SORP Committee

Minutes of the SORP Committee Meeting of 17 October 2012
(Approved at the November 2012 SORP Committee Meeting)

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Present:

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

In attendance:

Nigel Davies, Secretary to the SORP Committee
Caron Bradshaw, Charity Finance Directors' Group (observer member)
Joanna Spencer, Financial Reporting Council (observer member)

Apologies:

Debra Allcock-Tyler
John Graham
Frances McCandless (observer member)
Lynne Robb
Carol Rudge
Kate Sayer
Catriona Scrimgeour
Paul Spokes
Sam Younger, Joint Chair of the SORP Committee

Item 1: Opening remarks and declarations of interest

1.1 Laura Anderson opened the meeting by recording the Committee's thanks to Grant Thornton for hosting the meeting. Declarations of interest were invited and none were noted.

Item 2: Approval of the minutes and matters arising

2.1 The minutes of the meeting of the 10 May 2012 were considered and were approved with two amendments:

The correction of a date in the first sentence of paragraph 5.5 to read 'end of 2012'.

A clarification to the first sentence of the second bullet point to read 'not available until Christmas 2012'.

2.2 The amended minutes were approved.

2.3 The Committee decided to take agenda item 3, update on progress with issues raised with the FRC, and item 4, update from the FRC, as one item.

Items 3 and 4: Update on progress with issues raised with the FRC

3.1 Ray Jones introduced this item by referring to Paper 2 which identified each issue raised in the consultation response made to FREDs 46, 47 and 48 and the progress made so far with the Financial Reporting Council's (FRC) Project Team in addressing the concerns identified. He noted that following the re-structuring of the FRC that the FRC would now issue the proposed new accounting standards. These standards had previously been consulted upon by the Accounting Standards Board (ASB).

3.2 The consultation draft of the SORP would need to be cleared with the relevant advisory Committee, the Committee for Accounting for Public Benefit Entities (CAPE). Following CAPE's consideration, the draft SORP would then need to be considered by the FRC's advisory Council, the Accounting Council, prior to final agreement to its issue by the FRC's Board. Joanna Spencer advised that the intermediate step of gaining approval by the Auditing and Codes and Standards Committee prior to approval by the FRC's Board would not be required for the consultation draft version of the SORP.

3.3 The SORP making body's response to the ASB's consultation was informed by the views of the SORP Committee and had focused on the essential changes needed to make the new standards workable for charities and had included suggested amendments to the draft standards in the form of 'tracked changes' to the text of the draft standards.

3.4 The FRC Project Team had made the changes that had been requested to the definitions of a performance condition and a restriction, thereby preserving existing accounting practice as set out in the current Charities SORP. To provide clarity, the FRC was going to now refer to a 'performance related condition' where relevant throughout the final versions of the new standards.

3.5 The Accounting Council had now accepted that 'value to the entity' was an appropriate measure for valuing donated services. Donated goods for the entity's own use would be recognised at fair (market) value taking account of any restrictions on their future sale. The SORP would be able to further elaborate on the nature of the restrictions on sale that can be taken into account when adjusting fair (market) value.

3.6 The Committee noted that in some instances a corporate donor might wish to see market value adopted to recognise both the donor's contribution and the character of the donated goods. In other instances market value might overstate the income and expenditure of the charity, for example when a generic alternative was available to a donated branded drug. The SORP would need to provide a framework in which the preparer and the charity's auditor can exercise reasonable professional judgement as to the appropriate basis for the measurement of fair value and value to the entity.

3.7 Although the Committee had sought the removal of the provision in the guidance that ‘a promise to provide cash conditional on the receipt of future income does not give rise to a liability’, the Accounting Council wished to see a recognition that the simple offer of funding did not necessarily create a constructive obligation and a liability. The Committee were anxious that the final drafting avoided the suggestion that the inclusion of such a clause would in itself prevent the recognition of a liability where the criteria for recognition of a constructive obligation had otherwise been met. The SORP Secretariat is continuing to liaise with the FRC Project Team on the drafting of the guidance to be included in the standard on this issue.

3.8 The Committee noted that the recognition options provided in Section 24 of the draft Financial Reporting Standard for grant income would now to be restricted to government grants in line with International Accounting Standard’s Board (IASB) IFRS for Small and Medium-sized Entities. The Committee noted that the current SORP takes the performance model approach to grant income recognition and this remained the Committee’s preferred option.

3.9 Joanna Spencer confirmed that the SORP would be able to rule out the accruals option altogether. She confirmed that the performance model would also apply to non-government grants in the same way as it did for other donations. The FRC intended to undertake a research project at a future date on this issue but no time-table had yet been set for this project.

3.10 The FRC had agreed to simplify its proposed disclosures for the components of the primary statements when merger accounting was adopted for a combination by reverting to the disclosures currently required by FRS 6 – Acquisitions and Mergers.

3.11 The option to value concessionary loans at the amount paid or received (with subsequent adjustment for the interest paid or received) would be extended to intra-group loans within public-benefit entity groups where the loan was made to further the parent entity’s purposes.

3.12 The reduced disclosure framework provided by FRS 101 only applied to entities with a parent prepared accounts under EU adopted IFRS but for clarity charities would be specifically excluded from following this standard. This approach would be helpful because those charities which are to be consolidated into whole of government accounts might otherwise be able to avoid compliance with the SORP and certain FRS 102 disclosures by claiming that their parent entity was following a version of IFRS in its group accounts.

3.13 Joanna Spencer advised that the extended guidance and definition of PBEs was to be reintroduced into FRS 102. Also the legal requirement to comply with the methods and principles of the current SORP, required by charity law in certain UK jurisdictions, was to be acknowledged. This was important because a switch to new standards would not possible in those jurisdictions where the law requires the application of the current SORP (which is based on current Generally Accepted Accounting Practice) until the revised SORP was issued and relevant accounting regulations amended.

3.14 Ray Jones also advised that the FRC were consulting on two proposed amendments to Financial Reporting Exposure Draft 48 (FRS 102) concerning the treatment of employee benefits and specialised activities.

3.15 The change to employee benefits related to the accounting treatment of multi-employer pension schemes. Currently where an entity participates in a multi employer pension scheme and the scheme is unable to identify its share of a defined benefit pension scheme liability, the entity treats the scheme for accounting purposes as though it were a defined contribution scheme. The consultation proposes that where an entity has agreed a schedule of additional payments to rectify a funding deficit in the scheme that a liability is recognised for the present value of those payments.

3.16 The Committee noted the incidence of multi-employer defined benefit pension schemes in the charity sector is relatively common. In the private sector such arrangements were more likely to involve a group pension scheme; however, in the public-benefit sector such arrangements tended to be outside of group structures. The Committee discussed the practice of actuaries and reflected on the apparent inconsistency in that pension scheme actuaries could identify the liability of members to make good a deficit in a scheme but at times seemed unable to identify the share of the underlying pension scheme liability relating to each member of the scheme for accounting purposes. The Committee speculated that this may be due to the nature of the mathematical models used.

3.17 The Committee noted that the valuation of a pension scheme liability differed significantly between its buy out valuation, a triennial valuation and the present value of an agreed schedule of payments for accounting purposes and that these calculations were very sensitive to the underlying assumptions used. The proposed change by the FRC was consistent with the underlying IFRS standard IAS 19 Employee Benefits. Although the change was a useful one, inevitably the valuation would differ in its basis and meaning from other pension scheme valuation approaches and would therefore not be comparable.

3.18 The second amendment related to the accounting treatment of service concession arrangements. Such arrangements mainly involved the development and operation of infrastructure assets such as hospitals, roads and railways. The Committee noted that examples could arise in the charity sector e.g. waterways and in the HEFE sector for the provision of student accommodation or within charity group structures created to minimise tax liabilities involving the use of land and construction of buildings.

3.19 The amendment proposed that the grantor of a service concession adopt an accounting approach comparable to that of a finance lease, recognising both the infrastructure asset and the corresponding liability to the operator of the service concession for the construction of that asset. The liability is treated as though it were a finance lease in accordance with the methodology of IFRIC 12 Service concession arrangements.

3.20 The Committee, in advising the SORP making body, recommended that:

A response should be made to the FRC consultation that was generally supportive of the two changes proposed to FRED 48.

The service concession arrangements should be disapplied in the context of a group where transactions involve a parent and a wholly owned subsidiary.

Item 5: Recent research on areas of public interest in charity reporting

5.1 Nigel Davies introduced this paper. He noted that the SORP Committee had previously considered who were the main audience for the trustees' annual report and the accounts. Although funders and donors were important, the Committee had previously concluded that other stakeholders including the public were also important. With this in mind, two recent pieces of research on public perceptions of charities, the IPSOS MORI report: Public Trust and Confidence in Charities (2012) and nfpSynergy's research contained in their Charity Awareness Monitor (2012), were identified for discussion.

5.2 The IPSOS MORI research highlighted themes that were consistent with their previous reports in 2008 and 2010. The 2012 report identified the impact of a charity's work as the strongest driver of public trust. The public appeared to view the level of spending on salaries and administration as a proxy for a charity's efficiency and impact. High salaries and administrative costs appear to be equated in the public mind with inefficiency and poor performance.

5.3 The findings of nfpSynergy reported in the sector press in April 2012 appeared to be consistent with those of IPSOS MORI with a public preoccupation with salaries and staff expenses.

5.4 The Committee noted that the context of nfpSynergy's and IPSOS MORI's research was that of a public debate over the remuneration of banking staff and the expenses of Members of Parliament. The research findings were therefore reflective of a wider public mood.

5.5 The Committee considered the disclosure of salaries. The current disclosures by number of staff in salary bands of £10,000 starting at £60,000 applied to larger charities. Although disclosure of individual salaries might increase transparency, there was a danger that this would distract public attention towards inputs, such as salaries, and away from outputs, outcomes and impact. The sector needs to explain better its activities and the impact of its work so that the public can assess the evidence of its achievements.

5.6 The Committee considered whether the disclosure of individual remuneration, beyond that already required of trustees, would enhance public confidence. It recognised that public money was involved and that research had consistently shown a high degree of public interest in remuneration. The risk of further detailed disclosure was that media and public interest would then focus on particular personalities rather than on what the charity had actually done or achieved. In a commercial setting, listed companies provided details of their Remuneration Committee and executive remuneration policies. This approach might provide an alternative way forward and allow charities to explain their approach to remuneration and the factors that determined their remuneration policies.

5.7 The Committee had previously noted the difficulties in defining administrative costs in a way that could be applied consistently across the sector. The Committee still favoured the approach of larger charities providing in a note an analysis of their support costs with the focus in their primary statement remaining on the cost of delivering its activities.

5.8 The Committee noted that there were a number of useful initiatives and models for impact reporting being developed within the sector. Although the SORP making protocol precluded the SORP specifically cross-referencing to such guidance, the SORP's guidance on reporting outputs, outcomes and impact could be enhanced by highlighting the key principles of good reporting in this area.

5.9 The Committee reflected on whether reporting outputs, outcomes and impact should be a requirement for larger charities rather than a recommendation. However, given the sheer diversity of the sector's activities, no single uniform approach should be mandated by the SORP. Charities needed to consider a proportionate approach where 'impact reporting' is an approach that trustees may consider as appropriate to the reporting of their particular charity's activities.

5.10 The Committee noted that the SORP had introduced a requirement for larger charities to report on risk, once approaches to risk management had made its reporting practicable. Although there was a body of practice developing for 'impact reporting', it had not reached a stage whereby a single method of reporting achievement could be identified and required. Instead 'impact reporting' should be regarded as best practice, where it was appropriate to the activities of a charity, rather than made a mandatory requirement for all larger charities.

5.11 The Committee considered whether impact reporting should only be required of the largest charities, for example by adopting the company law definition of medium companies as an extra threshold. However, in discussion it was noted that size, whether measured by income or assets, was only one factor that might determine how achievements should be reported. Other factors included the nature of the activities undertaken, the timescale over which results or 'impact' could be identified and the extent to which the activities of others and the operating environment influence the impact observed.

5.12 Nigel Davies noted the findings of Lord Hodgson’s review of the Charities Act 2006 (England and Wales): Giving Charity back to Charities. The report noted that: ‘reports and accounts are one of the major ways in which the transparency of the sector is achieved’. The report welcomed the steps being taken to simplify the SORP by the development of a modular SORP, where reference is made only to those sections that are relevant to the charity’s own accounts preparation, and the commitment that the next SORP will better meet the needs of small charities.

5.13 The Committee, in advising the SORP making body, recommended that:

The starting point for the disclosure of staff salaries in bandings of £10,000 by larger charities should remain at £60,000.

No change should be made to the SORP’s approach requiring the analysis of support costs by larger charities.

Impact reporting should remain best practice reporting rather than a requirement of SORP.

The SORP’s recommendations regarding impact reporting be reconsidered at the December meeting.

Item 6: IASB review of the IFRS for SMEs

6.1 Nigel Davies introduced this paper. He noted that the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs) had been developed by the International Accounting Standards Board (IASB) as a cut down version of full IFRS. Although not adopted into GAAP, the IFRS for SMEs had been the standard upon which the new GAAP framework (FRS 102) is based.

6.2 The IASB had promised to review the IFRS for SMEs after it had been in operation to learn from the experience of its implementation and to take account of subsequent developments in full IFRS. The review was to conclude with a revised IFRS for SMEs effective from 2015. It remained to be seen when, or if, the FRC would then amend new GAAP for the revision of this standard. It was noted that three yearly updates for the IFRS for SMEs gave rise to the potential for more updates in GAAP.

6.3 Although the IFRS for SMEs was developed as a for-profit sector standard, the review included a question about whether its use by not-for profit entities should be prohibited. The Committee noted that in the absence of an international standard or framework for reporting and accounting by not-for profits, the IFRS for SMEs had been used alongside the existing not-for-profit standards in New Zealand, the USA, Canada and the UK SORP. In the UK, the proposed FRS 102 was also based on IFRS for SMEs but was augmented by the addition of PBE requirements and supported by the Charities SORP. In the absence of an international standard, the IFRS for SMEs was a useful starting point and so this option needs to remain open.

6.4 The use of the IFRS for SMEs required adaptations for not-for profit entities and therefore the Committee welcomed the reference to these issues in the annex to the letter. The proposed FRS 102 identified and addressed these particular issues at a high level with the Charities SORP providing the detailed implementation guidance. The IASB might usefully look at the model adopted in the UK and include a specialist activities section within IFRS for SMES to address not-for- profit accounting issues.

6.5 The Committee, in advising the SORP making body, recommended that:

The letter's preamble should be shortened so as to emphasise the message about the need to adapt the standard for use by not-for-profit entities rather than to prohibit its use by not-for-profit entities.

The recommendation for 'cutting clutter' should be retained.

The recommendation for the development of an international standard for not-for-profit entities should be more clearly highlighted by closing the letter with this point.

In the annex to the letter, the charity specific issue of fund accounting by charities should be added as an area of difference and a reference to gift accounting being used as a substitute for acquisition accounting should also be added.

Item 7: Any other business

7.1 There being no other business the meeting closed