Education
Funding
Agency

A brief guide to the charities SORP 2015

For academy chief financial officers, auditors, accounting officers and trustees

August 2014

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1 Introduction

1.1 In March 2013 the Financial Reporting Council (FRC) published a new financial reporting standard (FRS 102) to replace existing UK accounting standards for accounting periods beginning on or after 1 January 2015. The Charity Commission and the Office of the Scottish Charity Regulator, as the joint SORP-making body for charities, subsequently issued a new Charities SORP (Statement of Recommended Practice) on 16 July 2014, based on FRS 102, hereafter referred to as 'SORP 2015'.

1.2 The Education Funding Agency (EFA) takes the SORP and translates it into a form relevant to academy trusts, which it publishes as an annual Academies Accounts Direction. Academy trusts need to be aware of the changes introduced by SORP 2015 as these changes will be integrated into future Accounts Directions.

1.3 This guide provides:

- an overview of the main changes arising from SORP 2015 that are expected to be relevant to academy trusts;
- a timeline of key dates; and
- specific actions that academy trusts should consider now.

1.4 This guide is not intended to summarise all of the requirements or a substitute for SORP 2015.

1.5 The Charity Commission has also published a separate SORP based on the Financial Reporting Standard for Smaller Entities (FRSSE). EFA will not be producing an Accounts Direction based on the FRSSE SORP 2015. This will minimise the accounting and disclosure gap when consolidating academy trusts' accounts with those of government, and reduce supplementary checks. Academy trusts will be required to follow the Accounts Direction based on the FRS 102 SORP 2015.

1.6 As academy trusts are required to have their annual accounts audited as a condition of their funding agreement, the audit exemption available to smaller companies remains unavailable to trusts.

2 The main changes in SORP 2015

Trustees' report

2.1 The changes required by SORP 2015 in the trustees' report are minimal and should not require too much additional effort for most academy trusts. Changes include explaining arrangements and policies for setting the pay and remuneration of the academy trust's key management personnel. 'Key management personnel' is a term used by FRS 102 for those persons having authority and responsibility for planning, directing and controlling the activities of a reporting entity, directly or indirectly, including any director (whether executive or otherwise). This definition includes academy trustees and those members of staff who are the senior management personnel to whom the trustees have delegated significant authority or responsibility in the day-to-day running of the academy trust. In practice this is likely to equate to trustees and members of an academy trust's senior leadership team. For multi-academy trusts it may also include principals and senior leadership teams of individual academies. However, this will depend on the specific circumstances in place.

2.2 The trustees' report should also include an explanation of social investment policies and how any programme-related investments have contributed to the academy trust's aims and objectives, although most academy trusts are unlikely to have such investments.

Statement of financial activities (SoFA)

2.3 The activity basis of accounting, under which charities should classify their income and expenditure by activity, has been retained. However, the income categories of 'income from generated funds', 'income from charitable activities' and 'other incoming resources' (which were introduced for the first time in the current SORP 2005) have been replaced by five broad headings:

- income from donations and legacies
- charitable activities
- other trading activities
- investments
- other

2.4 These are changes in titles rather than changes to the basis for classification.

2.5 Comparative figures will now be required for all columns in the SoFA, either by way of adding further columns or by providing this information in the notes. The current SORP 2005 only requires a total column to be provided for the comparative period's funds.

2.6 SORP 2015 introduces new terminology when describing income and refers to two broad categories of income: income from exchange transactions (contract income, for example, from letting out sports facilities) and income from non-exchange transactions (gifts including donations and grants, for example, GAG funding). The accounting treatment of an academy trust's general annual grant (GAG) funding would be unaffected by this. However, if a trust is seeking additional sources of funding, they will need to consider the distinction between exchange and non-exchange transactions.

2.7 If an academy trust has investments, then any gains and losses will now be reported in the SoFA as part of net income/expenditure rather than being reported as other recognised gains and losses.

2.8 Governance costs will no longer be separately disclosed on the face of the SoFA, but will be included within charitable activities as support costs.

Balance sheet

2.9 The balance sheet format is generally unchanged. However, under SORP 2015, there is a newly-defined type of fixed asset – social investments. This type applies where the purpose in making an investment is wholly or partly to further a charity's aims. It includes mixed motive investments, which is a form of social investment made both to further the charitable purposes of the investing charity and to generate a financial return. Social investments, including mixed motive investments, are disclosed separately on the face of the balance sheet, if they are material.

2.10 Software licences that extend beyond one year and have been capitalised as fixed assets are now classified as 'intangible' rather than 'tangible'.

Cash flow statement

2.11 This now reconciles down to cash and cash equivalents rather than just cash. This means that deposit accounts that were not repayable on demand without loss of interest (for example, three-month term deposits, and indeed any other liquid resources) will now be included in the bottom total rather than reflected as a movement in the cash flow statement.

Accounting policies and disclosures

2.12 SORP 2015 makes some specific changes to accounting policies and disclosures, and those affecting many academy trusts include the following:

- Income should be recognised in the accounts when it becomes 'probable' (i.e. more likely than not) whereas under SORP 2005 it was recognised when income became 'virtually certain'. This may mean income being recognised earlier than at present. For example, an academy trust that receives income subject to terms or conditions should recognise the income as soon as it is probable the terms or conditions can be met.
- The total paid to key management personnel must be disclosed.
- There is now a requirement to recognise a liability in the balance sheet for any outstanding paid annual leave and sick leave, if material. Such a circumstance may arise when the holiday year is not coterminous with the financial year.
- SORP 2015 states that financial statements must include disclosure of any material uncertainties of which the trustees are aware in making their going concern assessment, and where there are no material uncertainties about the academy trust's ability to continue as a going concern, this should be clearly stated.
- A definition of 'de-facto trustees' has been added. This is a person who has not been validly appointed as a trustee but is acting as a trustee of the charity and is exercising the functions that could only be properly discharged by a trustee.
- Any transactions involving a trustee or other related party must now always be regarded as material transactions, meaning that this may capture the disclosure of more transactions in the financial statements. Additionally, the new SORP requires disclosure of the terms and conditions of any related party transactions and states that a related party transaction should not be described as being 'at arm's length' unless this can be substantiated.

Transitional arrangements

2.13 SORP 2015 allows for a number of simplifications for the preparation of the opening balance sheet and comparative figures when reporting under it for the first time. In particular, an academy trust may elect to measure a fixed asset (including buildings) on the date of transition at its fair value and use that fair value as its deemed cost at that date. Academy trusts will need to weigh the cost of obtaining such valuations against the potential benefit.

3 Timing of the changes

3.1 SORP 2015 is effective for accounting periods commencing on or after 1 January 2015.

3.2 It will apply to academy trusts as follows:

- **established trusts** – trusts incorporated before 1 January 2015 will first use it to prepare their financial statements for the period ending **31 August 2016**
- **new trusts** – as companies, new trusts must have an initial accounting period that is not more than 18 months long, and there will be a small cohort of academy trusts (those whose date of incorporation falls between 1 January 2015 and 1 March 2015) that will need to apply SORP 2015 earlier – for the period ending **31 August 2015**

3.3 For the majority of academy trusts, transition will begin on 1 September 2014. For example, established academy trusts preparing their financial statements for the year ended 31 August 2016 will need to restate the comparative figures from their financial statements for the year ended 31 August 2015 and their opening balance sheet at 1 September 2014 to reflect any changes to accounting policies under SORP 2015.

Impact on the Academies Accounts Direction

3.4 The timeline set out above means that two Academies Accounts Directions will be in force for the period ended 31 August 2015 – one based on SORP 2005 for established trusts and one based on SORP 2015 for new trusts. For the subsequent period ended 31 August 2016 there will be only one Accounts Direction, based on SORP 2015.

3.5 EFA will produce the Academies Accounts Directions in consultation with sector representatives through the Academies Finance and Assurance Steering Group, and intend to publish those for the period ended 31 August 2015 in May 2015.

Impact on the academies accounts returns

3.6 The staggered adoption of SORP 2015 in the academies sector means that at 31 March 2015, 31 August 2015 and 31 March 2016 (the reporting dates for the academies accounts return) the population of academy trusts will not be coherent with regard to their underlying accounting approach.

3.7 We do not anticipate issuing separate accounts returns at these three dates to reflect the two available SORPs. Instead, we will continue to use the existing accounts return, as modified by annual updates. We expect to issue the first accounts return, revised to reflect SORP 2015, for the 31 August 2016 reporting season.

3.8 As academy trusts' operations are not overly complex, there should not be significant changes to academy trust financial reporting arising from SORP 2015. However trusts should be mindful of the impact of the SORP on compiling accounts returns across the transitional period from now to 31 August 2016.

4 What academy trusts should do now

4.1 As a minimum, academy trusts should consider:

- when the trust will first need to adopt SORP 2015 (for academy trusts incorporated before 1 January 2015 first adoption will be for the period ending 31 August 2016);
- revisiting their accounting policies;
- whether their accounting systems will be able to accommodate the changes;
- whether they need specialist assistance to identify transitional issues;
- whether staff need training on the changes to the SORP;
- obtaining valuations for fixed assets that they wish to measure at fair value at the transition date (for an established academy trust preparing accounts for the year ended 31 August 2016, the transition date will be 1 September 2014);
- whether any business combinations have been entered into in the comparative period. Any such business combinations will need to be restated and measured in accordance with SORP 2015, which may mean recognising separate intangibles. Business combinations undertaken prior to the transition date can either be exempted or restated; and
- whether the holiday year for staff and the academy trust's financial year coincide. If not then the trust will need to consult with their HR team to determine the extent of any outstanding paid annual leave at the period end.

Further information

This guide provides a brief overview of forthcoming changes. In May 2015, EFA will provide further information in the Accounts Directions explaining how to apply the SORP. In the meantime, trusts should discuss any queries with their professional advisors.

A full copy of the new SORP and some useful help sheets are available on the Charity Commission and the Office of the Scottish Charity Regulator's SORP web page.

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