Following a long period of consultation, the joint SORP making body have released two new Statements of Recommended Practice (SORPs):

• SORP 2015 for Charities applying FRS 102; and
• SORP 2015 for Charities applying FRSSE.

The new SORPs replace the previous edition (2005) and apply for accounting periods beginning on or after 1 January 2015. The SORPs are available to download from the charity SORP website (www.charitysorp.org) and are a joint project between the Charities Commission and Office of the Scottish Charity Regulator.

The new SORPs have been produced as a result of the introduction of FRS 102, The Financial Reporting Standard Applicable in the UK and Republic of Ireland, which will replace all current UK accounting standards with the exception of the Financial Reporting Standard for Smaller Entities (FRSSE) in 2015.

Whilst UK GAAP has been subject to a significant review, accounting for smaller entities (as defined by the Companies Act 2006) remains broadly unchanged and these entities can continue to use the FRSSE as long as they meet two of the following three criteria:

• Income less than £6.5m;
• Assets less than £3.26m; and
• Employees fewer than 50.

The new SORPs are set out in a modular format. They contain a number of core modules that are relevant to all charities and specialist modules that only apply to particular charities according to their constitution, structure and activities. Each module has an introduction which explains what the module is about and details, in bullet points, its contents. Requirements have been written so that they are placed into three categories – “must”, “should” and “may” so that mandatory requirements can be separately identified.

The Trustees’ Annual Report will retain the headings set out in the previous SORP (2005), however there are a number of notable additional requirements. The first of these is that the principal risk and uncertainties facing the charity, along with plans and strategies for mitigating the risks, will need to be disclosed. Many larger charities already do so but it now becomes an explicit requirement for any charity requiring an audit.

There is also a greater emphasis on progress against objectives, identifying the results of the charity’s activities and their impact on beneficiaries and more detailed disclosure recommended about the charity’s reserves.

Possibly the most noticeable change as a result of the new SORP is that the SoFA has been simplified:

• Four incoming resources headings (donations, earned income split, between income earned from charitable activities and other activities, and investment and other income) replace the six income analysis headings in the SORP (2005); and
• Three headings for expenditure (fundraising costs, expenditure on charitable activities and other expenditure) replace the seven analysis headings of the SORP (2005);
• Governance costs are no longer shown on the face of the SoFA and must now be allocated to the other expenditure headings; and
• Investment gains/losses are shown ‘above the line’; i.e. as part of incoming resources (in line with FRS 102).
The new SORPs also introduce different accounting treatment for some items, including:

Legacies
The general rule for income recognition within the new SORP is that income should be recognised when the charity is (a) entitled to the legacy, (b) receipt is probable and (c) the income can be measured reliably.

This has been a controversial change from the previous SORP, where income was recognised when virtually certain. The new SORPs state that receipt of a legacy is probable when following probate, the executors have established there are sufficient assets in the estate and any conditions have either been met or are in the control of the charity. However, the SORPs have been written to allow flexibility in the accounting policy choice for legacies.

Holiday pay
Under FRS 102 there is now an explicit requirement to account for ‘accumulated compensated absences’ (typically holiday pay) which are outstanding at the balance sheet date. For an entity with a holiday year that runs concurrently with the financial year and allows no carryover of holiday, then this would be zero. However, where the carryover of holiday is allowed or the holiday year and financial year are not the same, then a figure will need to be calculated for the unused entitlement.

Related parties and key management personnel
There has been a significant extension to the definition of related parties under the new SORP – from two paragraphs to more than two pages. Most notable is that all employees (not just senior management) are now related parties. Transactions with related parties (including employees) will need to be disclosed unless they fall within a list of transactions outside the scope (e.g. donations). Another area which has been met with some resistance is a new FRS 102 requirement to disclose an aggregate total for key management remuneration.

Fixed asset revaluations – Transitional option
Under current UK GAAP / SORP (2005) there was an option to hold property at cost or at valuation, with unrealised surpluses being held in a revaluation reserve. Choosing to revalue buildings would commit a charity to periodic revaluations to ensure that the property remains at fair value. This process of revaluations would create additional ongoing costs and may not seem an attractive option. These two choices are also available in FRS 102 and moving to revaluations would indeed still require periodic revaluations.

However there is a transitional option within FRS 102 that would allow a charity’s building to be valued at fair value on transition and then use that value as deemed cost going forward with no ongoing requirement to carry out further revaluations. This will affect the transitional balance sheet and any valuations will need to be undertaken relatively soon to ensure they reflect the value at that date.

Heritage assets
The SORPs significantly extend the scope of heritage assets in comparison to FRS 30 and FRS 102. Previously the requirements would have only applied to entities that hold assets to further preservation or conservation purposes (e.g. museums). However the new SORPs also requires charities that have assets whose preservation and contribution to culture are ancillary to faith or other purposes.

This has the potential to bring within its scope numerous assets that were not previously treated as heritage assets, such as historic churches or artefacts contained within them.

Heritage assets may be held at either cost or valuation. As many charities may have received such assets over a number of years, many will have not recorded these in the financial statements. This will not affect the balance sheet, but there are some additional disclosures that may be very tricky to draft.

Total return approach
Where a charity holds investments as permanent endowment and adopts a total return approach, the amount of the unapplied total return allocated to income must be identified separately in the SoFA as an allocation between endowment funds and income funds, either within the transfer row or within the ‘investment and other income’ section of the SoFA. Also required is the disclosure of the date the value of the initial gift component of the permanent endowment and initial value of the unapplied total return was established, as well as the amount of unapplied total return carried forward.

Long-term intercompany loans
Loans within a charitable group, typically from a charity to a trading subsidiary, are often interest free. Under FRS 102 and the new SORPs charities may be required to discount the loans to present value using market rates. It may be worth considering whether market level interest rates should be applied to avoid a scenario where intercompany balances will not reconcile due to discounting. The obvious solution would be to ensure that intercompany loans are repayable on demand or to apply a commercial rate of interest to such loans. There is however, an exemption for intercompany loans to entities that undertake charitable activities (e.g. loans between two charities in a group).

If you have any questions about the new SORPs, contact Nick Brooks.
International Financial Reporting for the not for profit sector

In August 2013, CCAB (Consultative Committee of Accountancy Bodies) commissioned a team from Sheffield Hallam University and the University of Durham to take a short but intensive study of international financial reporting for the not for profit sector. The study’s objectives were to identify what was meant by not for profit internationally, identify any current accounting framework, focus on any specific accounting issues and make recommendations where there was a need for development or some form of international reporting standard. The full Report can be found on the CCAB website www.ccab.org.uk.

The key findings from the Report are as follows:

- The majority of survey respondents (72%) indicated that they thought it would be useful to have international standards for financial reporting by not for profit organisations, though respondents interpreted the term ‘standards’ in different ways.
- Many respondents, especially those involved with not for profit organisations operating in developing countries, would welcome a standard if it could contribute to resolving the diverse and inconsistent demands from funders.
- However, 14% were opposed to a new international standard. The strongest objections appear to come from countries such as the UK, which already have well developed frameworks for not for profit accounting.
- This report is the first step towards establishing whether or not there is a case for developing harmonised international standards for not for profit financial reporting.
- Much more analysis and discussion will be needed between interested parties: the findings presented in this report have the potential to inform the debate and move that discussion forward.

In conclusion, there appears to be some appetite by the CCAB in developing a reporting standard for the not for profit sector further.

Investment managers and how they classify their clients – what does this mean for you?

Charity trustees now have many choices about how and where they invest. Changes in how the investment industry works has prompted firms to clarify (or in some cases to alter) their business model and trustees need to be aware on the type of client they are, as it determines the role of investment provider and the protection of their assets.

The key driver for the change is not new; it stems from a 2004 European Directive (Markets in Financial Instruments), which requires firms to classify their clients. The main classifications are the distinction between whether a client is retail or professional. It also brought in rules concerning certain types of transactions, including management of discretionary portfolios. More recently, in 2013 the UK financial regulator (formerly the FSA, now the FCA, Financial Conduct Authority) brought in new arrangements, under the ‘Retail Distribution Review’, some of which were aimed at raising standards in the type of advice given to retail investors.

So, what is the difference between professional and retail and what does the way your investment manager classify you mean to you? The professional investor category was intended for sophisticated wealthy investors, who are knowledgeable and comfortable in taking more responsibility and more risk. There are quantitative and qualitative determinants for identifying professional clients, one being the size of assets they have to invest. Charities have increasingly sought trustees and investment committee members with financial experience and many have considerable sums invested, thinking and operating as a major institution. Whilst that is undoubtedly a valuable skill set on a board, it does not by default determine their investor status.
The retail investor is deemed to require (or seek) a greater level of protection. Part of this is providing the maximum protection outlined within the regulations, including receiving best execution on investment deals, various risks being pointed out to you and access to the Financial Ombudsman Service and the Financial Services Compensation Scheme, should it ever be required.

**Investment advice versus product advice**

Different offerings from investment firms don’t just relate to your client classification and the associated protections; there are also differing forms of advice. The Charity Commission, in their CC14 guidance ‘Charities and Investment Matters - A Guide for Trustees’, set out what trustees should or may consider on a wide range of investment matters. Specifically on advice, they say that trustees must take advice from someone experienced in investment matters unless they have good reasons for not doing so.

If you have a discretionary agreement (whether you are a professional or retail client) you will be receiving investment advice, as well as the management of the money, albeit afforded by an investment agreement. If you have a discretionary agreement (whether you are a professional or retail client) you may consider on a wide range of investment matters within the regulations, including receiving best execution on investment deals, various risks being pointed out to you and access to the Financial Ombudsman Service and the Financial Services Compensation Scheme, should it ever be required.

**Choice or no choice?**

So whose choice is it on what kind of investor a charity should be? It is for trustees to determine what they think appropriate for them and then up to each firm to define its own business and what it wishes to offer.

The recent industry changes prompted many firms to review their business models, some confining themselves to a higher minimum investment and to dealing with professional investor’s only. Others offer retail agreements to all clients. Most charities fall quite clearly into one of the following; professional or retail agreement; under which they may have their own portfolio or be invested in a pooled fund/s.

The main point for trustees is to be clear what they require and what they are receiving (be it from their existing investment firm or when reviewing arrangements, which is also recommended from time to time). The position trustees need to end up in is whichever one provides the best balance of the investment solution they want; from the firm they choose; and with the appropriate business model.

**Ruth Murphy**

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The value of investments can fall and you may get back less than you invested. An investment is suitable in all cases and if you have any doubts as to an investment’s suitability then you should contact us.

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Liz at the charity said of icaewvolunteers.com “Having been without a treasurer for nearly 2 years and having 3 failed attempts to take someone on, this website was suggested to us. Once the advert went up on the website, we had three enquiries within 48 hours! That sort of things just does not happen in Cornwall!”

In the end retired accountant Mike was appointed Treasurer of the charity. Mike had been looking for a finance or accounting volunteering role for a worthwhile cause that was within easy reach of his new home. As a result of looking for a volunteering role on www.icaewvolunteers.com Mike ended up volunteering for two local charities.

Mike has already recommended the website to the local CAB and said “I think that the use of your website does a lot of the weeding out of unsuitable candidates that a newspaper advert attracts. From my perspective, the reverse is also true. All the vacancies advertised appear to be genuine and worthwhile.”

When asked about the benefits of volunteering, Mike said “Not only does it keep one’s mind and body agile, it also gives some purpose to life after work, getting you out and meeting people of all ages (not just other pensioners!).”

Liz feels that Mike has made a huge difference in his role already by, amongst other things, supporting their book keeper in getting their annual accounts ready and introducing accounting by projects, enabling the charity to better track their expenditure. Liz said “above and beyond that, he showed up at the beach to meet all the young people on the first weekend he could. To be honest, he hasn’t really stopped!”

Since the launch last year, organisations have reported back that 78 volunteering roles have been filled with skilled volunteers so far. The majority of these are at board level but there are no restrictions on what sort of role can be posted on the website as long as it is unpaid.

Chair of the ICAEW Charity and Voluntary Sector Group and head of not for profit at Kingston Smith, Nick Brooks, said: “I am delighted by the success of this project. Being the number one website of financial volunteer roles was one of the project’s aims and to achieve this in the first year is fantastic.

There is still a lot of work to be done and I am confident that the site will go from strength to strength.”

“Evidence shows that the need to strengthen boards with skilled volunteers, particularly with accounting skills, is essential. This website is helping to address this need.”

Quick Stats
Number of roles posted since the launch 1,123
Number of organisations signed up 692
Number of volunteer users signed up 1,365

What does FRS 102 mean for Pensions?

The introduction of FRS 102, effective for periods beginning on or after 1 January 2015, will have an impact on many charities and other not for profit organisations with pension schemes. FRS 102 contains what is, essentially a cut down version of IAS 19, Employee Benefits. This is a similar standard to that applied in current UK GAAP, FRS 17, Retirement Benefits and the changes are not radical.

Defined Contribution Schemes
There will be no changes to the way defined contribution schemes are accounted for. This will continue to be recognised as an expense for the period unless the cost contributes to the cost of another asset (e.g. stock or fixed assets). There may, however, be changes to multi employer schemes that are currently accounted for as defined contribution schemes (see below).

Defined Benefit Schemes
The underlying principles behind accounting for defined benefit pension schemes in an employer’s financial statement remain. That is, a defined benefit obligation is measured on an actuarial basis, a net defined benefit liability (or rarely an asset) is recognised on the balance sheet, current service by employees is recognised as a service cost in the SoFA and other changes are accounted for as other gains and losses.

One change to note is that the current year charge will now use a discount rate based on net interest on the net defined liability rather than the FRS 17 approach of using expected return on assets. This is likely to increase charges in the top half of the SoFA where schemes have a growth orientated strategy.

Multi-Employer Schemes
Many charities and other not for profit organisations operate multi employer defined benefit pension schemes and may now need to account for a liability on their balance sheet on transition to FRS 102. Under FRS 17 most charities have accounted for multi employer schemes as defined contribution plans and accounted for contributions paid as an expense (permitted under FRS 17 unless the employer is able to identify its share of the underlying assets and liabilities on a reasonable basis).

Large numbers of organisations with multi employer schemes have agreed to additional contributions as part of a deficit recovery plan. The treatment of such deficit recovery plans has varied significantly in practice, with some organisations recognising a liability, whilst others have not, depending on the nature of the plan. However FRS 102 now mandates the recognition of such deficits as a liability, which should be discounted to net present value.

This could potentially create a disconnect between organisations which have actuarial information that identifies their assets and liabilities who will recognise a defined benefit obligation based on an actuarial valuation, compared to those that do not have this information and base their balance sheet provision on the discounted value of deficit reduction payments.

FRSSE
Organisations able to use the Financial Reporting Standard for Smaller Entities (FRSSE) will be unaffected by the changes above and can continue to use their current accounting policies. Organisations not currently using the FRSSE will need to change to the FRSSE before the period ending on or after 1 January 2015; otherwise they will need to follow the policy set out above.
The latest announcement confirms that an Income Tax credit of 30% will be available for investors as well as a deferral relief for tax on capital gains realised on other assets.

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