



Our comments on the future of UK financial reporting for charities.

In July 2013, the Charity Commission issued an exposure draft of the new 'Charities Statement of Recommended Practice (SORP): Accounting and Reporting by Charities' for consultation. The new SORP will have a significant effect on the future of UK financial accounting and reporting for charities and other not-for-profit organisations. We at UHY Hacker Young are well aware of this and, therefore, submitted our comments to the Charity Commission during the consultation period, as set out below. Please refer to the inserted sheet within this document for the full list of questions. Alternatively, the full questions can be found on the dedicated charity SORP website: www.charitysorp.org.

Q1., Q2. AND Q4. THE MODULAR FORMAT AND THE NEEDS OF SMALLER CHARITIES

In our view the modular format adopted in the exposure draft is a very successful.

The SORP Committee is to be congratulated not only on the overall framing of the SORP, but also on the website construct that enables any user to compile a version of the SORP that contains only the parts relevant to that user's charity.

We are however not convinced that paragraphs 4.22 – 4.26 are successful, as discussed below.

Q3. MUST, SHOULD AND MAY

The careful and deliberate introduction of the concepts underlying the terms "must",

Our comments

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"should" and "may" brings a welcome clarity to the requirements and recommendations set out in this SORP. However, the popular use of the term "should" is much less clear than its intended use in the SORP as a proxy for "best" or "good" practice guidance.

We suggest that some consideration is given to whether "must", best practice and other guidance need to be distinguished in a different way, for example by headings.

It is particularly important in reinforcing the Committee's commitment to the FRC's "cutting the clutter" maxim that the preparers of charity accounts and annual reports can easily identify and distinguish absolute requirements from material that may not be of critical importance in understanding the activities of their charities.

Q5., Q6. AND Q7. TRUSTEES' REPORT

In broad terms we believe the exposure draft does a good job in identifying a suitable structure for the trustees' report.

However, subsequent to the publication of the draft SORP the government has of course published legislation requiring the preparation of a "strategic report" by medium and large sized companies. We believe that the Committee must now wait for the completion of the FRC guidance on the content of the strategic report, and then ensure that the SORP is both complete and consistent with the new requirements and the new guidance.



We welcome the simplification of the SoFA and the use of plain language.



Q8. AND Q9. SOFA FORMAT

We welcome the simplification of the SoFA and the use of plain language.

We note with approval paragraph 4.10 and its permission to vary the order of headings within the income and expenditure sections of the SoFA.

However, we believe that the activity based classification of expenditure gives an incomplete picture of how a charity is managing its finances and resources. For above-threshold charities, we consider that an analysis of total expenditure by nature is also important, and that suggested categories should be given. A strong case can be made for this to be a “must” requirement.

For below-threshold charities we would brook no argument and actually mandate that the SoFA must report expenditure by nature, and have the SORP give at least a recommended list of the captions to be used. This obligation would recognise and address a number of issues:

- that smaller charities may not in fact have many activities, and often have one;
- that smaller charities that do identify several activities are likely to have to apportion most of their costs between activities, and have to do so on subjective bases (because most costs will have multiple purposes);
- that funding bodies and other users of the accounts are likely to find this by nature analysis more helpful in assessing the governance, sustainability (ie. going concern risk) and cost effectiveness of the charity; and
- that the trustees will find it more straightforward and meaningful to report on expenditure by nature than on expenditure by activity.

Specifically, we also note that the interaction of paragraphs 4.22 – 4.26 and 9.29 – 9.32 appears to mean that natural and informative staff cost disclosures are not made by smaller charities. Personnel costs must be fully disclosed by all charities.

In our view charities which have adopted the total return basis should be encouraged to present their gains and losses on investments immediately after their investment and other income by acknowledging this possible presentation in the more detailed section 20. The transfer should also be presented at this point in the SoFA.

We continue to support the use of the (multiple) columnar format for presenting income and expenditure from unrestricted and restricted funds. The distinction between unrestricted and restricted funds and the fact that the charity understands and acknowledges this distinction is critical to the proper financial reporting of charities’ activities.

Adopting a single column presentation will necessitate additional analysis that, for many charities with two or three funds, can be achieved simply by the current format.

We note briefly that the second sentence of paragraph 4.2 appears to be incomplete in that it does not set out the alternative presentation which is anticipated by the use of the word either.

Q10. AND Q22. EXTENT OF ACCOUNTING GUIDANCE

We have not identified any charity specific accounting and reporting issues that have been omitted from the SORP.

However, we note that the total return basis is a relatively new concept and yet that there is no transition date guidance. Specifically, there is an assumption that the original endowment and hence the unapplied total return since inception are known amounts, whereas these in practice are of no significance and may be lost to a charity switching to this method many years after its establishment.

Particularly when viewed in the context of the charity sector, the “amortised cost using the effective interest rate method” can be described (with some understatement) as giving rise to a spurious accounting “gain” in the case of a concessionary loan received; the accounting loss on a concessionary loan disbursed has a little more credibility, but the subsequent income from writing back the discount would confuse the vast majority of lay readers.

Given that FRS 102 has gone so far as to permit that a charity can record concessionary loans at face value, the SORP should mandate the use of the method and disclosures set out in FRS 102 PBE 34.90 – 34.97, and import these paragraphs.

We also observe that whilst it is well known that a SORP is not intended to be a complete accounting guide, users might usefully be reminded more often that the underlying FRS/FRSSE addresses other transactions.



We agree that naming the beneficiaries is properly in the spirit of charity financial reporting.



Q11. DISCLOSURES OF BENEFICIARIES

In our experience grant making charities often give a complete list of the institutions they have supported, so that the requirements of paragraph 16.17 relating to the disclosure of material grants would not be burdensome. We agree that naming the beneficiaries is properly in the spirit of charity financial reporting; it is also commonplace and we endorse this proposal.

Giving (by implication or overtly) charities a choice of where to display a full list of beneficiaries is acceptable.

Q12. SALARY DISCLOSURE

A principal concern of the general users of a charity's accounts is often to satisfy themselves that expenditure has not been lavish. A table indicating the numbers of highly paid employees is quite sufficient for this; there is no particular public interest that is satisfied by giving information that in many cases will identify the highest paid employee.

Q13. DISCLOSURE REQUIREMENT

Contrary to the Accounting Council's suggestion, we do not consider that it will be important to the users of the SORP to distinguish disclosure requirements from different sources; and to do so by any means that diminishes the usefulness of the SORP itself would be counterproductive and waste an opportunity.

We do suggest that the overriding objective as regards disclosure obligations is to ensure that the SORP is complete. Whatever is done in the main body of the SORP we strongly recommend that comprehensive disclosure checklists are provided as appendices to the standard for each of FRSSE and FRS 102, for each of incorporated and unincorporated charities. In doing so, any SORP disclosure checklists must faithfully reflect the "must, should, may hierarchy".

Q14. REDUCED DISCLOSURE FRAMEWORK

Although, as the SORP committee acknowledges, the reduced disclosure framework provides relatively little by way of reduction in disclosure obligations it is nevertheless a modest deregulatory provision which does no overt harm. If the SORP committee would rather that one particular disclosure exemption should not be taken it could instead mandate that key management employment benefits are nevertheless disclosed in any reduced disclosure accounts.

Q15. AND Q16. FRSSE AND FRS 102

It is absolutely essential that the SORP addresses both large and small charities. Given what has already been achieved by the modular format, we believe the exposure draft has an entirely successful approach to handling both requirements.

Q17. AND Q18. MIXED MOTIVE OR SOCIAL INVESTMENTS

Where any asset or expense has a dual purpose the alternatives are to treat those mixed items as a separate category, which would add clutter, or to apportion those items across headings, which in the case of a mixed social investment would seem impractical, or to choose that the item be categorised in accordance with one of its component aims. The latter is clearly the most practical and we endorse the Committee's decisions.

Q19. BRANCHES AND SUBSIDIARIES

The SORP appears clear enough to us, but we must acknowledge that we do not have direct experience of cases where the distinction would be difficult to make.

Q20. ASSOCIATES AND JOINT VENTURES

We agree that the equity accounting treatment is appropriate for the consolidated accounts of an entity that has interests in associates and joint ventures.

We consider that there should be disclosure of the gross income and expenditure of significant associates and joint ventures specifically so that the scale of activity undertaken through these vehicles is placed before the users of the charity's accounts.

Q21. INCOME FROM GOVERNMENT GRANTS

We agree with the SORP committee that consistency of accounting treatment as between grants received from different sources is essential.

Q23. SIMPLIFICATIONS

As noted above, we consider that there should be authoritative ("must") guidance on expenditure disclosure by nature for smaller (below threshold) charities.

Where a charity has received substantial funding towards a major fixed asset, perhaps several years previously and/or where that

asset is being depreciated, it is likely that the financial statements will show net resources expended on a seemingly perpetual basis. Whilst a diligent analysis of the notes to the accounts is likely to identify the historic cause of such an apparently negative SoFA performance, an expenditure category for depreciation, amortisation and other amounts written off would assist an understanding of likely future cash outflows.

Alternatively, if the above suggestion did not find favour, and only where there is no cash flow statement, we believe the SORP could usefully include a mandatory, well-designed "liquidity statement" intended to facilitate an assessment of future cash flows by the users of the accounts. Accordingly, we recommend that consideration is given to reinstating and upgrading this particular item.

Q24. FURTHER SIMPLIFICATIONS

We have no suggestions of additional simplifications.

Q25. CUTTING CLUTTER

Of the suggested alternatives we prefer option C, a series of examples, since this will give the opportunity for the different examples to make different points and for the Committee to include express guidance explaining that in the particular circumstances of each of their specimen reports certain of the recommended disclosures were not considered significant.

THE NEXT STEP

If you would like to discuss our submission to the Charity Commission or would like to arrange a meeting to discuss the future implications of the new SORP on you and your charity, please contact your usual UHY adviser or contact:

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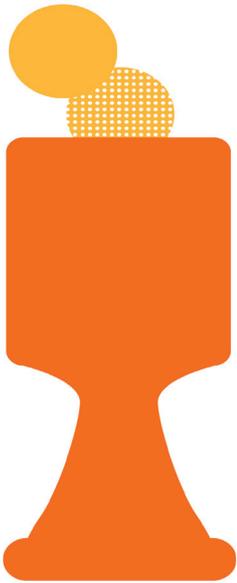
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The consultation questions

Exposure Draft Charities SORP

The SORP's structure, format and accessibility

Q1. Do you agree that the modular format adopted in the Exposure Draft improves accessibility to issues and therefore better meets the needs of the preparers of charity accounts? If not, what alternative format should be adopted and why?

Q2. Do you agree that the Exposure Draft better meets the needs of smaller charities compared to the current SORP, if not, what are your suggestions for further improvement that will better help smaller charities?

Q3. Does the use of the terms 'must', 'should' and 'may' when making a recommendation or explaining requirements clearly distinguish between those requirements that have to be followed to comply with the relevant accounting standard and the SORP from those recommendations which are good practice and those that simply offer advice on how a particular disclosure or other requirement might be met?

Q4. Do you have any suggestions as to how we can improve the SORP micro-site and web navigation of the Exposure Draft?

The trustees' annual report

Q5. Do you agree with the proposed structure and content of the trustees' annual report? If not, what changes do you recommend and why?

Q6. Do you agree with the requirements and recommendations set out in the Exposure Draft for reporting a charity's achievements and performance? If not, what changes do you recommend and why?

Q7. Do you think there is any additional information which should always be included in a trustees' annual report that is not required in the Exposure Draft? Alternatively, is there any information currently required by the Exposure Draft that you think is unnecessary?

The Statement of Financial Activities

Q8. The format and headings of the SoFA have been simplified. Do you agree that these changes will assist preparers whilst still providing users of the accounts with relevant information about the income and activities of a charity? If not, please explain how the SoFA could better present information about a charity's income and activities.

Q9. The current SoFA adopts a columnar format for presenting income and expenditure from unrestricted and restricted funds. Do you agree that this columnar approach for reporting funds in the SoFA should be retained? If not, please explain why you prefer a single column presentation combining restricted and unrestricted funds.

Charity specific accounting and reporting issues

Q10. Do you agree that the Exposure Draft of the SORP addresses those issues which are of particular relevance to charity accounting and reporting? If not, are there specific accounting or financial reporting issues faced by the charity sector or in the sphere of activity in which your charity operates that the SORP should address?

Charity specific disclosures

Q11. The Exposure Draft proposes that grant making charities disclose in the notes to their accounts details of the name of institutions in receipt of material grants and the amount of such grants paid to them by the charity. Do you agree that this information should be given by way of note rather than in a separate publication that can be obtained from the charity on request as currently allowed by the existing SORP?

Q12. The SORP requires larger charities to disclose staff salaries paid in bands of £10,000 for employees earning over £60,000. Should larger charities also be required to also disclose the job title and remuneration of their highest paid employee?

Q13. The Accounting Council has suggested that a clearer distinction is desirable between those disclosures required by accounting standards and those resulting from charity law or the higher level of accountability expected of charities. Which one of the following options do you consider to be the best way of achieving this distinction?

- a. Remove the disclosures related to accounting standards altogether and simply substitute with cross references to the relevant standard.
- b. Provide a brief summary to explain what disclosures are required by accounting standards along with cross references to the particular standard.
- c. Retain the current approach of the Exposure Draft but separately identify in each module those disclosures that are required by charity law or for the public accountability.

Q14. Do you agree that charities should not be able to adopt the reduced disclosure framework provided by FRS 102? If not, please explain why you think charities should be able to take advantage of this framework?

Accounting methods and principles

Q15. Do you agree that the next SORP should support both charities that prepare their accounts using FRS 102 and also those that are eligible and choose to use the FRSSSE? If not, please explain why.

Q16. Do you agree that the Exposure Draft successfully supports the use of the FRSSSE and FRS 102? If not what changes would you suggest and why?

Q17. Do you agree that investments held both to produce an investment return and also for the contribution the funding makes to a charity's purposes (mixed motive investments) should be classed as a component of financial investments and separately disclosed on the balance sheet or in the notes to the accounts when material? If not, what alternate approach to classification do you recommend and why?

Q18. Do you agree that an impairment loss arising on a mixed motive investment should be analysed as an investment loss in a charity's SoFA? If not, how else might the loss be analysed in a charity's SoFA and why?

Q19. Are there any circumstances in which a separate corporate body can be regarded as a branch and included in a charity own individual entity accounts? If so, how would you distinguish a separate corporate body that is a branch from one which is a subsidiary and included in a parent charity's group accounts?

Q20. The Exposure Draft requires a charity's share of any surplus or deficit in an associate or jointly controlled entity to be shown as a single line in a parent charity's consolidated SoFA. Do you agree with this accounting treatment? If not, should the charity's share of income and expenditure be shown separately so that the user of the accounts can better understand the scale of the charitable activities carried out by the associate or joint venture?

Q21. Do you agree that income from government grants should be recognised on the same basis as other grants and donations? If not, why should government grants be recognised on a different basis?

Q22. Do you have any comments on any other accounting principles or treatment within the Exposure Draft? If making a comment, please state:

- the name of the module(s) and the paragraph number(s);
- your suggestion for change(s) to be made; and
- the reason(s) why change is needed.

Removing unnecessary requirements

Q23. Do you agree with the simplifications made to the current SORP's recommendations and if not why do you consider a particular requirement should be retained?

Q24. Do you have any suggestions for further simplifications to the Exposure Draft and if so what are they and what do you believe are the benefits of the additional simplification(s) you propose?

Example accounts and reports

Q25. In responding to the FRC's report 'Cutting Clutter' would you recommend that the joint SORP-making body:

- a. cease publishing any illustrative examples of trustees' annual reports and accounts; or
- b. publish only two illustrative example of trustees' annual reports and accounts, one for a charity adopting the FRSSSE and a second for a charity adopting FRS 102; or
- c. publish a series of examples for different types and sizes of charity?

For further information about the charities SORP and the consultation or to read the full 'Charities SORP Consultation: Invitation to comment' document, visit the dedicated website at www.charitySORP.org.