SORP information sheet 4

The adoption of FRS 102 by charities reporting under the SORP

1. Background

1.1. The Charity Commission and the Office of the Scottish Charity Regulator are the joint SORP-making body for charities and as such is required by the Financial Reporting Council's (FRC) code of practice (SORPs: Policy and Code of Practice) to keep the Statement of Recommended Practice (SORP) under review.

1.2. As part of this work, the joint SORP-making body may issue information sheets which seek to clarify the application of the SORP or particular recommendations contained with the SORP. Information sheets do not amend the SORP and are advisory in nature and are released to assist preparers, auditors and examiners of accounts in applying the SORP's recommendations.

1.3. It should be noted that information sheets do not form part of the SORP, nor are they reviewed by the FRC and therefore do not carry the authority of the SORP.

1.4. On 14 March, 2013, the FRC issued the new Financial Reporting Standard (FRS 102). FRS 102 along with the existing Financial Reporting Standard for Smaller Entities (FRSSE) form the basis of new Generally Accepted Accounting Practice (new GAAP) applicable in the UK and Republic of Ireland.

1.5. Larger charities required to adopt FRS 102 must do so for accounting periods beginning on or after 1 January 2015. Smaller charities may also choose to adopt FRS 102 rather than the FRSSE. Early adoption of FRS 102 is permitted by the standard for accounting periods ending on or after 31 December 2012 provided that early adoption does not conflict with the requirements of a current SORP or legal requirements for the preparation of financial statements. Until new GAAP becomes mandatory, existing Generally Accepted Accounting Practice (existing GAAP) remains in place alongside these new standards.

1.6. The joint SORP-making body has considered, in conjunction with the SORP Committee, whether early adoption of FRS 102 is permitted by charity law in the jurisdictions covered by UK-Irish Generally Accepted Accounting Practice and whether to do so would be consistent with the current SORP: Accounting and Reporting by Charities issued in 2005 (SORP 2005).

1.7. A new SORP is being developed to provide application guidance on preparing charity accounts to give a true and fair view when reporting under FRS 102. Once a new SORP has been issued, new accounting regulations will be sought in England and Wales and Scotland that will enable charities preparing accounts under charity law to adopt the new SORP and FRS 102.

1.8. The following sections of this information sheet set out:

- the legal position of SORP 2005 in each jurisdiction covered by UK-Irish Generally Accepted Accounting Practice; and
- the basis of joint SORP-making body's guidance on early adoption of FRS 102; and
- the joint SORP-making body's statement on early adoption of FRS 102.

2. The legal position of SORP 2005 in each jurisdiction covered by UK-Irish Generally Accepted Accounting Practice

2.1. England and Wales: the Charities (Accounts and Reports) Regulations 2008, made under the Charities Act 2011, specify that charities, other than investment funds and certain other special case charities, must prepare their statement of accounts in accordance with the methods and principles of the SORP (regulation 5) to give a true and fair view (regulation 4). The Regulations define the SORP as the Statement of Recommended Practice for Accounting and Reporting by Charities, issued on 4th March 2005. However, these Regulations do not apply to charities established under the Companies Act (unless group accounts are prepared on a voluntary basis under that Act) or to particular classes of exempt charities which apply another SORP.

2.2. Charitable companies preparing their accounts under the Companies Act 2006 must prepare their accounts to give a true and fair view (section 393) and charitable companies must prepare Companies Act individual accounts (section 395). These accounts are prepared in accordance with prevailing accounting standards (section 464).

2.3. SORP 2005 applies to charitable companies and specifically requires charities to apply Statements of Standard Accounting Practice, Financial Reporting Standards, and Urgent Issue Task Force abstracts and to take note of the Interpretation for Public Benefit Entities of the Statement of Principle for Financial Reporting.

2.4. Scotland: Schedule 1 to the Charities Accounts (Scotland) Regulations 2006 (as amended) requires the accounts of a charity to be prepared in accordance with the methods and principles of the Charities SORP to give a true and fair view. Regulation 1(2) specifies that the applicable SORP is the second edition of Statement of Recommended Practice for Accounting and Reporting by Charities, published in 2008. The SORP published in 2008 is SORP 2005 updated with new legislative references. All charities, including charitable companies, required to register with the Scottish Charity Regulator must prepare their accounts in accordance with these Regulations.

2.5. Northern Ireland: there are no requirements in charity law governing the form and content of a charity's accounts. Except for charitable companies which must prepare accounts to give a true and fair view, there is no legal duty on charities to apply GAAP.

2.6. Republic of Ireland: there are no charity law requirements governing the form and content of a charity's accounts. Except for charitable companies which must prepare accounts to give a true and fair view, there is no legal duty on charities to apply GAAP.

3. Basis of joint SORP-making body's guidance on early adoption of FRS 102

3.1. The SORP 2005 was developed in accordance with the FRC's code of practice in the context of existing GAAP which remains extant for all reporting periods commencing up to and including 31 December 2014.

3.2. SORP 2005 remains in effect until a new SORP has been issued to provide guidance to charities on the application of new GAAP. Charity law in England and Wales and Scotland currently adopts the methods and principles of SORP 2005 and also relies on that SORP to set the form and content requirements for charity accounts. Regulations that set the accounting requirements of charity law are to be amended once a new SORP has been issued but until relevant regulations are made, the application of the methods and principles of SORP 2005 remain a requirement of charity law in England and Wales and Scotland.

3.3. The Accounting Council in developing FRS 102 considered issues surrounding its early application by entities that are within the scope of a SORP. It noted that most SORPs required updating for consistency with FRS 102 and that for charities there are also legal requirements relating to the application of the SORP.

3.4. Charities reporting under the Charities Act 2011 (in England and Wales) or Charities and Trustee Investment (Scotland) Act 2005 (in Scotland) are specifically required by Regulations made under those Acts to prepare their accounts in accordance with the methods and principles of SORP 2005 when prepared to give a true and fair view. SORP 2005 specifically requires charities to apply Statements of Standard Accounting Practice, Financial Reporting Standards, Urgent Issue Task Force Abstracts and to take note of the Interpretation of Statements of Principles for Financial Reporting all of which would be disapplied by the adoption of FRS 102.

3.5. The adoption of the methods and principles of the SORP is not a legal requirement for charities reporting solely under Companies Act 2006 or for charities reporting under charity law in Northern Ireland or the Republic of Ireland. However, early adoption of FRS 102 is only permitted when to do so does not result in a conflict with the requirements of a current SORP.

3.6. FRS 102 provides a complete accounting framework with its own concepts and pervasive principles separate from the previous suite of UK accounting standards on which SORP 2005 is based. The practicability of attempting to apply FRS 102 in conjunction with a SORP derived from existing GAAP is problematic.

3.7. Although FRS 102 supersedes existing GAAP, SORP 2005 still requires adherence to existing GAAP and its disclosures as well as requiring certain additional charity specific disclosures not addressed in FRS 102. For example, SORP 2005 does not require the total amount of management compensation to be disclosed but does require the amount and name of trustees (or other related parties) in receipt of remuneration or benefits to be disclosed along with banding disclosures for staff remuneration.

3.8. Whilst, it might be possible to prepare accounts that meet both the disclosure requirements of FRS 102 and SORP 2005, to do would add complexity to the preparation process and may add clutter to accounts. However, the issues arising from preparing accounts under FRS 102 and SORP 2005 are more complex than disclosure alone. FRS 102 is a complete accounting framework with its own concepts and pervasive principles. In particular, there are differing measurement, recognition bases and presentational requirements which conflict with the requirements of SORP 2005. For example:

- FRS 102 requires changes in fair value of investments to be recognised in the income section of the statement of comprehensive income whilst SORP 2005 require recognition outside of the income and expenditure account as part of other recognised gains and losses.
- FRS 102 allows government grants to be recognised as income on a systematic basis over the periods in which related costs are recognised whilst SORP 2005 requires all grant with performance-related conditions to be recognised with performance and for unconditional grants to be recognised with entitlement, measurability and certainty of receipt.
- FRS 102 permits reduced disclosures for subsidiaries (and ultimate parents) of qualifying entities which are not permitted when reporting under SORP 2005.
- FRS 102 requires mixed use property to be separated between investment property and property, plant and equipment whilst SORP 2005 allows for analysis based on preponderance of use.
- FRS 102 requires the expensing of the costs of an internally generated database whilst SORP 2005 would allow an asset to be recognised when future income steams from its use is demonstrable.

- FRS 102 provides different measurement bases for donated goods, services and facilities. In particular, fair value replaces value to charity in the case of donated goods. Moreover, the recognition point for goods donated for resale or distribution is brought forward to their receipt rather than point of sale or distribution (unless recognition at point of receipt is impracticable) as required by SORP 2005.
- FRS 102 requires the equity method of accounting for jointly controlled entities whilst SORP 2005 requires the use of the gross equity method of accounting.
- FRS 102 requires discontinued operations to be identified as a separate column in the statement of comprehensive income whilst SORP 2005 uses a columnar approach to identify restricted funds with discontinued activities presented as a 'line' or 'row' item within the columns of the statement.

4. The joint SORP-making body's statement on early adoption of FRS 102

4.1. The Charity Commission and the Office of the Scottish Charity Regulator, as the joint SORP-making body for charities, welcomes the development of FRS 102 and the modernisation and simplifications it brings to financial reporting. Moreover, FRS 102 is an important step forward as it addresses certain key reporting issues faced by charities for the first time within accounting standards. However, it does not address all interpretational, presentational and disclosure issues arising from transactions common in the charity sector. The SORP has and will continue to provide an important element of the successful application of GAAP to charities and addresses a number of significant reporting issues affecting charities where accounting standards are silent. Charities would therefore face significant difficulties in applying FRS 102 unsupported by a new SORP written in the context of new GAAP.

4.2. The joint SORP-making body has concluded, after taking advice from its SORP Committee, that the early adoption of FRS 102 by charities required by charity law to adopt the methods and principles of SORP 2005 would be in conflict with those legal requirements. It has also concluded that early adoption of FRS 102 for those charities falling within the scope of SORP 2005 but not required by law to apply its methods and principles would be impracticable as a number of FRS 102 requirements would be in conflict with those of SORP 2005.

4.3. Charities should follow the progress of the development of the new SORP that will accompany the new GAAP. A new SORP is being developed to support accounts prepared by charities under either the FRSSE or FRS 102 and will be released, subject to clearance through FRC review procedures, for consultation later this year. The publication of a new SORP and new regulations coming into force, where charity law applies to accounts preparation, will enable the adoption of FRS 102. Charities not eligible to adopt the FRSSE will be required to apply FRS 102 for financial years beginning on or after 1 January 2015.