An Introduction to FRS102 for Charities

Spring 2015

Introduction

The Financial Reporting Council (FRC) has issued three new accounting standards, FRS 100-102, which will replace all existing FRS's, SSAPs and UITFs. The new financial reporting framework will be applicable on a mandatory basis for the majority of UK entities for reporting periods starting on or after 1 January 2015. Charities will be required to apply FRS 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland' which was issued in March 2013.

FRS 102 addresses some of the specific reporting issues faced by charities and other public benefit entities, including the basis for recognising government grants, business combinations and the recognition of income from donors and other sources. The charity SORP has been updated to reflect the new framework and the final SORP has now been published and is available at www.charitysorp.org.

Charities will be required to adopt the new financial reporting regime for accounting periods starting on or after 1 January 2015, with the comparative balance sheet and opening position requiring restatement. For charities with a December year end, this will mean a 1 January 2014 transition date, a 31 December 2014 comparative balance sheet and the first FRS 102 compliant accounts being prepared for 31 December 2015. For a March year end, the first set of FRS 102 accounts will be required for 31 March 2016, therefore the transition date is 1 April 2014. In England, Wales and Scotland, early adoption will only be permitted once the Regulations have been updated to allow the use of the new SORP.

It is not too soon to start considering how you will address the transition process. From our extensive experience in assisting clients with transition to EU-adopted IFRS, we know that good planning is key to success. Timely actions and the right support will ensure that the process goes as smoothly as possible.

There are also operational matters which may need to be addressed in preparing for transition, such as training requirements for your finance and operational teams, systems changes to ensure relevant information is captured, education of your stakeholders, and the potential need for additional resources.

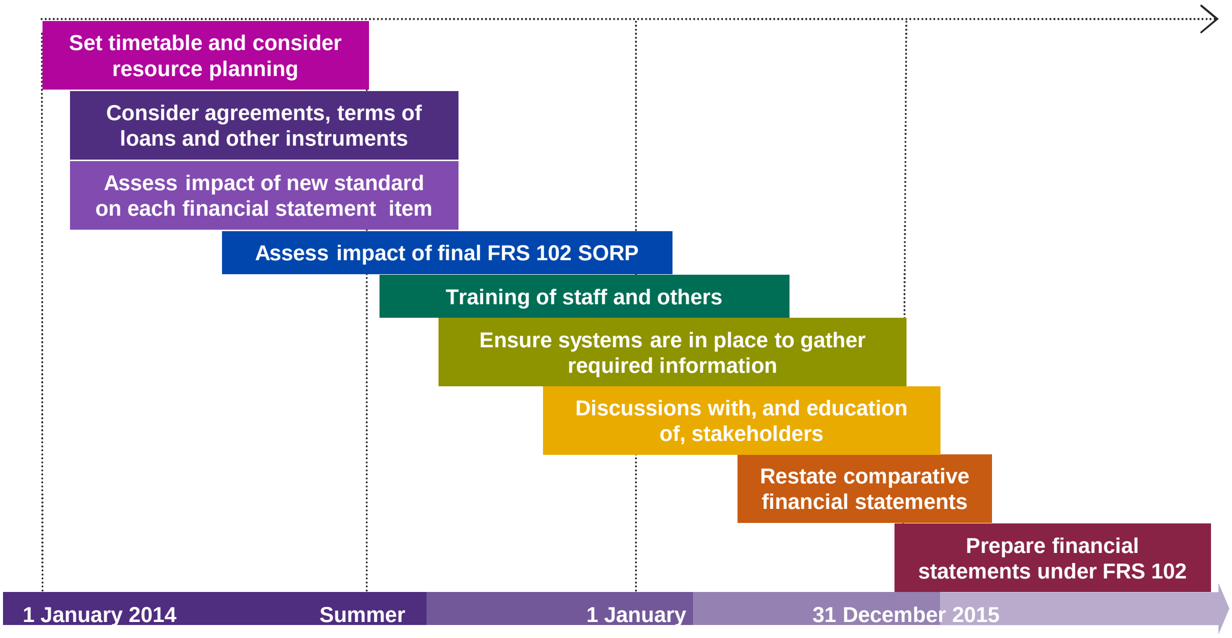
This factsheet provides a summary of the key changes brought about by the FRS 102 compliant SORP (FRS 102 SORP), our interpretation of the practical effects of implementation, together with suggested actions. Most actions involve conducting a review of accounting policies. There is also a second SORP for smaller charities who elect to adopt the FRSSE (FRSSE SORP). Where relevant, the changes listed on the following pages will also apply to smaller charities.

Planning for transition

Transition timeframe

There is no doubt that the transition will require time and has the potential to cause disruption to your finance function. However, this should not just be viewed as a change to your financial statements. The impact on the business as a whole must also be considered carefully. Our experience from assisting our listed clients with the transition to IFRS has shown us that starting to think about the issues early can save time and reduce problems later. With thorough planning and the right support, the process can be made as smooth as possible.

A smooth transition will require careful planning and a plan for a charity with a December year end might look something like this:



Planning ahead will allow you to address issues such as negotiating bank covenants and having the right amount of resource available

Key areas of impact

We set out below the key areas and issues we have identified as being relevant for the sector. We also provide a high level consideration of actions to include in a transition plan and the potential impact on the financial statements and resources. Unless otherwise stated, the financial statements will need to be restated retrospectively on transition to FRS 102, as if it has always applied. Retrospective adjustments will be reflected in the opening balance sheet.

Impact:	**Reflects our assessment of the potential impact on transition to FRS 102 based on two separate criteria, recognising that some issues may impact different charities to a varying extent. Grading of high, medium or low is represented by red, amber and green.**
£:	Potential impact on the financial statements either in terms of the balance sheet or performance statement. High reflects a potentially significant impact on the results and/or position for the charity.
Resource:	Potential impact on resources during the transition process. High reflects areas that may be complex and/or resource intensive.

FRS102 issue — *Potential approach*

Branches with separate local registration

Where a charity branch is a separate corporate entity, for example to fulfil local registration requirements overseas, these operations will be considered to be subsidiaries in the context of the group.

For some charities, this will lead to a change in classification of certain operations to subsidiaries, rather than branches. This will result in income, expenditure, assets and liabilities in the subsidiary only being recognised at the consolidated group level as opposed to in the charity's own financial statements.

Impact:	£ - High	Resource - High

- Review operations currently classified as branches to identify those with a separate legal registration that will need to be recognised as subsidiaries.
- Consider nominal ledger structure and chart of accounts to ensure balances and transactions can continue to be tracked accurately.
- Consider impact on bank covenants, if applicable.
- Communicate these changes to stakeholders.

Key areas of impact (continued)

FRS102 issue

Financial instruments

Under FRS 102, the treatment of financial instruments is different to current UK GAAP. There are now two categories of instrument, basic and other, or non-basic. Non-basic instruments, including all derivatives (eg. forwards, swaps, options), are reported at fair value which may be a significantly different position from the current amortised cost. Measuring at fair value will impact net assets and is likely to introduce more volatility into the results each year.

FRS 102 allows charities to account for financial instruments under IAS 39 or IFRS 9 (full IFRS). This policy choice may be beneficial to entities with certain non-basic instruments as it could result in reduced volatility.

Volatility on the performance statement may also be reduced, in appropriate circumstances, by applying hedge accounting. Documentation will need to be prepared to demonstrate the hedge has been designated, how the effectiveness will be measured and the effectiveness tests completed to demonstrate that it is effective.

Potential approach

Impact:	£ - High	Resource - High

- Undertake a review of the financial instrument agreements to determine classification.
- Consider basis for determining fair value for any non-basic instruments (eg. open market value, discounted cash flows etc).
- Consider whether applying full IFRS could provide a better result in terms of volatility where there are non-basic instruments.
- Note that hedge accounting is available in certain circumstances and will need separate consideration. If hedge accounting is applicable, we recommend seeking advice early on in the transition process.

Key areas of impact (continued)

FRS102 issue	*Potential approach*
Intra-group loans Intra-group loans that are not currently on open market terms, being financing transactions, will be recognised initially at fair value. Fair value means estimating the expected cash flows and discounting at a market rate. This includes any long-standing 'trading' balances. For some groups, the impact could be significant if loans are not made on market terms and could result in different values being recognised in each entity within the group.	**Impact:** £ - High | Resource - High • Review intra-group balances to determine treatment. • Key elements are the rate of interest charged (is it equivalent to the rate that would be available to that entity in the open market) and whether it is repayable on demand.
Retirement benefits – multi employer schemes As with current UK GAAP, multi-employer schemes can be accounted for as defined contribution schemes if the share of assets and liabilities for each entity cannot be determined. There will, however, be a need to recognise any contractual obligations with the pension scheme. This will include any agreement to pay additional contributions to fund the deficit. This contractual obligation will need to be recognised as a liability at its net present value.	**Impact:** £ - High | Resource - Medium • Consider what agreements are in place with the pension fund. • Consider impact of additional liability on the net asset position. • Assess overall impact on net incoming resources, including the unwinding of the discount and any year on year movements in the provision. • Consider information from the pension scheme as the next review date approaches and factor any expected increases in obligation into the relevant forecasts. • Consider the impact of the additional obligation on bank covenants.

Key areas of impact (continued)

FRS102 issue

Potential approach

Group defined benefit schemes

Under current UK GAAP the deficit or surplus on a group defined benefit scheme might only be shown in the consolidated financial statements if the available exemption is taken on the basis that it is not possible to split the share of assets and liabilities between the group companies.

Under FRS 102, such a deficit or surplus must be recognised in the individual accounts of at least one group entity. By default this will be the entity that is legally responsible for the plan (this is often the parent). This could have a significant impact on that entity's accounts.

The default treatment may be avoided where a group has a stated policy or contractual agreement for charging the net defined benefit cost as calculated under FRS 102 to one or more individual group entities.

Impact:	£ - High	Resource - Medium

- Consider whether the requirement to apply defined benefit accounting in an individual entity's financial statements may apply.
- Consider introducing a stated policy or contractual agreement to allocate the liability amongst group entities.
- When introducing such a policy or agreement, take care over the wording and its impact on the allocation of the liability.
- If applicable, this issue should be considered early in the transition process as any stated policy or contractual agreement cannot be retrospectively applied.

Key areas of impact (continued)

FRS102 issue	*Potential approach*
Financial statement presentation Financial statements comprise of the following: a. Statement of financial activities (SOFA) b. Balance sheet c. Statement of cash flows d. Notes, including accounting policies. Key changes include: • reduced number of income and expenditure categories on the face of the SOFA • gains/losses on investments included within net incoming resources as opposed to other recognised gains/losses • comparatives to be included on the face of the SOFA or in the notes • reduced number of headings on the face of the cash flow statement • cash flow statement to be reconciled to the total of 'cash and cash equivalents'.	**Impact: £ - Medium Resource - High** • Review the mapping of the nominal ledger to ensure the trial balance reflects changes to the presentation in the financial statements. • Review accounting policies to ensure they are FRS 102 and FRS 102 SORP compliant. • Prepare skeleton accounts in advance of the first year end in sufficient time to allow input from the Board and in order to obtain any information that is not readily available. • Consider impact of changes on bank covenants, if applicable. • Communicate changes to stakeholders.
Taxation For entities within a charitable group that are subject to tax, the changes to the accounting treatments may have a knock on effect on the tax treatment . For example valuation of intra-group loans will result in fair value movements and imputed interest charges being recognised in the results, and which may not be allowable for corporation tax purposes. The changes may also impact the level of profits available to be gifted to the parent charity.	**Impact: £ - Medium Resource - Medium** • Assess potential tax implications.

Key areas of impact (continued)

FRS102 issue	*Potential approach*
Income recognition The recognition criteria has changed so revenue can be recognised when receipt is probable instead of virtually certain. Some donations or legacy income may be able to recognised earlier under FRS 102 SORP, however, the impact will vary across the sector depending on the current policies adopted.	**Impact: £ - Medium Resource - Medium** • Consider key revenue streams, focussing on the most judgemental items, such as legacies and donations. • In particular, consider whether any items are probable (but not virtually certain) at each balance sheet date, including as at the date of transition.
Leased assets Under FRS 102, there is no rebuttable presumption that where the present value of the minimum lease payments is 90% or more of the fair value of the asset, then the lease is a finance lease. Therefore greater judgement may be required to distinguish between a finance and operating lease. Lease incentives are released over the lease term as opposed to the period up to the first rent review, although transition relief is available.	**Impact: £ - Medium Resource - Medium** • Review lease arrangements to determine treatment. • Calculate delayed recognition of lease incentives for any new leases.
Creditors Additional liabilities may be required for short term employee benefits such as holiday pay. For example, an accrual may be required for those holidays not taken at the year end – where the year end is not in line with the holiday year this may require detailed calculations.	**Impact: £ - Medium Resource - Medium** • Review systems to capture information on holidays carried forward. • Consider the alignment of the holiday and financial year ends, bearing in mind any impact on HR issues. • A calculation for the opening balance sheet at the date of transition will be required.
Trustees' Annual Report The new SORP gives greater flexibility to reorder the content of the report to ensure key information is given priority and to use headings that are most appropriate to their charity.	**Impact: £ - Low Resource - Medium** • Review Trustees' Annual Report to ensure it meets the new guidance and provides relevant information to the readers of the financial statements.

Key areas of impact (continued)

FRS102 issue | *Potential approach*

Related party and remuneration disclosures

Trustees' Annual Report - There is a new requirement for larger charities to include an explanation of the arrangements for setting the pay and remuneration of the charity's key management personnel, and any benchmarks or other criteria used in setting their pay.

Related parties – the definition of a related party includes key management personnel, and therefore, additional disclosure is required for the total remuneration for those responsible for the management of the charity. Charities may also consider further disclosures that are relevant to the users (especially funders) such as the highest paid employee or disclosing the senior management team on an individual basis.

Staff costs – disclosure note for staff costs and emoluments will include a separate line for redundancy or termination benefits and an explanation of the nature of the payment and the related accounting policy.

Impact:	£ - Low	Resource - Medium

- Review policies for remuneration and consider impact of disclosure on stakeholders.
- Review information held about related party transactions for missing information.
- Consider impact of additional disclosures relating to remuneration on stakeholders.

Other changes to disclosures

- Governance costs are no longer presented as a separate line on the face of the SOFA, but are included in the notes.
- Total return accounting has been simplified by recent changes to the Charity Law, and the presentation in the SOFA is also simplified but specific disclosures are required in the notes to the accounts to reconcile movements in the period.

Impact:	£ - Low	Resource - Medium

- Review information held about related party transactions for missing information.
- Consider impact of additional disclosures on stakeholders.
- Review information held about grant making activities to be included in the notes to the accounts.
- Consider if total return accounting is appropriate for the charity and review potential accounting treatment and disclosures.

Key areas of impact (continued)

FRS102 issue	*Potential approach*
Defined benefit schemes The net finance charge in the net incoming resources includes the interest income and the current service cost. Under FRS 102, the interest income will be calculated using the discount rate applied to the pension liabilities rather than the expected return on the assets. This is likely to result in an increase in the net finance charge. There is no longer a requirement to have an independent actuarial valuation each year.	**Impact:** £ - Medium · Resource - Low • Consider the impact on net incoming resources. • Consider impact on covenants.
Small charities Charities that meet the small company thresholds, irrespective of whether they are a registered company or not, can continue to apply the FRSSE before the proposed changes to the EU Accounting Directive and the likely removal of the FRSSE are implemented. The Charity SORP requirements for smaller charities have been separated into a stand-alone SORP (FRSSE SORP) following feedback from the SORP consultation.	**Impact:** £ - Low · Resource - Low • Small charities to consider if the FRSSE is appropriate for them.
Debtors No significant impact on transition although any extended credit arrangements for rental arrears may need to be discounted to the net present value.	**Impact:** £ - Low · Resource - Low • Consider whether any extended credit arrangements may be material.

Key areas of impact (continued)

FRS102 issue	*Potential approach*
Investments Investments in subsidiaries are measured at cost or fair value. Fair value movements can go through either net incoming resources or other recognised gains or losses, rather than through other recognised gains or losses under current UK GAAP. Investments in joint ventures and associates are measured at cost or fair value, as above, in the individual accounts and using the equity method in the group accounts.	**Impact:** £ - Low Resource - Low • Determine accounting treatment for each investment.
Mixed motive investments The FRS 102 SORP has introduced a new category of investments, mixed motive investments. These are where the investment decision is made based on both the financial return and for charitable purposes, with equal prominence. The accounting for any gains and losses in this category of investment would follow that used for financial investments, with any gains or losses recognised as investment gains/losses on the face of the SOFA rather than within income or expenditure from charitable activities as for programme related investments.	**Impact:** £ - Low Resource - Low • Review investments in order to identify whether there are any potentially "mixed motive" investments which would need to be classified separately.

How Grant Thornton can help

Grant Thornton has depth and strength across the Firm so your transition review will be performed by a relationship-led charity specialist engagement team, supported by a dedicated, project based charity accounting and financial reporting technical team that specialises in FRS 102 SORP conversions and training.

- We will work closely with you to ensure that your FRS 102 SORP accounting policies are understood and applied appropriately in the context of your organisation and that the implications of these policies are understood (for example the impact that new sources of income will have on reported financial performance and how best to report this both internally and externally).

- We will provide you with practical interpretations of existing and new accounting standards, to ensure that you are fully FRS 102 SORP compliant, as well as adopting accounting policies and practices that are relevant to your charity.

- We will provide you and your finance teams with on-going support throughout this process and after completion, so you always have someone to support the practical implementation of the FRS 102 SORP after the initial conversion period. We are ideally situated to provide all of the support you require.

- We are at the forefront of development of sector specific guidance. Our UK FRS 102 specialists were seconded to the Accounting Standards Board so Grant Thornton directly influenced the formation of the new reporting framework.

Full, 'hands-on' assistance

Providing full, 'hands-on' assistance would include the following:

- spend time meeting relevant, different teams/individuals to understand your organisation
- hold an impact assessment workshop with you to understand the key areas of difference arising from adoption of FRS 102 and the FRS 102 SORP
- formal, documented review of accounting policies noting any potential differences under the FRS 102 SORP
- formal, documented review of your 2013 transactions, balances and financial statements identifying potential FRS 102 SORP differences
- through discussion with you, understand future transactions (particularly those post your transition date) which may be accounted for differently under the FRS 102 SORP and the impact thereof – from both an organisational and an accounting perspective, eg changes to any intra-group loan arrangements
- assessment of actual transactions in 2013, 2014 and 2015 (and 2016 if relevant) considering the impact of the FRS 102 SORP
- papers would then be prepared with calculations and supporting documentation covering the identified areas for the years 2013, 2014 and 2015
- a financial statements template (including all the relevant notes) would be prepared in accordance with the FRS 102 SORP which could then be populated
- review of your financial statements, prepared under the FRS 102 SORP, by our charity technical team.

Acting as reviewer

Acting in a review capacity we would propose to assist as follows:

- spend time meeting relevant, different teams/individuals to understand your organisation
- hold an impact assessment workshop with you to understand the key areas of impact from the FRS 102 SORP
- through discussion with you, understand future transactions (particularly those post your transition date) which may be accounted for differently under the FRS 102 SORP and the impact thereof – from both an organisational and an accounting perspective, eg changes to any intra-group loan arrangements or treatment of future business combinations.
- assess your review of accounting policies under the FRS 102 SORP noting any potential omissions
- assess your review of the transition balance sheet, 2014 and 2015 transactions, balances and financial statements identifying potential FRS 102 SORP differences including a review of your work papers
- provide a financial statements template (including all the relevant notes) in accordance with the FRS 102 SORP which would then be populated by your finance team
- review and comment on your financial statements.

Impact assessment

Our impact assessment involves the following:

- spending time meeting relevant, different teams/individuals to understand your organisation
- through discussion with you, understanding future transactions (particularly those post your transition date) which may be accounted for differently under the FRS 102 SORP and the impact thereof – from both an organisational and an accounting perspective, eg changes to any intra-group loan arrangements or treatment of future business combinations
- preparing an impact assessment detailing key differences between the existing SORP 2005 and the FRS 102 SORP – that assessment will also highlight what needs to be done and by when.

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