the draft module by e-mail.**

Item 7: Dates for SORP Committee meetings in 2012

7.1 The Committee agreed that as a contingency seven meetings should be arranged for 2012 so that the ASB's next draft of the FRSME can be considered on a timely basis and the consultation draft of the SORP could be completed.

7.2 The Committee agreed that:

- **Dates to be arranged for 2012 are: March, April, May, and September, October, November and December.**

Item 8: Any other business

8.1 (Deleted)

8.2 There being no other business the meeting closed.