



SORP 2005

For some time the Charity Commission has been keen for charity accounts to focus more on the outcomes of charity activities and the impact on beneficiaries. This requires non-financial measurement and hence a revised Statement of Recommended Practice (SORP). John Howard, Director of our Charity and Not-for-Profit Group, outlines the changes.

The SORP was developed by a committee comprising charity finance directors, auditors, academics, charity advisers and regulators. The aim is to provide a new basis for transparent and consistent reporting, "enhancing the relevance, comparability and understanding of information presented in the accounts".

SORP 2005 is applicable to all accounting periods beginning on or after 1 April 2005, although early adoption is encouraged.

KEY CHANGES IN SORP 2005

- New approach to the Trustees' Annual Report promoting the reporting of activities undertaken and performance achieved against annual objectives.
- More specific guidance on recognising when incoming resources and resources expended should be brought into the SOFA.
- Clearer guidance on the recognition of grants.
- New category of "heritage assets" is introduced replacing the "historic and inalienable" category.
- Relaxation of grants payable disclosures.
- Section on accounting for smaller charities has been moved to a separate Appendix.



THE CHARITIES BILL

The Queen's Speech on 17 May brought the news that the Government will re-introduce the Charities Bill in the new session of Parliament.

RESPONSIBILITIES OF CHARITY TRUSTEES

The Charity Commission has also recently issued a new publication, CC3 – The Essential Trustee: What you need to know. This publication replaces the previous CC3 – Responsibilities of Charity Trustees. Further details together with a PDF version of the publication can be obtained from the Charity Commission website at www.charity-commission.gov.uk

Wilkins Kennedy's Charity and Not-for-Profit Group advises a wide variety of clients in this sector. As well as audit and accounting, we carry out consultancy, governance and systems work. The multidisciplinary group is headed by Director John Howard, who is based in our London office. Please contact him on 0207 403 1877 or at john.howard@wilkinskennedy.com



TRUSTEES' ANNUAL REPORT

The accounts of a charity cannot alone explain or measure what a charity has achieved or what difference it has made. The Report provides the opportunity for trustees to show the impact being made on the organisation's beneficiaries. The SORP recognises that charities may incorporate other material into their annual reporting, such as a chairman's report, environment report or an operating and financial review (OFR). SORP 2005 reiterates that charity trustees are responsible for preparing the Trustees' Annual Report. The report should provide a fair review of the following areas:

Reference and Administrative Details: list of trustees and advisers including details of senior staff members to whom day to day management has been delegated by the trustees.

Structure, Governance and Management: including details of how the charity is constituted, how its trustees are recruited and trained and how the charity's decision making processes operate.

Objectives and Aims: including details of all the strategies and activities undertaken to achieve them. The Report should provide details of activities undertaken by subsidiary undertakings.

Achievements and Performance: including a fair review of the charity's performance against objectives that have been set. The review should contain both qualitative and quantitative information and be more informative than has hitherto been the case. For instance, the recommendations of SORP 2000 to report on the effectiveness of fundraising activities have been expanded.

Review of the financial position of the charity: together with the principal financial policies adopted in the year. Reserves are also now reported as part of the financial review section. In addition details are included of the charity's principal funding sources and how expenditure has supported the key objectives of the charity. Where investments are held, the report should include details of the extent to which social, environmental or ethical considerations are taken into account in setting investment policy.

Plans for future periods: including any key objectives set for future periods. Where specific factors or influences may affect future performance, these should be disclosed.

SOFA - INCOMING RESOURCES AND RESOURCES EXPENDED

Users of charity accounts have had difficulties interpreting the Statement of Financial Activities (SOFA), particularly in correlating incoming and outgoing resources. Where possible, charities are encouraged to disclose incoming and outgoing resources through an activity analysis.

FOR INCOMING RESOURCES:

Incoming resources are categorised in the revised SORP as being obtained from generated funds, charitable or other activities while the previous SORP concentrated more on the source of the funds (see diagram opposite).

The revised SORP concentrates on the issue of when to recognise income. In accordance with more recent financial reporting standards, less emphasis is placed on the concept of prudence. The previous SORP required incoming resources to be included as soon as it was prudent and practicable to do so and lacked detailed guidance on income recognition – particularly for grants. SORP 2005 asks for incoming resources to be recognised in the SOFA when the effect of a transaction or other event results in an increase in the charity's assets.

As funders have introduced increasingly rigorous grant agreements, it has blurred the distinction between grants (voluntary income) and contracts (activity income). Since the income recognition principles of each are very different the revised SORP has included more guidance.

The introduction of grant funding to the SOFA on the receivable basis has been abolished. Instead grant funding arrangements that contain conditions specifying a service to be performed by the charity (performance-related grants) should be included in the SOFA when the charity has provided the services or goods.

Activities under long term contractual arrangements should be brought in to the SOFA when the charity obtains entitlement to consideration, that is, a fair reward for performance to date. In order to determine incoming resources under contractual arrangements, charities will need to assess the value of the goods or services provided up to the last day of their accounting period as a proportion of the total value of the contract. This assessment must measure work actually performed rather than any contractual definition of completion.

	SORP 2005		SORP 2000
	<i>Incoming resources</i>		<i>Incoming resources</i>
A	Incoming resources from generated funds: <ul style="list-style-type: none"> ■ Voluntary income ■ Activities for generating funds ■ Investment income 	A	Donations, legacies and similar incoming resources
B	Incoming resources from charitable activities	B	Incoming resources: <ul style="list-style-type: none"> ■ Activities in furtherance of the charity's objectives ■ Activities for generating funds
C	Other incoming resources	C	Investment income
		D	Other incoming resources

FOR RESOURCES EXPENDED:

As with incoming resources, much greater guidance is provided on recognition: previously all expenditure followed the accruals concept. Now expenditure is recognised when a liability is incurred or increased without a matching increase in assets or a reduction in liabilities (see diagram below).

	SORP 2005		SORP 2000
	<i>Resources expended</i>		<i>Resources expended</i>
A	Costs of generating funds: <ul style="list-style-type: none"> ■ Costs of generating voluntary income ■ Fundraising trading ■ Investment management costs 	A	Costs of generating funds
B	Charitable activities	B	Charitable expenditure: <ul style="list-style-type: none"> ■ Grants payable in furtherance of the charity's objects ■ Costs of activities in furtherance of the charity's objects ■ Support costs for the above ■ Resources expended on managing and administering the charity
C	Governance costs		
D	Other resources expended		

SOFA - CONTRACTUAL ARRANGEMENTS, GRANTS PAYABLE AND OBLIGATIONS

The revised SORP will have a significant impact on grant making charities. Greater guidance is provided for the recognition of contractual arrangements and grants payable and constructive obligations. There is an example of a multi-year grant obligation as this has been an area of much confusion since FRS12 (the accounting standard that deals with provisions) was issued.

BALANCE SHEET - HERITAGE ASSETS

The existing SORP deals with inalienable assets and historic assets the same way, despite the two concepts being distinct: inalienable assets being part of a charity's endowed funds (which may not be historic); historic assets being assets of historic, scientific or artistic importance that are held directly to further the objects of the charity. SORP 2005 introduces the term heritage assets to describe the latter if used to fulfil the aims of a charity. The definition of heritage assets excludes those held for administrative, fund generation or investment. Under SORP 2005 newly acquired heritage assets should be capitalised. Previously acquired heritage assets may be excluded from capitalisation on the grounds of reliability and a cost/benefit basis. These exclusion criteria should be applied on an asset-by-asset basis.

For further information on the revised Charities SORP, please contact John Howard in our London office or your own engagement partner or manager

INVESTMENT OF CHARITABLE FUNDS

The Charities Commission has recently produced document CC14, providing guidance by explaining the powers and duties of charity trustees when investing charitable funds. A number of important requirements are contained within this document including:

- Investment policy - a strong recommendation to have a formal investment policy
- Duty of Care - to exercise such care and skill as is reasonable when making investments
- Suitability - must consider the suitability for the charity of the investments
- Diversification - consideration must also be given to the need for diversification
- Reviews - investments must be reviewed regularly
- Advice - trustees must obtain and consider proper advice from a suitably qualified independent adviser when making and reviewing investments
- Compensation - investments should be made in markets where financial services are closely regulated, and compensation schemes are in place

This document concludes by stating "Trustees are not liable to make good the charity's loss simply because an investment made by them is unsuccessful. However, trustees may be liable if, in making or retaining an unsuccessful investment, they have acted outside the scope of their powers, or have failed to discharge the duties as defined above."

To ensure charities and their trustees are safeguarded with regard to these obligations we would recommend appointing an independent adviser to help guide them through the increasingly complex world of investments.



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