CHARITIES SORP (FRS 102)

Amendments to Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland

Update Bulletin 1

Updating the Charities SORP (FRS 102) issued in July 2014 for:

- Amendments to FRS 102 issued by the Financial Reporting Council in July 2015: *Amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Small entities and other minor amendments*.
- *The Charities Act 2011 (Accounts and Audit) Order 2015* made on 19 February 2015 for increasing the charity audit income threshold from £500,000 to £1 million in England and Wales that also affects the definition of 'larger charity' in the Charities SORP (FRS 102)
- Withdrawal of the *Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard for Smaller Entities (FRSSE)*

Publication date: 2 February 2016

CHARITY COMMISSION

CIPFA The Chartered Institute of Public Finance & Accountancy

OSCR Office of the Scottish Charity Regulator

Background

All Statements of Recommended Practice (SORPs) are developed within the context of law and accounting standards. This is made explicit in paragraph 3 of the Charities SORP (FRS 102) which states that:

> "This SORP provides guidance on how to apply FRS 102 to charity accounts and it should be noted that in the hierarchy established in accounting standards, FRS 102 requirements and legal requirements take precedence over the SORP. Therefore, should an update to FRS 102 or a change in relevant legislation be made after the publication of this SORP, any of the provisions of this SORP that conflict with the updated FRS 102 or relevant legislation cease to have effect."

Purpose

The purpose of SORP Update Bulletins is to amend the text of the underlying SORP for changes in Accounting Standards and legislation subsequent to the SORP's issue.

The amendments set out in this Update Bulletin apply to all charities in the United Kingdom and Republic of Ireland that follow this SORP for reporting periods beginning on or after 1 January 2016.

1. Introduction

1.1 This Update Bulletin sets out the following amendments to the text of the Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS 102) (Charities SORP (FRS 102)) issued in July 2014:

- **Accounting and Reporting by Charities: The Statement of Recommended Practice (SORP) - Scope and Application module:** inserting from when the amendments in this Update Bulletin are effective and implementing the withdrawal of the Charities SORP (FRSSE);
- **Module 6: Donated goods, facilities and services, including volunteers:** amending the measurement basis of the carrying value for inventories held for distribution at no or nominal consideration to require their measurement at the lower of cost adjusted, when applicable, for any loss of service potential and replacement cost. The bulletin offers a definition of 'replacement cost';
- **Module 10: Balance Sheet and Module 24: Accounting for Groups and the Preparation of Consolidated Accounts:** revising the maximum period over which goodwill and other intangible assets may be amortised from five to ten years in those exceptional cases where an entity is unable to make a reliable estimate of the asset's useful economic life;
- **Module 12: Impairment of assets:** prohibiting the reversal of impairment losses for goodwill;
- **Module 14: Statement of cash flows:** requiring larger charities to prepare a Statement of cash flows.
- **Module 17: Charity mergers:** prohibiting merger accounting for charities that are companies and enter into a business combination with a third party; and
- **Appendix 1: Glossary:** amending the definitions of larger charities and related parties.

1.2 There are no other changes other than those set out in this Update Bulletin to the Charities SORP (FRS 102). These changes are due to the amendments set out in *Amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Small entities and other minor amendments issued in July 2015, The Charities Act 2011 (Accounts and Audit) Order 2015* made on 19 February 2015 for increasing the charity audit income threshold from £500,000 to £1 million in England and Wales that also affects the definition of 'larger charity' in the Charities SORP (FRS 102) and the withdrawal of the *Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard for smaller Entities (FRSSE)*

1.3 Amendments to the Charities SORP (FRS 102) are indicated as follows:

- deleted text is struck through; and
- inserted text is underlined.

2. Financial Reporting Council's statement on Update Bulletin 1 to the Charities SORP (FRS 102)

The aim of the Financial Reporting Council (FRC) is to promote high-quality corporate governance and reporting to foster investment. In relation to accounting standards applicable in the UK and Republic of Ireland the FRC's overriding objective is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs. In particular industries or sectors, clarification of aspects of those standards may be needed in order for the standards to be applied in a manner that is relevant and provides useful information to users of financial statements in that industry or sector.

Such clarification is issued in the form of Statements of Recommended Practice (SORPs) by bodies recognised for this purpose by the FRC. The Charity Commission and the Office of the Scottish Charity Regulator (OSCR) in their role as the joint SORP-making body have confirmed that they share the FRC's aim of high-quality financial reporting and have been recognised by the FRC for the purpose of issuing SORPs for charities.

In accordance with the FRC's *Policy and Code of Practice on SORPs* the FRC carried out a limited scope review of Update Bulletin 1 focusing on those aspects relevant to the financial statements.

On the basis of its review, the FRC has concluded that Update Bulletin 1 has been developed in accordance with the FRC's *Policy and Code of Practice on SORPs* and does not appear to contain any fundamental points of principle that are unacceptable in the context of present accounting practices or to conflict with an accounting standard.

27 January 2016

Financial Reporting Council

3. Amendments

Accounting and Reporting by Charities: The Statement of Recommended Practice (SORP) - Scope and Application module

3.1 Paragraph 18 in the Scope and Application Module of the Charities SORP (FRS 102) is amended to clarify from when the amendments are effective from.

3.2 The following paragraph sets out the amendments to:

18. This SORP is applicable to the accounts of relevant charities for reporting periods beginning on or after 1 January 2015 and <u>in [month] 2016 amendments were made to this SORP to incorporate amendments necessary to maintain consistency with accounting standards and changes in charity audit thresholds in England and Wales. The changes made by this Update Bulletin are applicable for accounts of relevant charities for reporting periods beginning on or after 1 January 2016. Except where prohibited by regulations or charity or company law, the early application of the amendments made to this SORP is permitted for reporting periods beginning on or after 1 January 2015. If the option of early application is taken then all the amendments made to this SORP must be effected, as applicable to the charity's circumstances, in the reporting charity's trustees' annual report and accounts.</u>

Choice of accounts preparation methods

3.3 Paragraphs 21, 22 and 23 in the Scope and Application Module of the Charities SORP (FRS 102) are amended to implement the withdrawal of the Charities SORP (FRSSE).

3.4 The following paragraphs sets out the amendments to:

21. Charities in the UK and the Republic of Ireland must apply FRS 102 when preparing their accounts on an accruals basis. ~~unless eligible for, and opting to, prepare their accounts using the Financial Reporting Standard for Smaller Entities (FRSSE).~~

~~22. An eligible charity opting to apply the FRSSE when preparing its accounts must refer to the recommendations of the separate SORP applicable to charities preparing their accounts in accordance with the FRSSE.~~

~~23. Charities not eligible to, or choosing not to, prepare their accounts under the FRSSE must prepare their accounts under FRS 102 in conjunction with the recommendations of this SORP.~~

Module 6: Donated goods, facilities and services, including volunteers

3.5 Charities SORP (FRS102) is amended so that inventories held for distribution at no or nominal consideration shall be measured at the lower of cost adjusted, when applicable, for any loss of service potential and replacement cost.

3.6 The following paragraph sets out the amendments to Module 6: Donated goods, facilities and services, including volunteers:

6.12. The cost of any stock of goods donated for distribution to beneficiaries is deemed to be the fair value of those gifts at the time of their receipt. If the goods held are to be distributed freely or for a nominal consideration, then the carrying amount should be subsequently adjusted to reflect the lower of deemed cost adjusted for any loss of service potential and replacement cost.

Where replacement cost is the economic cost incurred if the charity was to replace the service potential of the donated goods at its own expense in the most economic manner.

Module 10: Balance Sheet

3.7 Charities SORP (FRS102) is amended so that in exceptional cases where an entity is unable to make a reliable estimate of the useful economic life of goodwill or other intangible assets, the maximum period over which the asset shall be amortised is increased from five to ten years.

3.8 The following paragraph sets out the amendments to Module 10: Balance Sheet.

10.23. Capitalised goodwill and intangible assets must be amortised on a straight-line (or a more appropriate systematic) basis over their useful economic lives, which must be reviewed at each reporting date. If, in exceptional cases, the useful life cannot be estimated reliably it is presumed to be no more than ~~five~~ ten years.

Module 12: Impairment of assets

3.9 Charities SORP (FRS102) is amended to prohibit the reversal in a subsequent period of impairment losses of goodwill. This is required for all other assets in certain circumstances.

3.10 The following paragraph sets out the amendments to Module 12: Impairment of assets:

12.20. On occasions, the recoverable amount of an asset may subsequently increase as a result of external conditions or an increase in the expected use of the asset. In these circumstances, for all assets other than goodwill, the carrying amount of the asset must be increased to the recoverable amount by reversing the impairment loss previously recognised. This reversal must be immediately recognised under the appropriate expenditure heading(s) in the SoFA as a reduction in expenditure. The reversal of an impairment loss must not increase the carrying amount of an asset above the amount that would have been its carrying amount if no impairment had been recognised. An impairment loss recognised for goodwill must not be reversed in a subsequent reporting period.

Module 14: Statement of cash flows

3.11 Charities SORP (FRS102) is amended to require larger charities to prepare a statement of cash flow.

3.12 The following paragraph sets out the amendments to Module 14: Statement of cash flows:

14.1. Larger ~~C~~charities preparing their accounts under FRS 102 must provide a statement of cash flows except where the disclosure exemptions permitted by this SORP have been taken. Charities should refer to section 7 of FRS 102 for more information about how to prepare a statement of cash flows.

Module 24: Accounting for Groups and the Preparation of Consolidated Accounts

3.13 Charities SORP (FRS102) is amended so that in exceptional cases where an entity is unable to make a reliable estimate of the useful economic life of goodwill and other intangible assets, the maximum period over which the asset shall be amortised is increased from five to ten years. This amendment also affects business combinations.

3.14 The following paragraph sets out the amendments to Module 24: Accounting for Groups and the Preparation of Consolidated Accounts:

24.32. Where the parent charity purchases a non-charitable subsidiary and the consideration paid exceeds the value of the net assets acquired, goodwill arises on acquisition and is disclosed in the consolidated balance sheet. 'Goodwill' is an intangible fixed asset arising on the acquisition of a subsidiary purchased by the reporting charity. If, in exceptional cases, the useful economic life for goodwill cannot be estimated reliably, it is presumed to be no more than ~~five~~ ten years. Goodwill must be amortised and reviewed for impairment at each balance-sheet date.

24.39. Where the reporting charity acquires a material subsidiary in the reporting period, it must disclose:

- the date of acquisition;
- the cost of acquisition and how it was settled, for example by cash or debt instrument;
- the useful life of goodwill, and if this cannot be reliably estimated ~~this exceeds five years~~, supporting reasons for the period chosen;
- the periods in which any negative goodwill will be recognised; and
- the amounts recognised for each class of assets, liabilities and contingent liabilities at acquisition.

Module 27: Charity Mergers

3.15 Charities SORP (FRS102) is amended to clarify that company law will not permit merger accounting where charities that are companies enter into a business combination with a third party.

3.16 The following paragraph sets out the amendments to Module 27: Charity Mergers

27.4 A charity combination must be accounted for as a merger if all of the following criteria are met:

- <u>It is permitted by the statutory framework.</u>
- No party to the combination is portrayed as either acquirer or acquiree, either by its governing body or management or by that of another party to the combination.
- All parties to the combination, as represented by the members of the governing body, participate in establishing the management structure of the combined charity and in selecting the management personnel. Such decisions are made on the basis of a consensus between the parties to the combination, rather than purely by exercising voting rights.
- There is no significant change to the class of beneficiaries of the combining entities or the purpose of the benefits provided as a result of the combination.

<u>27.4A Due to changes in UK company law, charities that are UK registered companies and enter into a business combination with a third party, will no longer be able to apply merger accounting to that combination. Unincorporated charities, charitable incorporated organisations and non-UK registered companies will continue to be able to apply merger accounting if they meet the criteria set out in FRS 102 and this SORP and merger accounting is not prohibited by other relevant legislation. If a charitable company is considering a true and fair override in order to use merger accounting it is encouraged to read Appendix IV: *Note on legal requirements* of FRS 102 and if adopting merger accounting provide the corresponding disclosures.</u>

Appendix 1: Glossary of Terms

3.17 Due to the regulations made, subsequent to the Cabinet Office proposals, the charity audit income threshold in England and Wales has increased from £500,000 to £1 million with effect for reporting periods ending on or after 31 March 2015, the bulletin will amend the definition of larger charity in Appendix 1: Glossary of Terms.

3.18 The following paragraph sets out the amendments to the definition of larger charities in the glossary to the Charities SORP (FRS 102):

Larger charities is a term used in the SORP to identify those charities ~~subject to audit under charity law in their jurisdiction(s) of formation, registration or operation which the SORP requires to make additional reporting disclosures. In those jurisdictions where there is no charity law audit requirement, the reference to larger charities is construed as applying to those charities~~ with a gross income exceeding £500,000 (UK) or 500,000 euros (Republic of Ireland) in the reporting period.

3.19 The amendments to FRS102 include an amendment which is necessary to maintain consistency with changes in the legal definition of a related party.

3.20 The following paragraph sets out the draft amendments to the definition of larger charities in the glossary to the Charities SORP (FRS 102):

Related parties is a term used by the SORP that combines the requirements of charity law, company law and the Financial Reporting Standard applicable in the UK and the Republic of Ireland. The term is used to identify those persons or entities that are closely connected to the reporting charity or its trustees. Accounting and reporting by charities

The following 'natural persons' are classed as related parties:

A. any charity trustee and custodian trustee of the charity;

B. a person who is the donor of any land to the charity (whether the gift was made on or after the establishment of the charity); and

C. any person who is:

   1. a child, parent, grandchild, grandparent, brother or sister of any such trustee (A) or donor (B) of land;
   2. an officer, agent or a member of the key management personnel of the charity;
   3. the spouse or civil partner of any of the above persons (A, B, C1 and C2);
   4. carrying on business in partnership with any of the above persons (A, B, C1, C2 and C3);
   5. a person, or a close member of that person's family, who has control or joint control over the reporting charity;
   6. a person, or a close member of that person's family, who has significant influence over the reporting charity.

'Close member of a person's family' refers to:

a. that person's children or spouse;

b. the children, stepchildren or illegitimate children of that person's spouse or domestic partner;

c. dependents of that person; and d. that person's domestic partner who lives with them as husband or wife or in an equivalent same-sex relationship.

A charity is not necessarily related to another charity simply because a particular person happens to be a trustee of both. It will only be 'related' if the relationship means that one charity, in furthering its charitable aims, is under the direction or control of the trustees of another charity.

The following entities, which are not ‘natural persons’, are classed as related parties of a reporting entity (including a reporting charity) if any of the following conditions apply:

- the entity and the reporting charity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others);
- one entity is an associate or joint venture of the other entity (or a member of the group in which the other entity is the parent or a member);
- both entities are joint ventures of the same third entity;
- one entity is a joint venture of a third entity and the other entity is an associate of the third entity;
- the entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity;
- the reporting charity provides/receives key management personnel services to/from the entity;
- an entity that is controlled or jointly controlled by a person, or two or more persons, identified in A, B or C; Accounting and reporting by charities
- an entity in which a person, or two or more such persons, identified in A, B or C, taken together, have a substantial interest or significant influence over the entity;

Control is presumed to exist when one or more persons identified in A, B or C, taken alone or together, hold directly or indirectly, more than half the voting power of an entity. However, control can also exist when they, directly or indirectly, control half or less than half of the voting power of an entity, if they have:

- power over more than half of the voting rights by virtue of agreement with other investors;
- the power to govern the financial and operating policies of the entity under a statute or an agreement;
- the power to appoint or remove the majority of the members of the board of directors or equivalent governing body, and control of the entity is by that board or body; or
- the power to cast the majority of votes at the meetings of the board of directors or equivalent governing body, and control of the entity is by that board or body.

An individual has a substantial interest or significant influence in an entity where that person, or two or more persons identified in A, B or C, taken together, have an interest in the equity share capital of that entity of a nominal value of more than one-fifth of that share capital, or is entitled to exercise, or control the exercise of, more than one-fifth of the voting power at any general meeting of that entity

Appendix 3: Thresholds for the UK and the Republic of Ireland

3.21 Paragraphs A1 in Appendix 3: Thresholds for the UK and the Republic of Ireland is amended to implement the withdrawal of the Charities SORP (FRSSE).

3.22 The following paragraph sets out the amendments in Appendix 3 resulting from the withdrawal of the Charities SORP (FRSSE).

A.1. ~~Information about eligibility criteria for using the Financial Reporting Standard for Smaller Entities (FRSSE) is set out in the applicable SORP: 'Accounting and reporting by charities: statement of recommended practice applicable to charities adopting the Financial Reporting Standard for Smaller Entities (the FRSSE) (effective 1 January 2015)'. For charities opting to prepare their accounts in accordance with the FRSSE, reference must be made to this separate SORP whether the charity is a charitable company or non-company charity. Charitable companies in the Republic of Ireland which are classified as public guarantee companies are not permitted to file information under the small companies concession and so are not eligible to prepare their accounts in accordance with the FRSSE.~~ [Deleted]