

SORP Development

1 Introduction

- 1.1 The work of developing the new SORP began with the December 2009 meeting and the convening of a sub-group to consider options for reformatting the SORP to improve its accessibility. The work of the sub group was considered at the next meeting held in July 2010 along with more detailed plans to develop a new modular SORP.
- 1.2 At the July 2010 meeting it was agreed that the SORP be drafted around international financial reporting standards as they would apply to medium-sized entities and the Financial Reporting Standard for Smaller Entities (FRSSE).
- 1.3 This decision took account of: the Accounting Standards Board's (ASB) plans for UK/ Irish Generally Accepted Accounting Practice (GAAP), the nature of the sector which is skewed by income towards smaller charities, and the feedback from the SORP research that the SORP should continue to provide a complete solution for charities.
- 1.4 The context of the SORP Committee's deliberations is the ASB's consultation on the future of financial reporting which closed on 30 April 2011. This consultation proposed the retention of public benefit SORPS and three tiers of reporting. It included a draft Financial Reporting Standard for Medium-sized Entities (FRSME). Subsequently the ASB issued a draft Financial Reporting Standard for Public Benefit Entities (FRSPBE), the consultation on which closes on 31 July.
- 1.5 The initial SORP development timetable was approved at the July 2010 meeting. The complexity of the ASB's three tier proposal and the ongoing consultations made drafting the SORP a more demanding exercise than before. The initial plan was for the new SORP to have been agreed by the June 2011 meeting. This timetable was extremely ambitious but was intended to ensure SORP was available in time for the 18 month transition period promised by the ASB when it set the implementation date of 1 July 2013. However the ASB has since tentatively decided that the implementation date for changes to UK GAAP may slip to 1 January 2014.
- 1.6 A series of SORP Committee meetings have been held since October 2010. To date, 20 modules have been reviewed across 7 meetings by the Committee and in total 28 have been drafted. This period included the Committee's consideration of the ASB's consultations on the FRSME and FRSPBE.
- 1.7 This paper considers the issues remaining on those modules considered by the Committee so far. It also identifies the outstanding modules for review and the progress to date on their development.

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2 The SORP development process

- 2.1 The factors informing the drafting of the next SORP are:
 - The SORP research exercise held in 2008-09
 - Concerns raised in the UK Parliament in October 2005
 - The work of the SORP Committee sub-group reported in July 2010
 - The 'three tiers' proposed for UK GAAP (FRED 43)
- 2.2 The SORP research findings noted a number of difficulties with the current SORP: legalistic language, the need to draft with smaller charities in mind first, and a desire for a framework that has a degree of flexibility whilst it applies to all charities.
- 2.3 The Queen's University, Belfast, research report concluded that SORP 2005 had got the balance between required and recommended about right. However a number of detailed findings were made. These detailed findings have been reviewed in drafting the relevant modules.
- 2.4 General comments from the research included a unanimous endorsement of the SORP 'as a force for good'. However a general area for improvement was to make the SORP less intimidating for smaller charities since it was currently 'quite complex and technical'.
- 2.5 The concerns raised in the UK Parliament in 2005 during the passage of the Charities Act 2006 (England and Wales) were two fold. Firstly that the SORP is a "long and complex document" and secondly that it did not "make sufficient distinction between large and small charities". Whilst it is anticipated that a combination of the modular approach and drafting the modules from the perspective of smaller charities will address these concerns, this conflicts with the demand for a less technical SORP which is a 'one stop' solution which are factors adding to its length. This is not helped by the ASB retaining two versions of UK GAAP, the FRSME and the FRSSE which are not wholly consistent.
- 2.6 The scope for drafting is constrained by the growing complexity of UK GAAP and the lengthy disclosure requirements imposed on accruals accounts. These factors have also lead to increasing detail and length.
- 2.7 The approach to developing the new SORP provides for each module to be reviewed by the Committee. Post review the draft module is circulated in tracked changes format for further comment, and then the draft text is settled and circulated for information. Where an issue of principle remains unresolved that issue is taken back to the Committee for final discussion before the draft text is settled

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2.8 Once the settled draft text of the new SORP is agreed it will be:

- reviewed for drafting consistency and an appropriate balance between technical accuracy and plain English;
- compliance with the published FRSME, FRSSE and FRSPBE;
- developments in charity and company law and regulation in Scotland, England and Wales, Northern Ireland and the Republic of Ireland;
- reformatted in a version suitable for an internet based public consultation.

3 Progress on the modules

3.1 Paper 2.1 identifies the SORP modules in development and notes the progress of each module. It is anticipated that the last modules to be compiled will be the checklists. These cannot be drafted until all the other modules are complete and the final FRSME and FRSPBE standards are issued. There are three areas where agreement is needed before the series of modules is complete.

Annual Review

3.2 The SORP research findings noted the popularity of the annual review as a flexible and user friendly way of communicating with donors and the public. Whilst acknowledging that the audiences for the annual review and Trustees' Annual Report are different, the research noted an appetite for guidance stipulating how charities communicated financial information and what should be included.

3.3 The annual review and other forms of communication via websites, newsletters and other media are non-statutory and so it is proposed that the SORP does not extend into this area. The basis for this recommendation is that the sector is better placed to develop best practice in this area. The role of SORP is to supplement accounting standards. The ASB's Statement of Principles for Financial Reporting – Interpretation for Public Benefit Entities states that the primary focus: 'is on those financial statements that are required to give a true and fair view'. The SORP has therefore focussed in the past on the preparation of the statutory Trustees' Annual Report and the financial statements.

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Summarised Financial Statements

- 3.4 SORP 2005 paragraphs 371 to 379 require extensive disclosures by the trustees where summarised financial statements are produced. The disclosures required are modelled on company law (now section 427 of the UK Companies Act 2006). A statement is also required from the external auditor or examiner. There are no legal requirements applying to the production of these statements for non-company charities. The SORP's recommendations also extend to summarised financial information with trustees being required to attach a statement.
- 3.5 Since there are no statutory requirements in charity law concerning the production of summarised financial statements or summarised financial information, it is proposed to drop the SORP's recommendations as a simplifying measure. This will permit the majority of charities, which are not companies, to enjoy greater freedom in the presentation of financial information without extensive disclosures. It will also save the additional fee costs relating to the auditor or examiner certification. Instead the requirements relating to company law will be signposted in the relevant module. Alternatively the text could be retained and modified to a 'should' or 'may' format which trustees then follow at their discretion.

Net movement in funds

- 3.6 Finally a simplification is proposed in dropping the recommendations to produce an analysis of net movement in funds (SORP 2005 paragraphs 242 and 243). This analysis is additional to the funds analysis and is intended to highlight changes in endowment, net expenditure on additions to functional assets, and programme related investments.
- 3.7 The trustees can always provide such additional information or analysis at their discretion.

Questions on the drafting points:

- 1 Does the Committee agree that a module on the annual review is not required?
- 2 Does the Committee agree that the SORP should no longer cover summary financial information and summary financial statements?
- 3 Are there any further ways in which the next SORP can address the two concerns raised in the UK Parliament?
- 4 Are there any additional modules that are required but not listed in the schedule (PAPER 2.1)?

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4. Drafting issue outstanding: heritage assets and the link with the charity's objects

4.1. The first issue has been identified in correspondence with the module on heritage assets. The draft text provides for a link between the objects of the charity and the asset. The text at issue is underlined and is reproduced in its context as follows:

'For the heritage asset to be furthering charitable activities it follows that the charity holding the heritage asset must normally have preservation or conservation objects or purposes. These preservation or conservation purposes may be ancillary to a broader purpose such as:

- *educating the public in history or in the arts or science as is the case of museums and galleries; or*
- *preserving habitats, rare breeds of animal or species of plant for future generations to know and understand or for scientific study.*

However some charities may not have preservation or conservation objects but still hold heritage assets. Examples would include: abbeys, monasteries, cathedrals and historic churches and monuments. Where a charity does not have preservation or conservation objects in order for an asset to be a heritage asset, the asset must:

- *have historical, artistic, scientific, technological, geophysical or environmental qualities;*
- *in its retention and use contribute to knowledge and culture be available for public access;*
- *be of such a character that valuation on the basis of depreciated replacement cost is not practicable. For example a building cannot be replicated using modern building methods or the creation of a replica will not retain the unique historic or heritage qualities of the asset.*

Similar issues may arise in the context of artefacts contained within, or associated with, such assets. For example associated artefacts could include religious artefacts contained within a cathedral or historic church.

Where a charity does not have preservation or conservation purposes and the trustees consider any heritage qualities of an asset to be incidental to its operational use it is classified as an operational asset and accounted for as property, plant and equipment.'

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- 4.2 The concern suggestion is that the text may be too restrictive, particularly for museums and conservation charities, and might lead to assets classified as heritage assets when these were better as property, plant and equipment. The definition of heritage assets is given in appendix III to the FRSPBE consultation document and is reproduced below:

‘an asset with historic, artistic, scientific, technological, geophysical, or environmental qualities that is held and maintained principally for its contribution to knowledge and culture.’

- 4.3 The sentiment the underlined text was endeavouring to reflect is that on occasion assets with heritage characteristics may be used for administrative purposes or for service provision by a charity in a way that is unconnected to the asset’s heritage qualities. For example, a historic building used by a service providing charity as administrative offices would not fall within the definition nor would a artistic work simply held as a store of wealth. In neither case are the assets held primarily for their contribution to knowledge and culture.

Question:

- 5 Does the SORP Committee agree with the existing draft text for heritage assets or should the text be changed and if so in what way?**