Charities SORP 2005
Information Sheet – Number 1

1. Annual Review Process

1.1. The Charity Commission and the Office of the Scottish Charity Regulator are the joint SORP making body and as such are required by the Accounting Standards Board's (ASB) code of practice to undertake annual reviews of the SORP. These reviews are undertaken in conjunction with the SORP Committee, and in particular considered:

- any implications for the SORP of new or proposed accounting standards;
- any evidence of widespread failure to follow any part of the guidance; and
- any developments within the sector that suggests further guidance on accounting matters is desirable.

1.2. The current SORP was issued in March 2005, and although its early implementation was encouraged, the effective date of implementation is for accounting periods beginning on or after 1 April 2005. The purpose of this Information Sheet, which provides informal guidance on the application of the SORP, is to assist practitioners in their preparation of financial statements. This Information Sheet does not form part of the SORP, nor has it been reviewed by the ASB, rather it attempts to explain and illustrate what is already recommended by the SORP, but does not carry the authority of the SORP.

2. Index of topics:

3. Accounting treatment for grants

3.1. Grant income received is analysed, in the Statement of Financial Activities (SoFA), as either voluntary income (paragraph 121) or incoming resources from charitable activities (paragraph 145) depending upon the character of the grant. Preparers of accounts have sought clarification as to how grant income should be analysed between the income categories of the SoFA and, in particular, whether the receipt of a restricted grant is equivalent to a performance related grant which should be categorised as incoming resources from charitable activities.

3.2. Contractual income derived from the provision of goods and services to beneficiaries will always be analysed as incoming resources from charitable activities. The SORP also recognises that some grants contain conditions that require the performance of a specified service where payment is conditional on a specified output being achieved (See SORP Glossary GL 45). Such grants are termed performance related grants and have conditions which make them similar in economic terms to trading income (See SORP Para.143) and are also analysed as incoming resources from charitable activities within the SoFA.

3.3. Simply because a grant is restricted to a particular purpose of the recipient charity does not mean it should be recognised as a performance related grant (See SORP Para 100). Restricted grants, that do not create a service requirement, are normally analysed as restricted voluntary income (see SORP Glossary GL 61). However, even where the conditions attaching to grants do not create specific performance related conditions, the funding may often be provided on terms that clearly require the funds to be utilised to support particular service providing activities of the charity. Where the nature of the conditions attaching to a restricted fund are such that they create a service requirement that must be met by the charity then the grant funding should also be analysed as incoming resources from charitable activities.

3.4. Voluntary income comprises gifts that will not normally provide any return to the donor other than the knowledge that someone will benefit from the donation. Voluntary income will normally include gifts in kind and donated services (See SORP Glossary GL 61). Grants received for the general purposes of the charity or do not have particular service requirements are analysed as voluntary income *(See SORP Para 144 and Para* 121 (b)).

4. The Charities Act 2006 and disclosures for grant-making charities

4.1. Schedule 8 to the Charities Act 2006, clause 133, on implementation in England and Wales, will provide that “there shall be no provision in the Regulations made under section 42 of the Charities Act 1993 that requires the charity trustees of a charity that is a charitable trust created by any person (the settlor), to disclose in the statement of the accounts, either the identities of recipients of grants made out of the funds of the charity, or the amounts of any individual grants so made, if the disclosure would fall to be made at a time when the settlor or their spouse or civil partner was still alive.”

4.2. For charitable trusts in England and Wales where this provision applies, the Charities Act 2006 will allow further grant disclosure exemptions in addition to those already set out in SORP paragraph 200.

4.3. The SORP does not, in any case, require details of grants made to individuals to be disclosed. In the case of institutional grants, the SORP requires disclosure of the name of the institution supported and the total value of grants made to it. Disclosure is limited to grants that are material in the context of grantmaking and requires the disclosure of a sufficient number of institutional grants to provide a reasonable understanding of the range of institutions supported.

4.4. Following the implementation of the Charities Act 2006 in England and Wales, the disclosures of the names of institutions supported by grants and the amount of funding they received will be discretionary in law during the lifetime of the settlor (or their spouse or civil partner) of a charitable trust that has funded the grant. This discretion does not extend to charities registered or operating in Scotland.

4.5. For other grantmakers where clause 133 of schedule 8 to the Charities Act 2006 does not apply, the only grounds for non-disclosure of this information remain those set out in SORP paragraph 200 and paragraphs 208 and 209.

4.6. The objectives of the SORP include improving the quality of financial reporting and therefore the grant information disclosures recommended by the SORP remains recommended practice for all grantmaking charities in the UK.

5. Investment management costs

5.1. A principle of the SORP is that all incoming resources should be reported gross. Paragraph 187 of the SORP recommends that where investment management fees have been deducted from investment income by investment managers that the charity should show investment income gross before the deduction of such fees and report the costs of managing investments separately within the SoFA.

5.2. With collective investment schemes, such as unit trusts, or common investment funds, investment management costs may be included within the bid-offer spread or recovered by transaction and portfolio charges rather than by a fee charged directly to the charity.

5.3. Where it is not practicable to ascertain the actual or a notional apportionment of costs charged to the individual participants of such schemes with reasonable accuracy then the investment income received should be reported without adjustment.

6. Bank interest and other finance costs

6.1. Interest and other finance costs may arise from short term borrowing to fund working capital or from longer term borrowing to fund the operating assets of a charity. Preparers of accounts have questioned whether such interest costs should be allocated to activities funded by the loan or whether such costs should be regarded as a cost of generating funds.

6.2. The SoFA provides an activity classification of costs. Where interest has arisen in order to finance a particular activity then it would generally be allocated to that activity. Interest costs that cannot be directly allocated to a particular activity will generally be apportioned on a reasonable basis as with other support costs.

7. The business review and company charities

7.1. Section 417 of the Companies Act 2006 requires the Director's Report to include a 'business review'. These provisions are brought forwards from section 234(1) (b) and section 234ZZB of the Companies Act 1985 which applied to accounting periods beginning on or after 1 April 2005. Small companies are relieved from this reporting requirement by section 417(1). Medium sized companies need not disclose the performance information so far as they relate to non-financial information (section 417(7)).

7.2. Charitable companies applying the SORP's recommendations for the Trustees' Annual Report are likely to meet the general requirements for a business review if an expanded narrative is provided on the risks and uncertainties faced by the charity.

7.3. The content of a business review and the SORP paragraphs that are likely to meet these requirements are summarised in the table below:

Contents of statutory business review **Sections 417 Companies Act 2006**	**SORP 2005 paragraph reference**
A fair review of the business.	Paragraph 36
Description of principal risks and uncertainties.	Paragraph 45 & 53(d)
Review the development and performance in the financial year, and the position of the business at the end of the year. The review should be balanced and comprehensive and consistent with the size and complexity of the business.	Paragraphs 53(a) 53(d) and Paragraph 55
The review must, to the extent necessary for an understanding of the development, performance or position include: a) analysis using key performance indicators, b) where appropriate, analysis using other key indicators, including environmental and employee matters (applicable only to large companies).	Paragraph 53
Key performance indicators means factors by reference to which the development, performance or position of	Paragraph 36 & 53(a)

the company (or group) can be measured effectively.	
Where a group, the report shall address the performance of both parent and subsidiary.	Paragraph 53

7.4. In practice charities subject to statutory audit, through their compliance with the SORP's recommendations, are likely to be compliant with the requirements of the business review provided they include an explanation of the risks and uncertainties facing the charity.

8. The operating financial review (OFR) and reporting by charities

8.1. In 2005, the requirement to prepare an OFR was repealed by Statutory Instrument 3442/2005. The OFR was considered too prescriptive and the business review (see above) was considered to cover much of the ground covered by the OFR in a more proportionate way. The ASB withdrew 'Reporting Standard 1: Operating and Financial Review' following the repeal of the regulations and reissued the contents as a statement of best practice 'Reporting Statement: Operating and Financial Review' (the Reporting Statement) in January 2006.

8.2. The SORP does not create any requirement for charities to prepare an OFR. However, the SORP's recommendations for a Trustees' Annual Report already cover a number of the key disclosures recommended by the Reporting Statement.

8.3. The Reporting Statement was written with quoted companies in mind, but is also applicable to other entities, including charities, that choose to prepare an OFR. The Reporting Statement was developed as best practice and is not mandatory even for quoted companies.

8.4. Where the trustees, particularly of larger charities, choose to expand their reporting to encompass a full OFR, they are encouraged to make reference to the Reporting Standard. Indeed, the principles put forward by the statement may also be helpful to trustees more generally in the preparation of their annual report.

8.5. The table below, which provides a synopsis of the OFR, may be helpful to charities considering expanding their annual report into a full OFR. Particular areas which the SORP Committee considers are not currently addressed by the SORP are highlighted in **bold.**

Contents of best practice OFR	**SORP 2005**
A balanced and comprehensive analysis consistent with the size and complexity of the business of:	Paragraphs 36, 47, 53,

a) development and performance in the financial year b) position at the end of the year c) main trends and factors underlying the development, performance and position during the year d) the main trends and factors which are likely to affect future development, performance and position so as to assist 'members' to assess the strategies adopted and potential for success	57
In supplementing the accounts, provide additional explanations of amounts and explain the conditions and events that shaped the information in the financial statements	Paragraphs 10, 21,35 &36
Key elements of disclosure: a) nature of the business including a description of the market, competitive and regulatory environment and entity's objectives and strategies b)development and performance both in the financial year and in the future c) resources, principal risks and uncertainties and relationships that may affect long-term value d) position of the business including **liquidity** performance both in the financial year and in the future	Paragraphs 47, 53, 57 &55
Details of particular matters, where appropriate, to provide a balanced and comprehensive analysis: a) **environmental matters** and related policies b) **employees** and related policies c) **social and community issues** and related policies d) persons with whom entity has contractual or other arrangements essential to the business e) other matters	Paragraphs 44 & 51
Director's strategies for achieving the objectives of the business	Paragraph 47
Include key performance indicators both financial, and where appropriate, non financial used by directors to assess progress against their stated objectives	Paragraph 53
For each KPI disclosed, disclose key matters including definition and calculation	-