Guidance on the FRS 102 SORP

March 2016

Key Changes under the FRS 102 SORP

The FRS 102 SORP is effective for all charities with accounting periods commencing from 1 January 2015. As most hospices have a March year end, this means their accounts to 31 March 2016 will be the first set of accounts that they will need to prepare under the new regulations.

As well as the main FRS 102 SORP, a FRSSE SORP has been published for smaller entities (to qualify the charity must meet any two of these three criteria: income under £6.5 million, assets not exceeding £2.6 million, no more than 50 employees). However, as the FRSSE is being withdrawn after one year, it is recommended that all hospices follow the main SORP even if they are eligible for the FRSSE – these notes are prepared on the assumption that all hospices will follow the main SORP.

This document highlights some of the major changes that are likely to affect hospices as a result of the new rules. This guidance is necessarily of a general nature and specific advice should be sought from your own professional adviser for your specific situation. Hospice UK would like to thank Price Bailey for preparing the model set of hospice accounts which accompany this guidance.

Contents

1. Income recognition

Under the previous SORP (2005), income should be recognised where it met the following three criteria:

- Certainty
- Entitlement
- Measurement

Under the new FRS 102 SORP (2015), “certainty” has been replaced with “probable”. The criteria of entitlement and measurement remain, so the three criteria for recognised income are that:

- its receipt is probable
- the hospice is entitled to it
- the amount can be accurately measured.

These are defined as follows:

- Entitlement – control over the rights or other access to the economic benefit has passed to the charity.
- Probable – it is more likely than not that the economic benefits associated with the transaction or gift will flow to the charity.
- Measurement – the monetary value or amount of the income can be measured reliably and the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

In reality, it is unlikely that this change will significantly affect when hospices recognise income, as it is difficult to think of many scenarios where a hospice was entitled to a specific item of income and was able to measure it, but where the likelihood of receiving it was only probable, not certain – except perhaps with legacies.

Therefore, it is expected that income will continue to be recognised by hospices on the same basis as it has been in previous years. (There are two exceptions to this: legacy income and donated goods. These are considered below).

2. Recognition of legacy income

The rules for the recognition have been clarified in an effort to prevent some of the confusion and inconsistency around when to recognise legacy income, as this is an area where there have historically been significant differences in how charities interpret the rules.

Paragraph 5.31 of the FRS 102 SORP 2015 states that receipt would normally be probable when:

- there has been grant of probate
- the executors have established that there are sufficient assets in the estate, after settling any liabilities, to pay the legacy, and
- any conditions attached to the legacy are either within the control of the charity or have been met.

The second bullet point is likely to be the most judgemental issue.

For pecuniary legacies it may be relatively simple to establish probability, as the publication of a draft statement of assets and liabilities is likely to be sufficient for the hospice to conclude they will probably receive the money.

However, it is likely to be more complicated in the case of residuary legacies (where the hospice has been left a proportion of the estate rather than a specific monetary amount). Hospices may well take the view that it is only when the estate accounts have been filed that the executors will have established there are sufficient assets in the estate, and so the condition of probability has been met.

Therefore, there remains an element of judgement as to when legacy income should be recognised. As it is probably unhelpful to recognise legacy income significantly in advance of when the cash is received, our recommendation is that for residuary legacies hospices wait until estate accounts have been approved.

But the most important thing is to adopt a consistent approach which complies with the SORP.

3. Gifts for resale

This change could significantly affect hospices, given the huge contribution shops make to the funding of hospices.

Under FRS 102, where goods are donated to the charity they should be recognised as income (and stock on the balance sheet) once the goods have been received (not when the goods are sold as was previous practice).

However, there is a very important caveat to this.

FRS 102 states that if this is not practical then this policy does not need to be followed, and the income can instead be recognised when the goods are sold.

Therefore, the hospice needs to consider whether the benefits to a user of the accounts in terms of understanding the value of donated goods held by the hospice shops is greater than the costs involved in obtaining that valuation.

It is expected that most, if not all, hospices will conclude that this is not the case, and so will continue to recognise such goods when sold – this is permissible under the FRS 102 SORP. Para 6.29 of the SORP states: ‘Estimating the fair value of donated goods for resale is often impractical because of the volume of low-value items received or the absence of detailed stock control systems or records. In such circumstances, donated goods for resale are not recognised on receipt. Instead, the value to the charity of the donated goods sold is recognised as income when sold.’

A possible exception is if a hospice is operating a separate furniture or white goods specialist shop. Then it may have an accurate stock system in place which enables it to identify and easily value the stock of donated goods at the balance sheet date – in which case the figure should be included in the accounts if it is material.

4. Presentation of income and expenditure

The mandatory headings under which income should be analysed have been simplified. The following five headings should be used on the face of the SOFA (unless there is no material income, in which case they can be omitted):

- Income from donations and legacies (including any grants received from charitable trusts)
- Income from charitable activities (this would include income from a CCG in England whether under an NHS standard contract or grant – see note 9 of the template accounts; the same applies to equivalent income in Northern Ireland, Scotland and Wales)
- Income from trading activities
- Investment income
- Other income (likely to be used very rarely by hospices as most items should fit into one of the above four categories).

Further analysis into sub categories appropriate to the hospice's activities for all material items should be shown on the face of the SOFA or the notes (eg income from trading activities could be split between shop and lottery income).

Under the previous SORP, all expenditure was shown on the face of the SOFA within one of three categories: cost of generating funds, charitable expenditure and governance costs.

Under the FRS 102 SORP, there are only two categories: expenditure on raising funds and expenditure on charitable activities. As with income, appropriate sub headings should be used to further analyse material items, and where possible these should mirror the headings used for income.

Governance costs are no longer shown on the face of the SOFA; instead they are apportioned across the two categories in a similar manner to support costs. Both governance costs and support costs must still be analysed in the notes to the accounts.

It is up to the hospice to come up with a fair and reasonable method of allocating governance and support costs to the two main headings – and different methods may well be appropriate for different types of costs.

Two things worthy to note with regards costs are:

a) Grants for charitable activities

The costs of negotiating for initial contracts/applying for grants on specific charitable activities is expenditure on charitable activities (para 4.52 – ie for a hospice the staff time costs involved in negotiating NHS funding is a charitable cost not a fundraising cost).

b) Governance costs

Beware the definition has slightly changed – governance costs are costs associated with the strategic as opposed to day-to-day management. This will include any of the cost of charity employees involved in meetings with trustees and the cost of any administrative support provided to the trustees.

5. Comparative figures

Under the old SORP many hospices may have just split income and expenditure between restricted, unrestricted and designated for the current year but only provided a total figure for the previous year.

Under the new standards comparative figures are now required for each separate class of funds for all notes.

This does not necessarily have to be done on the face of the SOFA – it may be done in the notes (this may be necessary in some cases for reasons of space). There are four different ways this can be achieved:

- Comparative columns on the SOFA – so you could have up to 10 columns.
- Comparative information is given in narrative form under each note to the SOFA. This requires that every line on the SOFA has a corresponding note so that information can be given. This is the method adopted in the SORP model accounts.
- Comparative columns are detailed in each note to the SOFA – so each note has the current year analysis followed by the prior year analysis.
- The final note to the accounts is the prior year SOFA.

There is some discussion in the accountancy profession at the moment on the issue of comparatives and how detailed these need to be. While these discussions are ongoing we have used the Charity Commission model example accounts on comparative requirements, which could be subject to change.

6. Statement of cash flows

All hospices who prepare accounts under the FRS 102 SORP will need to include a cashflow statement, which may be a change for some hospices.

(There is a potential exception to this for hospices with incomes under £500,000).

7. Multi-employer defined benefit pension schemes

Previously, hospices who had a defined benefit pension scheme were required to recognise any surplus or deficit on the scheme in the balance sheet, whereas hospices with a multi-employer scheme generally did not (on the basis that it was not possible to split the assets and liabilities of the scheme between the different employers).

FRS 102 brings in a modification to this, which is that where there is an agreement by a hospice in a multi-employer scheme to pay additional contributions to fund the deficit, these contributions will be considered a contractual obligation and so will need to be recognised as a liability on the balance sheet (at their net present value). This is an example where a hospice may prefer to use the FRSSE SORP so it has one more year without the recognition of this liability.

8. Senior management pay

As the senior managers are considered “related parties” under the new definition provided by FRS 102, the accounts must show the total (not individual) remuneration for those responsible for the management of the charity (in practice this is likely to mean the senior management team).

This total must include salaries, bonuses, employers pension contributions, the value of any other benefits and any redundancy or settlement payments

Note that the SORP just requires the total value – disclosure of individual remuneration of senior management salaries is not required (although it is recommended by NCVO).

The requirement to disclose all salaries over £60,000 in bands of £10,000 remains.

9. Donations from related parties

The total donations from trustees and other related parties must be disclosed. In addition, if a related party (eg a trustee) gives donations that are restricted to a particular project, then the specific details of that donation must be given (regardless of the value).

10. Redundancy pay and payments under settlement agreements

The staff costs note now needs to disclose the value of any payments for redundancy pay or under settlement agreements in total. An explanatory note should outline the nature of the payment, eg "During the year the hospice closed one of its shops and three members of staff were paid redundancies payments totalling £9,500 (Previous year: One member of staff left the hospice following an agreed settlement and was paid a sum of £3,000 in excess of their contractual entitlements).

11. Holiday benefits

Under FRS 102, hospices will be required to accrue for holiday earned but not yet taken. To take a very simple example, if a hospice had one hundred staff, each of whom was entitled to 25 days holiday but had all only taken 24 days, then in the year end accounts the hospice should accrue for one days pay for all of its staff.

The calculations may be more complex if the holiday year is not the same as the financial year (eg if a hospice has a financial year running to 31 March but the holiday year is based on the calendar year, then they need to check that employees have taken a quarter of their annual leave by 31 March, and recognise the liability if they haven't).

It is important to note that like all items, this only applies where the amount is material. It is recommended that hospices do a quick 'back of the envelope' calculation to estimate if the amount is likely to be material.

12. Additional requirements of trustees report

There are significant changes to the trustees report under FRS 102.

The most significant changes are that:

- The hospice must explain its policy for holding reserves, state the amount of reserves and explain why they are held.
- The hospice is required to provide a description of the principal risks and uncertainties facing it (this means all principal risks, not just financial ones). It must also report on their plans and strategies for managing those risks.
- The hospice must disclose how the remuneration of key management personnel is set (in most cases this is likely to mean the senior management team). This includes details of the criteria used and any benchmarks referred to as part of the process.
- Although not strictly a new requirement, there is an amplification that the aims and objectives section must set out the changes the hospice aims to make and how, its

strategies for achieving its aims and objectives, its criteria for measuring success and reporting against the objectives, details of significant activities and how they relate to the aims, and details of how the hospice fulfils public benefit. The new element of the above is the requirement to disclose the criteria for measuring success of delivery of the strategy.

- The achievements section follows on to require details of significant charitable activities undertaken and their achievement against the objectives set. This is very much more outcomes or impact focused reporting and seeking justification for why the organisation exists, its activities, demonstration of delivery and impact.
- The hospice must explain the contribution made by volunteers, which should help the reader understand the nature and scale of the activities undertaken. This could include an explanation of the activities that volunteers support or help to provide and details of the contribution in terms of volunteer hours or staff equivalents.

13. Lease incentives and leases

Previously, a lease incentive, such as a rent free period, was spread over the period to the first break clause in the lease. Under FRS 102 the benefit of such incentives will now be spread over the full term of the lease. This could lead to be a transitional change if you have a material difference in the previous year on such a restatement, as you would need to restate the basis of leases taken out in the comparative period to spreading the benefit over the full term of the lease.

Also worth noting is that the operating lease commitments note will now include all amounts payable to the end of the lease – not just the amount on the following year. So if you had a 10-year lease, all 10 years would be analysed in one year, between two and five and over five years.

14. Concessionary loans

A concessionary loan is a loan bearing no or a lower than average rate of interest. Under SORP FRS 102 a discount rate needs to be applied so that such loans are shown at their net present value.

However, this does not apply to any loans within a group – such loans can be shown in the accounts at cost. It is very likely that hospices would only be giving such loans to their trading subsidiaries.