stewardship

transforming generosity

SORP 2015:

the key aspects

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Stewardship Briefing Paper

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1 Introduction

Every so often (10 years in this case) a new charity Statement of Recommended Practice (SORP) is produced. Although entitled "recommended practice", these statements are in fact underpinned by law and set out the accounting rules that govern the way that charities which report on an accruals basis produce their annual financial statements.

Those churches (or other charities) with financial reporting periods that begin on or after 1 January 2016 and that are required[1], or that opt, to use accruals accounting will now have to adhere with the full requirements of FRS102 SORP 2015 (The SORP).

This paper looks at the key aspects of The SORP as we see them applying primarily to churches. It is **not** intended to be a complete guide to the whole of The SORP and focusses on those areas of change or of significant impact to the church community. Whilst the church community is the primary focus, this paper can be applied, with appropriate modification, to other small Christian charities.

The SORP has been constructed in modular form, and can be accessed via www.charitiessorp.org remembering that the FRSSE version (still currently referred to) only applies to financial periods that commence before 1 January 2016. From 1 January 2016 the **only** available option is the full FRS102 SORP.

[1] In England, Wales, Scotland and Northern Ireland unincorporated charities and Charitable Incorporated Organisations are only required to prepare accruals accounts if their gross income in the year exceeds £250,000. Charitable companies limited by guarantee must always produce accounts on the accruals basis.

2 What does it mean for financial reporting?

Some churches reporting on an accruals basis may have already opted to report under the FRS102 SORP. These churches will of course see no additional changes to their reporting requirements..

However, for other churches which in previous accounting periods have chosen to report under the requirements of the FRSSE SORP, they will—for accounting periods beginning on or after 1 January 2016—have to switch to reporting under the full requirements of the FRS102 SORP with a few concessions for smaller charities[2] which will not be required to:

- Prepare a cash flow statement;
- Report on an activities basis;
- Complete quite as extensive a trustees report (see section 5 below).

Where churches are not required to use the accruals method, we would strongly suggest that the receipts and payments basis is considered as this removes many of the reporting requirements necessary under the SORP.

[2] Those with annual income below the £500,000 gross income threshold.

3 So what are the key areas of change or significance?

Rather than attempt to prioritise these changes, we have listed them in the modular order of the SORP, but we start with the more significant changes that are required to the trustees' report.

Changes to the trustees' report

Reserves policy

A charity must disclose its reserves policy or state that it does not have one and provide an explanation as to why not. Arriving at a reserves policy is not an onerous responsibility, so on the face of it meeting this requirement should cause little difficulty. However, we see many churches that appear to put little or no thought into what should be a sensible reserves policy and we would encourage churches to give the matter some serious thought, arriving at a policy that is shaped by Biblical principles and Charity Law requirements.

Added to this the Charity Commission makes it clear that under Charity Law, income that is received by a charity must be spent within a reasonable timeframe and that trustees should be able to justify holding income as reserves.

The Commission also recognises that it is good practice for a charity:

- To have a reserves policy;
- That any policy should take account of the charity's financial circumstances and other relevant factors;
- That such a policy is kept under review; and
- That any policy (or reason for not having one) is stated in the accounts.

A Stewardship briefing paper titled *How to think about reserves* exploring some of the principles and issues that trustees might wish to consider when putting together a reserves policy is available on the Stewardship website via the following link: stewardship.org.uk/downloads/briefingpapers/how-to-think-about-reserves.pdf

All trustees listed

All trustees (no longer limited to 50) who served in the accounting period together with those who were trustees on the date that the report was approved must be named. This will really only impact very large churches.

Significant changes to the trustees' annual report for larger charities[3]

- A description of the principal risks and uncertainties facing the charity together with a summary of the trustees actions to manage, mitigate or transfer those risks.

[3] Those with income above £500,000

- More about the structure, governance and management of the charity including:
    - The arrangements for setting the pay and remuneration of key employees including any benchmarks, parameters or other criteria used in setting their pay;.
    - The policies and procedures for the induction and training of trustees;
    - How the charity makes its decisions;
- An explanation of social investment policies and how they contribute to the aims of the charity.

SORP Modules – applicable to all charities

We now move onto the changes and issues that have been brought about by the introduction of The SORP and the withdrawal of the FRSSE SORP. These are addressed in the same modular order adopted by the SORP.

Module 3 – going concern

Any material uncertainties when considering if the church is a going concern must be disclosed, with trustees looking forward for at least 12 months from the date that the accounts are approved.

Whether constantly running a cash deficit (or indeed any other situation) brings into doubt the continuance of the church is a matter of judgement for the trustees. Where there are doubts these create significant and far reaching implications when completing the church's financial accounts and indeed for the future of the church itself.

These are not judgments to take lightly, and trustees need to follow the regulations but at the same time to take a balanced view of the surrounding circumstances. For a more in depth exploration of this issue, please see Appendix 1 which is a reproduction of a recent Stewardship blog.

Module 4 - headings in the Statement of Financial Activities (SOFA)

The income and expenditure headings included in the Statement of Financial Activities have been renamed, simplified and reduced. The new headings can be found in table 2 of module 4 of the SORP. In practice these changes will make little or no difference to the way that churches accounting systems are structured.

There is a new heading of "other income" introduced, which the SORP says should be used to capture items that can't be classified under any of the other headings. The SORP suggest that these might include:

- A gain on the disposal of a tangible fixed asset;
- A gain on the disposal of a programme related asset;
- Royalties from the exploitation of intellectual property rights.

Module 4 – prior year comparative figures

Prior year comparative figures will be required for each of the columns provided in the SOFA and not just the total of all funds, as was previously the case. This will result in a multi-columnar format being required. However, the detailed columnar analysis does not necessarily have to be shown on the face of the SOFA but can instead be included within the notes. Whilst obtaining these comparative figures will be straightforward, displaying them in a meaningful and uncluttered way might become a creative challenge especially for churches that make extensive use of restricted and/or designated funds.

Module 5 - income recognition

We include this, not because we consider it to be particularly significant, but rather because it is a change that has attracted considerable press comment. Section 5.10 states that: "Income from donations and grants is recognised when there is evidence of entitlement to the gift, receipt is **probable** and its amount can be measured reliably."

It is the second criteria which has attracted the comment with receipt now required to be 'probable' rather than 'virtually certain' as was previously the case. So what does this mean for churches and particularly for churches that are in receipt of future dated gift pledges to fund projects (building work etc.) or are anticipating income from legacies?

In reality, we consider that this change is likely to make little if any difference to the way in which churches recognise income. The probability of receipt is only one of the three criteria that should be fulfilled in order for churches to recognise income. The other two (entitlement and measurability) are equally important and in the context of a future dated financial pledge, this is particularly true of the entitlement criteria.

Financial pledges by church members (or others) to the church will generally not be legally enforceable and so the "entitlement" test will not be met. Future income should not therefore be recognised. There are however exceptions to this. If the pledge is made under deed of covenant or the church is obligated by the pledge to do something in return (that is, there is legal "consideration") the pledge could be enforceable. If in doubt and the issue is material to the accounts legal advice should be sought.

As such, we do not think that the question of probability of receipt will make a material difference in the vast majority of cases. If, however, both the donor and the church believes a pledge to be legally enforceable and the church is fully prepared to enforce payment if the donor later changes his mind, there is a strong argument for including the pledge as income.

In the case of a legacy, entitlement occurs when the charity has sufficient evidence that a gift has been left to them and the executor is satisfied that the property in question will not be required to satisfy other claims in the estate. Only then will the probability question be addressed.

Receipt normally becomes probable when there has been a grant of probate; the executors have established that there are sufficient assets in the estate; and any conditions attached to the legacy are either within the control of the charity or have been met. Where the estate includes assets whose value is uncertain, or that may fluctuate prior to realisation by the executors, the measurement criterion will also be a consideration.

Module 6 – accounting for donated goods for onward distribution to beneficiaries

Where churches merely act as 'collection points', collecting goods that are passed on to other organisations for distribution (e.g. Samaritan's Purse shoeboxes), the provisions of the SORP will not apply as the church is acting only as agent and the collected goods should not be recorded in the financial records of the church at all.

However, with more churches taking responsibility for **running** food banks or for collecting and distributing furniture and white goods as a way of helping those in need in their communities, this module of the SORP will apply to the way it accounts for donation goods that are for onward distribution to beneficiaries.

Goods donated in this way should be recognised as income at the point of donation and expensed at the point of distribution. The two transactions are treated independently and are not 'netted' off with the consequence that donated assets that are held by the charity over its balance sheet date are held as stock.

Ledger entry on receipt of gift

		Dr.	Cr.
Bal sheet	Stock for future distribution	xx	
Income	Donated goods		xx

Ledger entry on the onward distribution of the gift

Expense	Distribution of donated goods	xx	
Bal sheet	Stock for future distribution		xx

There is a concession granted where this treatment is deemed to be **impractical** or where **the cost** involved in undertaking the valuation **outweighs the benefit** of providing the information to the readers of the accounts. Where this concession applies, the gift must be recognised as a donation when it is distributed with the equivalent amount recognised as charitable expenditure. Adopting this treatment means that the balance sheet will not be impacted and that donated goods will not be treated as stock at the year end.

So churches that are running food banks or the distribution of other goods (e.g. second-hand furniture) need to consider:

- Whether it is practical to account for donated goods on receipt, and if so, what systems need to be put in place to capture this information and value the donations? Valuation may, for example, be affected by the proximity of a product expiry date.

- How to value stock that is held over the year end and to decide whether it should be written down to its recoverable amount. In a church context valuation is likely to be a rough estimate of what the 'real value' is to the potential recipient. Any methodology adopted should be both simple and practical.
- Whether the costs involved in providing this information outweigh the benefit to the reader of the accounts. This decision may, amongst other factors, be influenced by the significance of the food bank, or other activity to the overall charity accounts.

Whichever treatment is adopted, the accounts must reflect the donated assets; they cannot simply be ignored.

Module 7 – recognising liabilities from constructive obligations

This is a particularly difficult module for churches which we believe may be caught by the largely unintended consequences of applying to charities and churches rules that were largely designed for the commercial sector.

The module requires charities to recognise a liability where it has entered into a constructive obligation regarding future grant making. Although not always legally binding, where a church has no realistic alternative to settling an obligation that it has made then a liability has been created which has to be recognised in the accounts. Determining whether a constructive obligation exists is not always straightforward with general policy statements and mission statements unlikely to give rise to a liability because the church still has discretion in how these broad statements are implemented.

Section 7.14 states that evidence of a constructive obligation exists where:

- the commitment made by the charity is specific, for example a promise is made to provide particular goods, services or grant funding;
- this commitment is communicated directly to particular beneficiaries or grant recipients; and
- there is an established pattern of practice that indicates to the recipients of services or funding that the charity will meet its commitment.

The most likely situations in which this might apply to churches is grant funding of specific organisations or mission partners where the church is trying to balance the relationnal aspect of missionary support with the added financial liability that a constructive obligation brings.

A related briefing paper *The long-term support of missionaries*, which will soon be available on our website, explores this issue in more depth.

Module 8 – Allocating costs by activity in the SOFA

The SORP requires all charities with turnover above £500,000 to report on an activity basis although it does not address how to present a SOFA on an activity basis or the allocation of costs to activities in that statement. The SORP goes on to say that further analysis of significant activities included either in charitable activities or fundraising must be provided on the face of the SOFA or in the notes to the accounts.

We would argue that the operation of 'church' is often a single integrated activity with a number of different facets (worship, discipleship, mission, community etc.) and would therefore suggest that churches carefully consider how to apply this module and how analysing activities assists the reader of the accounts to get a better understanding of the church. Where churches consider that they do need to analyse activities, we suggest that these be kept broad and to a minimum.

Module 9 - Trustee and related party donations

Charities must provide an **aggregate** disclosure of the total amount of donations received from trustees and related parties[4]. The issue of related parties in churches is not always straightforward often with the grown-up children of trustees remaining within the same church. We suggest that this information is collected on a 'best endeavours' basis, recognising that particularly in certain denominations the trustee body is large and as a result identifying every related party may not be possible.

Charities only have to show **individual** donations and the name of the associated trustees to the extent that the donor has attached restrictions which would, or might, require the charity to alter significantly the nature of its existing activities if it were to accept the donation. It is hard to imagine a church situation where this might apply.

Whilst in most cases, making the required disclosures may be straightforward, even the disclosure of aggregate donations from trustees could trigger some sensitivity. For example, if one trustee has the ability to make significant donations but their fellow trustees are all of limited means, the disclosure of significant aggregate donations may point to the giving of the one trustee. It remains to be seen if this particular disclosure requirement comes in for criticism in future.

Module 9 – disclosure of remuneration

There are some changes regarding the disclosure of trustee and staff remuneration including:

For trustees

- Unless immaterial, the total amount of expenses waived by trustees must be disclosed. In reality this is almost impossible to determine as it will only be those expenses offered and declined by the trustees that will be known to the church, most expenses will remain unknown.

For staff

- Contributions by a charity to a pension fund for the benefit of employees must be disclosed.
- Details of redundancy and termination for staff must be disclosed.
- The total amount paid to key management personnel (see below) must be disclosed.

[4] Related parties comprise of all linear relations (children, parents, grandparents) and also siblings, further extending to include the spouses of all these relations.

All figures disclosed are aggregate figures. Charities are **not** required to show amounts on an individual basis, although for many churches that have just one or two employees linking a disclosed payment to an individual will not be difficult.

Module 9 – key management personnel

These are the senior management personnel to whom the day-to-day management of the charity is delegated and who report to the trustees. As set out above, the SORP requires the total amount (not analysed by individual) paid to this group to be disclosed.

Where a church has a core leadership team then it is likely that this same group will be the key management personnel envisaged by module 9. In many churches it often does not extend beyond the elders but should include anyone that has significant input at a strategic or directional level. However, because this term is not defined and therefore open to judgement, we consider that any reasonable conclusion is acceptable.

Once again, any figures disclosed are on an aggregate basis and do not relate to individuals.

Module 9 – payments made to an auditor or independent examiner working in another capacity

There are times when an auditor or independent examiner provides services to the church in another capacity beyond their statutory duties. For example, most professional audit firms and many independent examiners will offer payroll or consultancy services. Where this is the case, the church must identify and disclose these payments.

Module 14 - Cash Flow statement

Module 14 requires charities to provide a statement of cash flows which shows the net increase or decrease in cash during the reporting period. This requirement does not extend to providing a forecast of future flows and will only be mandatory for charities with gross annual income above £500,000. Details of the three mandatory headings can be found within module 14.

Whilst an understanding of cash flow (particularly future cash flow) is often helpful to charities the construction and interpretation of cash flow statements—even for experienced treasurers—is notoriously tricky and as a result we do not envisage (and would not encourage) many churches that fall below the £500,000 threshold to voluntarily undertake to complete a cash flow statement.

Module 17 – Pension schemes

Most churches will find themselves falling within one of three categories:

1. *Making payments into a defined contribution pension scheme*. The accounting treatment for such schemes is straightforward with the employer contribution treated as a cost of remuneration.
2. *Making payments into a multi-employer defined benefit scheme*. Regardless of the actuarial valuation of the scheme (whether in surplus or deficit), if the church's share of a surplus or deficit

cannot be identified, the contributions are accounted for in the same way as for a defined contribution scheme shown above. This is in stark contrast to the third category set out below.

3. *Making payments into a multi-employer defined benefit scheme that is in deficit* ***and*** *where there is an* ***agreement in place*** *to make* ***additional contributions*** *based on the current and past service of employees*. In such cases a balance sheet liability must be recognised for the present value of outstanding additional contributions. This is likely to be a significant issue for many Baptist churches in particular and for other churches which might operate a denominational or other form of multi-employer scheme.

   This is particularly the case where the agreement to fund the shortfall is large and determining the extent of each church's individual liability is difficult. There may even be cases where a pension shortfall brings the issue of going concern (see module 3) into sharp focus.

   With most pension funds subject to a valuation at least every three years. The impact of having to carry the liability in the balance sheet may result in significant movements in the SOFA as deficit values are revised at each valuation. If you participate in such a scheme, we would suggest that you take advice from the schemes operator before deciding how to account for it.

The remaining option could be for a church to be making payments into a 'single church' defined benefit scheme. However, we consider this to be such an unusual situation that we have made no further comment.

Module 21 – Social Investments and mixed motive investments

A new class of investment (known as social investment) is introduced by the SORP to recognise investments made primarily to further the charitable aims of the church (including programme-related assets). These are included in the balance sheet as a class of investment. Social investment also includes a sub class of investment that is used partly to further the aim of the charity and partly to provide an investment return. These are known as 'mixed motive investments'.

The investment is not justified wholly by the return or the contribution it makes to the investing charity's aims but by a combination of the two. An example would be a church that has provided financial support to another church or organisation in order to further its own charitable purposes but on which it is also expecting some kind of financial return.

4 Conclusion and what to do now?

In our opinion, whilst the introduction of SORP 2015 does not fundamentally alter the way that churches compile their financial statements, there are enough changes to mean that churches and treasurers need to think through the implications for their own church and may have to introduce changes to procedures in order to collect the data to meet the additional requirements.

Where churches are not required to report using the accruals basis we would suggest that a church gives serious consideration to preparing receipts and payments accounts. In the first instance receipts and payments accounts are often more readily understood by the average church member who has little understanding or indeed interest in the concepts of accruals and depreciation and secondly, most of these additional requirements are not required.

Where a church is required or still chooses to report under the accruals basis then it should:

- Take a look through the more significant changes set out in this paper and decide which ones might apply in your case and then read through the relevant SORP module(s). The full list of modules can be forum on the Charities SORP website.
- Keep abreast of any information that is made available by Stewardship, your denomination or other umbrella organisation that your church might belong to.
- Read the various help-sheets provided at www.charitiessorp.org

If you are still uncertain, speak with your auditor or independent examiner.

Appendix 1

Trustee requirement to consider going concern

Stewardship blog 12th December 2014

Going concern is a fundamental assumption underpinning financial reporting. When applied to charities, it means in general terms that the trustees expect the charity to continue operating as normal for the foreseeable future, able to meet its obligations as they fall due, and that they have no plans to close the charity or to significantly curtail its operations. For most trustees, for most of the time, this assessment should be almost routine but there are times and situations where this might not be the case.

Whether a particular situation or set of circumstances brings into doubt the continuance of the charity is a matter of judgement for the trustees. In accounting speak this judgement is known as "going concern" and where there are doubts, these create immediate implications when completing the charity's financial accounts and are likely to have wide ranging ramifications for the charity in the medium-term.

Any assessment that trustees make, must be based solely on the charity's unrestricted funds. Restricted funds must, by law, only be used for the purposes for which they were given, and as such cannot be considered by the trustees for covering general financial shortfalls.

What might bring about this doubt?

The sorts of situations that may bring going concern doubts into the minds of trustees of churches and Christian charities include:

- Running a persistent cash flow deficit;
- The imminent retirement or relocation of one or more significant donors or customers;
- Serious litigation which might require the charity to incur significant legal costs to defend or may result in a financial penalty that it is unable to meet;
- The financial impact associated with a change of pastor or minister.

But surely God will provide

As is often the case with churches and Christian charities, there can be a perceived conflict between the faith element "God will provide" and the legal regulations that must be applied to all charities regardless of their background. Although this tension is real, and indeed often helpful, it must be held properly in balance.

Trustees that do not pay due regard to the regulations in this area are not acting in the best interests of the charity and are breaking the law. Also, by ignoring genuine concerns, the financial wellbeing of the charity may deteriorate further and trustees may even oversee financial collapse with all of the reputational, legal and financial consequences which that brings to the individual trustees, the organisation, and to the Kingdom of God.

Going concern and accounting regulations

In module 3 of the Charity SORP, the matter of going concern is addressed. The trustees must make an assessment as to the going concern assumption after taking into account all available information about the future, looking ahead for a period of at least 12 months from the date that the current accounts are approved.

Trustee considerations

As there will be significant consequences arising from a trustee assessment that the charity is not a going concern, the trustees should not reach this decision lightly and without due regard to the surrounding circumstances and the options that are open to them.

For example, where a charity is running a regular monthly cash deficit, the trustees should include in their considerations;

- Whether, by continuing its current operations, the deficit is likely to be temporary or whether it is embedded, repeating month after month;
- How large are the charity's reserves and how quickly the deficit is eroding them;
- What actions might the charity be able to take to increase its income? The outcome of these actions does not have to be certain, but must be more than just wishful thinking;
- What actions might the charity be able to take to reduce its costs? Often the reduction of costs can be achieved quicker than increasing income.

As soon as it becomes apparent that there is a realistic going concern danger, professional advice should be sought immediately

Financial planning

It is at times like this, when the financial disciplines of preparing budgets and forecasts come into their own as early warning systems of what the future might hold. This financial information will help the trustees plot a future course that will hopefully avoid the need to bring the going concern of the charity into doubt, even if that course of action results in an orderly closure of the charity.

In times where many Christian charities are not immune from financial difficulties, more trustees are likely to have to make a more serious assessment of going concern than they may have done in the past. However, recognising any potential difficulty early and putting in place plans to deal with it should enable most trustees to form a positive going concern judgement without too many sleepless nights.