

long-term support of missionaries

**recognition of liabilities
under the revised Statement
of Recommended Practice**

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1 Introduction

A revised Statement of Recommended Practice 'Accounting and Reporting by Charities' (SORP) was issued early in 2005. Compliance with SORP is mandatory for all charities preparing accounts under the accruals basis of accounting (this includes all charitable companies and all charities with a gross income of over £100,000).

The revised text of SORP includes new provisions concerning the timing of the inclusion of grants in charity accounts, including future commitments to grant funding. These provisions could impact churches in an unexpected way. No doubt the SORP committee had in mind grant making charities that support tangible projects under grant agreements (for example medical research) in setting down these rules. But, we have identified these provisions can have a most unwelcome result for churches that support missionaries on a long-term basis.

This Briefing Paper seeks to explain the issues and offer some solutions to avoid the undesirable impact of a charity appearing to be insolvent as a result of compliance with SORP.

2 The Issue

Paragraph 148 of SORP 2005 states that liabilities should be recognised (included) as 'resources expended' (ie as expenditure in the church's accounts) as soon as there is a 'legal or constructive obligation'¹. These rules are derived, and adapted, from commercial accounting standards. A constructive obligation can arise as a result of past transactions or events that create a valid expectation in the mind of the recipient of the grant² funding.

Where there is a constructive obligation for support to a missionary, this can mean that the church should include all future support for that missionary in the current year's accounts. To do this can be impractical (for example, how do you put a figure on the future support?). It could also leave the church's accounts showing an insolvent position!

Closer examination is needed of what constitutes a constructive obligation. For there to be a constructive obligation, there must be a valid expectation of support. Paragraph 155 makes it clear that past practice alone would not create a valid expectation unless accompanied by a specific communication of support to the recipient. Of course this communication may have been verbal and may have been made many years ago. For example, following a decision of the church leadership, one of the leaders tells a missionary that the church will be supporting them for their duration on the mission field. The support given over the following years would not only confirm that commitment in the missionary's mind but may also serve to create an expectation as to the amount of support that they will receive each year. Here, there is a constructive obligation for many years meaning a funding commitment for all of those years in the current year's accounts.

¹ A **constructive obligation** is defined by SORP as one "... that derives from [the charity's] actions where: (a) by an established pattern of past practice, published policies or a sufficiently current statement, [the charity] has indicated to other parties that it will accept certain responsibilities; and (b) as a result, [the charity] has created a valid expectation on the part of those other parties that it will discharge those responsibilities." (Appendix 1, GL10)

² A **grant** in SORP 2005 terms is any voluntary payment (or other transfer of property) by a charity in favour of a person or institution in furtherance of the charity's objects. (Appendix 1, GL29)

This can be contrasted to a situation where a church decide, without a request from a missionary, to support them and then sends them a letter and payment saying that “we have decided to support you this year with the enclosed cheque” with no other indication of intention for the future. Even though this pattern may be repeated year on year, it is clear that the decision is taken in for one year at a time only. Here, only the obligation communicated to the recipient as at the balance sheet date (ie just one year) needs to be included in that year’s accounts.

Where a church makes general or policy statements such as to fund missionary support as a tithe or proportion of the church’s own income, this does not create a constructive obligation as discretion is retained by the church trustees as to implementation of that policy.

In contrast, a term in support correspondence that made support conditional only on sufficient future funds (eg “we will support you with £5,000 per annum if we can afford to”) would not eliminate the need to include future liabilities now if a constructive obligation otherwise exists. Here, if ultimately there were insufficient funds, the expenditure included in previous years’ accounts for future support would have to be reversed in the later accounts!

3 Imposing Conditions

A liability for future years support can be avoided by imposing conditions on that support. However, in order for avoidance to succeed:

- fulfilment of the conditions attached must be within the control of the church (so that the trustees retain discretion as to whether or not to incur the expenditure); and
- the conditions must have teeth and not be a sham!

Example 1

A church has indicated to Mrs James, a missionary going from the church to Africa, that it will support her for the duration of her time on the mission field, which is expected to be 10 years. Support is stated to be subject to an annual review of her activities and achievements (and could *in extremis*, discontinue following that review).

Scenario 1

An active annual review is taken by the church leadership and it is clear from their meeting minutes that this is rigorous and the outcome does affect the level of support for the coming year. Here, the review has substance and so long as the results are communicated to Mrs James, only the support agreed to by the leadership and communicated to Mrs James need be included in the accounts. In practice, this is likely to be one year’s support only.

Scenario 2

Mrs James sends a report each year, which is currently ‘reviewed’ at the next leaders’ meeting and is filed away. Meanwhile support continues according to the pattern that it always has. Here, the review has no substance and therefore, 10 years of funding should, according to SORP be recognised in the accounts in year 1.

Example 2

The church decide to support a local community project for a period of three years subject to the condition that the project obtain matched funding each year from the local authority. This commitment has been communicated to the project treasurer.

Here, the outcome of the condition is outside of the control of the trustees of the church and therefore, the full three years' funding should be recognised as soon as the obligation has been communicated to the project treasurer.

Note: where conditions imposed mean that a liability has not been recognised, SORP Paragraph 161 states that the future liability should be recognised as a contingent commitment (by way of a note to the accounts explaining the nature of the contingency and quantifying the estimated value of that commitment). From the context of this paragraph, it seems that this would only apply to arrangements where fulfilment of the stated conditions is within the control of the charity.

4 The Problems

Inevitably, there will be problems arriving at a value for the future liability commitment. How many years should the liability be calculated over if no specific end date (such as normal retirement date of the missionary) has been specified? Should those future liabilities be discounted using discounted cash flow techniques?

If future liabilities were to be recognised, what if the charity found in a future year that it could no longer afford to support the missionary? SORP states that future lack of funds is no reason not to recognise future years' grant commitments as liabilities in Year 1. If in a future year it transpires that the charity can no longer afford the commitment, the liability is simply 'de-recognised' in the later year – a somewhat absurd accounting treatment all round in the view of the author!

Very few if any churches carry significant reserves and, if they do, they should be held for a defined purpose³. Therefore unless the church has the resources to establish full funding for these future liabilities as part of their reserves policy, it is likely to find itself with net liabilities on the balance sheet and a significant deficit on the Statement of Financial Resources in the first year that the expenditure is recognised.

From the perspective of good charity management, huge funds would be unnecessarily tied up (whether or not a reserve is created for the purpose) which would not be available for use in serving current beneficiaries. This cannot be good policy and is likely to frustrate church members and leaders alike who will no doubt have valid alternative uses for current funds! Following the letter of SORP in these circumstances can therefore be seen to be against the stated policy of the Charity Commission and, arguably, runs contrary to trust law.

5 Possible Solutions

From the above discussion, it will be clear that there are two potential solutions:

1. Clarify the obligation(s) with the Missionaries supported

Here, the church is seeking to make clear that whilst the church intends to support the missionary on an ongoing basis, this cannot be assumed (so that there is no 'constructive obligation'). A sample letter to the missionary is included in the Appendix.

This will usually involve an annual review procedure, which has substance, under which the coming year's grant support will be considered by the relevant church authority.

Churches may understandably be reluctant to impose conditions for support on their missionaries.

³ The subject of charity reserves and the reasons that they can be held is dealt with in Charity Commission booklet CC19: Charities' Reserves.

2. Disclose the reality

The easiest solution is to disclose the arrangements and include a note (perhaps in the accounting policies section and in the liabilities note) that future commitments (if any) to missionaries arising from potential constructive obligations are not recognised together with the reason for this.

It is thought that only the most zealous of auditors or independent examiners would disagree with this treatment.

Suggested Notes to the accounts are included in the Appendix.

6 Conclusion

SORP has not been written with long-term missionary support in mind. Compliance with its provisions in this regard will inevitably give problems both in terms of actual valuation of that support and the impact that liability recognition will have on most church balance sheets.

However, with a little careful thought and co-operation of missionaries in the field, these problems can be overcome to the satisfaction of all concerned.

Appendix

1. Example annual letter to missionary

Although the following paragraphs are set out in the form of a letter, we strongly recommend that you use the text below as part of a more general letter or e-mail to the missionaries that the church supports. This will help keep the balance between fellowship, spiritual and financial aspects in their right Godly perspective. Clearly, each church will want to use their own phraseology. The text below is not intended to be prescriptive!

Dear ,

Thank you for the regular reports that you send us of your work in [area]. We were so pleased to read of the way that God is working through you in and we as [leaders] rejoice with you in seeing God's hand in this.

The news that you send us also enables the church to see the impact that our support is having in [area]. Our prayers for you and for the work have been enriched by these reports.

Either (first year of writing on this):

[They are also useful for another reason. Charity law and regulation is fast changing with an increasing emphasis on church and charity trustees being accountable for the way that financial resources are used. The information that you have provided has enabled us to comply with our responsibilities to ensure that the church funds are well used and has been very informative in our review of the support that we can give you for the coming year.]

Or (subsequent years)

[We have now completed our annual review of the support that we can give you for the coming year, based on the information that you have sent us over the last 12 months].

Whilst we have every expectation that the church will continue to support you in your valuable work for the Lord, our responsibilities as church trustees mean that we have to consider support on an annual basis.

Note:

For the annual review to be effective in avoiding the creation of a constructive obligation, it must have substance, for example, in affecting the level of support given or indeed if support is to continue. Evidence of the substance of the review should be recorded in the Leaders' minutes for the meeting at which the review was conducted.

2. Suggested notes to the accounts (disclosure to explain the arrangements)

Accounting policies - Grants

Grants for the support of [overseas] missionaries are accounted for on the basis of support agreed by [the leaders] that relates to the financial year.

Footnote to liabilities note

The church supports missionaries [give brief detail]. Where a particular missionary has been supported by the church for a number of years, strict compliance with the Charities' Statement of Recommended Practice (SORP) may regard some arrangements as constituting constructive obligations such that future years' support is accounted for in these accounts as a liability.

Whilst the support has no final end date, the trustees assess missionary funding on an annual basis and are confident that the missionaries would not view their support as an open ended obligation on the part of the church.