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## The Charity Law & Practice Review

# SORP 2000: NEW STANDARDS FOR CHARITY ACCOUNTANTS

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### Introduction

Acronyms are beloved of planners and jargonists of all kinds, and have been a bane of life ever since the Second World War when they proliferated on an unprecedented scale.

For over twelve years now, accountants acting for charities have been or become familiar with the acronym SORP as the accepted abbreviation for the Statement of Recommended Practice applicable to charity accounting. The first of these was in fact issued in 1988 while a revised version of it was issued by the Charity Commission in October 1995. With effect from 1st January 2001 a yet further revised SORP started to apply. This is SORP 2000 issued in October 2000.

The purpose of this article is to give an account of the main features of the latest Statement of Recommended Practice relating to Accounting and Reporting By Charities. The account of a document which runs to sixty five pages of narrative text and twenty four pages of Appendices must necessarily be of an unpretentious and selective kind. It can do no more than act as an introduction to a detailed and fairly comprehensive set of guidelines to which the accountant must go if his task is to be properly performed.

### Origins and History of SORPS

Statements of Standard Accounting Practice and more recently Financial Reporting Standards were generated by the Accounting Standards Committee. The same Committee has now been replaced by the Accounting Standards Board which in turn

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has also produced Statements of Recommended Practice. Statements of the latter kind do not have the force of standards but they are often more appropriate because they cover specific areas and indicate what is best accounting practice. The Accounting Standards Committee produced SORP 2 on charity accounting in 1988 to deal with the then accounting duties laid down for charities. The revised Charity SORP appeared in October 1995. The function of SORP 1995 (as it is convenient to call it) was to catch up with the new accounting regulations laid down by the Charities Act 1993. It provided the flesh on the bones of the regulations by indicating what was by then perceived to be best practice.

### **Ambit and Function of SORP**

From the very outset each SORP, being but a Statement of Recommended Practice, has not been mandatory. A recommended practice, as the very name indicates, is not an ordinance but a recommendation. All the same, the Charity Commissioners have consistently said that they would expect all charities to comply with the requirements. All charities regardless of their size, constitution or complexity are now within the SORP remit, save where governed by a more specialised SORP. Examples given of these exceptional cases include Higher Education Institutions and Registered Social Landlords.

Otherwise the guidance applies to charities registered and unregistered, excepted or exempt, and whether they are companies or not. Small charities which opt to prepare "receipt and payment" accounts also fall outside the SORP net. But they must still follow the guidance on reports.

The function of SORP 2000 is simple enough. It is to show those charged with the duty to do so how to prepare a charity's annual report and accounts so that they conform with the legal requirements and in particular so that the accounts (other than those prepared on the receipts and payments basis) give a true and fair view of the charity's financial activities and position.

### **The New SORP: Why and How it Has Been Revised**

The reason for the revision of the 1995 SORP is twofold.

First, a commitment was given when the 1995 SORP was issued that it would be reviewed after seeing how it had fared in practice. Secondly, the Accounting Standards Board (the successor to the Accounting Standards Committee) has itself

issued new accounting standards and these needed to be incorporated into a new SORP.

The process by which the provisions of the new SORP have been assembled involved four steps: (1) a consultation exercise (2) the formation of a Review Committee (3) the publication of an exposure draft (4) further discussion and decisions taken by the Review Committee following responses to the exposure draft.

The consultation exercise sought the views of charities, umbrella groups, professional advisers and other interested parties. Representatives from the first three categories drawn from England, Wales, Scotland and Northern Ireland made up the Review Committee chaired by the Charity Commission. The exposure draft was the result of the deliberations of the Review Committee. While the responses to the exposure draft did not occasion any changes in principle they helped the Review Committee to make changes in the text to assist understanding.

Finally, the Accounting Standards Board have also given their agreement to the issue of SORP 2000.

### **A Re-writing as Well As A Revision: Overview of the New SORP**

It needs to be emphasised that SORP 2000 has completely re-written as well as revised SORP 1995. True, there are no major changes to the structure of accounts. Nor are there any new requirements which could be regarded as onerous. But because the SORP has been re-written, those preparing and auditing charity accounts will need to read all those sections which apply to them.

In addition to the main SORP itself, there are five leaflets issued or to be issued by the Charity Commission, for they are not all yet available. These five leaflets represent necessary adjuncts to a proper understanding of the SORP provisions. They need to be noted (and in due course absorbed) and numbered, with their anticipated availability dates, the following: CC 61 Charity Accounts 2001: The Framework (available mid January 2001); CC 62 Charities SORP 2000: What has changed (already available); CC 63 Independent Examination of Accounts under SORP 2000: Directions and Guidance Notes (available mid-January 2001); CC 64 SORP 2000: Receipts and Payments Accounts Pack (available end March 2001); CC 65 SORP 2000; Accruals Accounts Pack (available end March 2001).

## **Purpose and Content of Trustees' Annual Report and Annual Accounts**

### **Purpose**

Put shortly the purpose of preparing a charity's Annual Report and Accounts is to discharge the charity trustees' duty of public accountability and stewardship. The new SORP sets out recommended practice for this purpose but adds the gloss that charity trustees should consider providing such additional information as to give donors, beneficiaries and the general public a greater insight into the charity's activities and achievements.

The recommended practice set out in the new SORP is not a substitute for other necessary checks and balances. Thus accounts prepared on the basis of SORP 2000 are not a substitute for management accounts required to run the charity on a daily basis.<sup>2</sup>

The Annual Report should explain what the charity is trying to do and how it is going about it. It should show whether the charity has achieved its objectives during the year and explain its plans for the future. It should also help the reader of the report and accounts understand how the numerical part of the accounts relates to the organisational structure and activities of the charity.<sup>3</sup>

### **Narrative Information**

SORP 2000 is less detailed than SORP 1995 in its requirements for narrative information. Narrative information will of course vary according to the circumstances of each particular charity. However the following information should be included in *all* trustees' annual reports:<sup>4</sup>

- (1) the objects of the charity;
- (2) the organisational and decision-making structure;
- (3) relationships between the charity and related parties and with any other charities and organisations with which it co-operates;

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<sup>2</sup> SORP 2000, para 3.

<sup>3</sup> SORP 2000, para 31.

<sup>4</sup> This is a summary. For details see SORP 2000, para 31.

- (4) review of the activities in the past year and plans for the future;
- (5) the charities policy on reserves;<sup>5</sup>
- (6) confirmation that major risks facing the charity have been identified and steps taken to mitigate them.

All the foregoing categories of information should be dealt with by all charities. Other items that should be included *where applicable* (in other words where relevant information is available on the topics concerned) include:

- (a) the charity's investment policy and performance
- (b) grant-making policies;
- (c) the contribution of volunteers;
- (d) the effectiveness of fund-raising activities; and an explanation of any deficit in funds and what action is to be taken.

### Accounting for Separate Funds

SORP 2000 has amplified the guidance on accounting for separate funds under the control of a charity. Essentially the accounts need to provide a summary of the main funds, differentiating in particular between unrestricted income funds (both general and designated,)<sup>6</sup> restricted funds where the income or capital or both can only be applied to particular purposes within the wider purposes of the charity and endowment funds (both permanent<sup>7</sup> and expendable).<sup>8</sup> Funds of a similar type can be grouped together.

<sup>5</sup> For further information see CC19 "Charities' Reserves".

<sup>6</sup> A designated fund is one resulting from a decision of trustees to set aside part of an unrestricted fund for a particular purpose falling within the charity's general purposes.

<sup>7</sup> Where the trustees must permanently maintain the whole capital of a fund it is known as permanent endowment and cannot normally be spent as if it were income.

<sup>8</sup> The converse of permanent endowment that arises when the trustees have a power or discretion to convert endowed capital into income.

## **Branches**

Special rules are laid down for branches. Before preparing accounts, trustees must be quite clear as to the legal structure of the charity. A charity may operate through branches to raise funds or to carry out its charitable purposes.

### **Definition of “Branch”**

Branches are defined at some length, it must be confessed, in the Glossary.<sup>9</sup> They are entities or administrative bodies set up, for example, to conduct a particular aspect of the business<sup>10</sup> of the reporting charity, or to conduct the business of a reporting charity in a particular geographical area. A “branch” for the purposes of the SORP is either:

- (a) simply part of the machinery of the reporting charity; or
- (b) a separate legal entity<sup>11</sup> which is administered by or on behalf of<sup>12</sup> the reporting charity and whose general funds are held for specific purposes which are within the general purposes of the reporting charity;
- (c) in England and Wales, a separate legal entity not falling within (b) which the Charity Commission has united by a direction under section 95(5) or 96(6) should be treated as linked to the reporting charity for accounting purposes.

### **Characteristics of a Branch**

Some of the characteristics of a branch are helpfully identified by Appendix 1 to SORP 2000 as being the following:

- (i) it uses the name of the reporting charity within its title;

<sup>9</sup> See SORP 2000, Appendix 1, para 1 (pp 66-67).

<sup>10</sup> Business here means presumably the charitable activities which are not of course a commercial profit-making “business” in the conventional sense.

<sup>11</sup> I.e. a trust or unincorporated association or other body formed for a charitable purpose.

<sup>12</sup> The words “on behalf of” should be taken to mean that under the constitution of the separate entity, a substantial degree of influence can be exerted by the reporting charity over the administration of its affairs: SORP 2000, App 1, 1 (b).

- (ii) it exclusively raises funds for the reporting charity or for its own local activities;
- (iii) it uses the reporting charity's registration number to receive tax relief on its activities;
- (iv) it is perceived by the public to be the reporting charity's local representative or its representative for a particular purpose;
- (v) it receives support from the reporting charity through advice, publicity materials etc.

If the branch exists to carry out the primary objects of the charity, typically it will receive funds from the reporting charity for its work and may be staffed by employees of the reporting charity.

A separate bank account is not in itself any indication of the autonomous status of a branch. Where the branch is not a separate legal entity, all funds held by the branch will be the legal property of the reporting charity, whether or not the branch has a separate bank account.<sup>13</sup>

### **Organisations Which Are Not Branches**

The Glossary in Appendix 1 to SORP 2000 attempts also to point to cases where the branch in question has a sufficient degree of autonomy as to constitute it a separate accounting entity. Some charities may be known as “branches” within a particular organisational or network structure. Nevertheless their level of administrative autonomy from the reporting charity - as determined by their constitutions - may be such that legislation requires them to be treated as separate accounting entities. In that case they should not be treated as branches for accounting purposes but should prepare separate accounts for submission to the appropriate regulatory authority.<sup>14</sup>

### **Method of Preparing Branch Accounts**

Separate legal entities which may be known as branches but do not fall within the definition of a branch in the Glossary should prepare their own Annual Report and

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<sup>13</sup> SORP 2000, at 66.

<sup>14</sup> SORP 2000, at 67.

Accounts and, if they are connected charities the relationship should be explained in the trustees' report.<sup>15</sup>

All branch transactions should be accounted for gross in the reporting charity's own accounts excluding those transactions which net off, for example branch to branch transactions or those between the branches and head office. Similarly all assets and liabilities of the branch including, for example, funds raised but not remitted to the reporting charity at the year end should be incorporated into the reporting charity's own balance sheet. This provision need not apply where the transactions and balances of the branches in aggregate are not material to the charity's accounts.<sup>16</sup>

Funds raised by a branch for the general purposes of the reporting charity will be accounted for as unrestricted funds in the accounts of the main charity. Funds raised by a branch for specific purposes of the reporting charity will need to be accounted for as restricted funds in the accounts of the main charity. Funds held for the general purposes of a branch which is a separate charity should usually be accounted for as restricted funds in the accounts of the reporting charity.<sup>17</sup>

Where a branch is not a separate legal entity, its accounts must form part of the accounts of the reporting charity but it may be in the interests of local supporters and beneficiaries for additional accounts to be prepared covering only the branch.<sup>18</sup>

## **Statement of Financial Activities (SOFA)**

### **General**

Some general observations are called for here about the Statement of Financial Activities (SOFA) before its detail is summarised.

In essence the SOFA is a single accounting statement whose objective is to show all incoming resources and resources expended by the charity in the year on all its funds. It is designed to show the reader how the charity has used its resources in furtherance of its objects for the provision of benefit to its beneficiaries. It shows whether there has been a net inflow or outflow of resources, including capital gains

<sup>15</sup> SORP 2000, para 52; and see also SORP 2000, para 31(c)

<sup>16</sup> SORP 2000, para 53.

<sup>17</sup> SORP 2000, para 54

<sup>18</sup> SORP 2000, para 55



and losses on assets, and provides a reconciliation of all movements in the charity's funds<sup>19</sup>.

It must also distinguish, so far as the charity has them, between unrestricted income funds, restricted income funds and endowment funds.

The SOFA is in columnar form, with all the funds of the charity analysed into their different categories.<sup>20</sup> Whilst the notes to the accounts should give details of all the material funds, the SOFA can give group incoming and outgoing resources of all funds of a similar type together.

In the discussion which follows some topics are perforce given abbreviated treatment. The author hopes to return to some of these topics in a later issue of this *Review* so as to afford them fuller treatment.

## **Incoming Resources and Resources Expended**

### **Incoming Resources**

The following incoming resources should be separately shown:

- (i) donations, legacies and similar incoming resources<sup>21</sup>
- (ii) incoming resources from operating activities of the charity<sup>22</sup> distinguishing between (a) activities in furtherance of the charity's objects and (b) income for generating funds
- (iii) investment income<sup>23</sup>

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<sup>19</sup> SORP 2000, para 56.

<sup>20</sup> Charities SORP 2000 CC 62, para 12-13. For the columnar "shape" of the SOFA see SORP 2000, para 69 (Table 1).

<sup>21</sup> See SORP 2000, paras 87-94.

<sup>22</sup> See SORP 2000, para 101-108.

<sup>23</sup> SORP 2000, paras 112-113.

- (iv) other incoming resources (e.g. net gains on disposals on fixed assets for use by the charity)<sup>24</sup>
- (v) the total by column of the above resources arising in the year

### **Resources Expended**

In the next section of the statement all resources expended for the year should be summarised totalled and analysed as set out below:

- (i) Costs of generating funds<sup>25</sup>
- (ii) Charitable expenditure showing separately:
  - (a) grants payable in furtherance of the charity's objects<sup>26</sup>
  - (b) costs in furtherance of the charity's objects<sup>27</sup>
  - (c) support costs for (a) and (b) where material<sup>28</sup>
  - (d) resources expended on managing and administering the charity<sup>29</sup>
- (iii) The total by column of the above resources expended in the year.<sup>30</sup>

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<sup>24</sup> *Ibid*, para 118.

<sup>25</sup> See SORP 2000, paras 132-135 for further details.

<sup>26</sup> See SORP 2000, paras 138-146 for further details.

<sup>27</sup> See SORP 2000, paras 147-150.

<sup>28</sup> SORP 2000, paras 147-150.

<sup>29</sup> SORP 2000, paras 151-152.

<sup>30</sup> SORP 2000, para 60.

### **Columnar Totals and Material Transfers Between Different Classes of Funds**

Each column should be totalled to show the net incoming and net outgoing resources before transfers.<sup>31</sup> Then all material transfers between different classes of funds should be shown separately. These should not be netted off but should be shown gross.<sup>32</sup> Then each column of the SOFA thus far is totalled to show the net incoming and outgoing resources before revaluations and investment asset disposals.<sup>33</sup> The next section in the SOFA records separately<sup>34</sup> (i) gains and losses on revaluation of fixed assets for the charity's own use; and (ii) gains and losses on the revaluation and disposal of investment assets.<sup>35</sup>

### **Net Movements: Totalling and Reconciliation**

Each column of the SOFA will be totalled to show the net movement in the charity's funds in the year.<sup>36</sup> The net movement in the charity funds should then be reconciled to the total funds as shown in the balance sheet as follows:

- (i) net movement in funds for the year
- (ii) total funds brought forward
- (iii) total funds carried forward

### **Discontinuance or Acquisition of Operations**

In order to comply with the Financial Reporting Standard 3 (FRS3) where a charity has discontinued any of its operations or acquired new ones, the SOFA should distinguish between continuing, discontinued and acquired operations. This will

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<sup>31</sup> SORP 2000, para 61.

<sup>32</sup> SORP 2000, para 62

<sup>33</sup> SORP 2000, para 63.

<sup>34</sup> See also SORP 2000, paras 155-156.

<sup>35</sup> SORP 2000, para 64.

<sup>36</sup> SORP 2000, para 65.

normally apply to the whole of a distinctive type of activity of a charity but not to the development or cessation of new projects within that activity.<sup>37</sup>

### **Adaptation of Formats**

The SOFA should be prepared following the columnar structure already adumbrated. However individual charities should expand it where necessary in order to present a true and fair view and convey a proper understanding of the nature of all their activities. A charity may also find it helpful to show extra columns, for instance where the purpose is to highlight the financial impact of a particular activity.<sup>38</sup> Whilst the SOFA may be adapted to give a true and fair view, disclosure requirements must always be met and the underlying structure should not be changed. Trustees should balance the provision of information with clarity.<sup>39</sup> Headings should be omitted where there is nothing to report in both the current and preceding periods.<sup>40</sup>

### **Further Details Relating to Sofa Contents**

#### **Rules for Recognising Incoming Resources**

The rules for recognising incoming resources have been clarified.<sup>41</sup> The value of all resources accruing to the charity should be recorded in the SOFA as soon as it is prudent and practicable to do so. This applies to both income and endowment funds. Incoming resources should not be recognised until the conditions for receipt have been met and there is reasonable assurance of receipt. This will depend on the satisfaction of the following factors:

- (a) entitlement which normally arises on actual receipt or from a legally enforceable right to receipt
- (b) certainty, in other words a reasonable certainty of receipt and

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<sup>37</sup> SORP 2000, para 67.

<sup>38</sup> SORP 2000, para 70.

<sup>39</sup> SORP 2000, para 72.

<sup>40</sup> SORP 2000, para 73.

<sup>41</sup> SORP 2000, paras 75-84.

- (c) measurement, that is to say when the monetary value can be sufficiently, reliably measured.<sup>42</sup>

Legacies should not be included as incoming resources until it is reasonably certain that they will be received and the amount can be measured with sufficient reliability.<sup>43</sup>

### **Intangible Income**

A charity may receive assistance in the form of donated facilities, beneficial loan arrangements, donated services or services from volunteers. Such assistance is generally referred to as “intangible income”. Such intangible incoming resources should be included in the SOFA where another party is bearing the financial cost of resources supplied and the benefit is quantifiable and measurable.<sup>44</sup> Examples might include circumstances where: (a) staff on secondment from a commercial organisation still have their salary paid by that organisation or (b) the costs of long-term rent-free accommodation are borne by the landlord.<sup>45</sup>

The value placed on the assistance should normally be the financial cost to the third party of providing them. However, where this information is not available or if the charity considers the value to be less than the costs borne by the third party, a reasonable estimate as to their gross value to the charity should be given.<sup>46</sup>

Services offered at a commercial discount, for instance a discount on an audit or on an initial short-term rent free period in a lease - would normally be regarded as simply part of doing business rather than the contribution of intangible income. There will be a point when a discount becomes a donation but each case must be judged on its merits.<sup>47</sup>

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<sup>42</sup> SORP 2000, para 75.

<sup>43</sup> SORP 2000, paras 89-94.

<sup>44</sup> SORP 2000, para 99.

<sup>45</sup> CC 62, para 21.

<sup>46</sup> SORP 2000, para 99.

<sup>47</sup> CC 62, para 23.

Where there is no financial cost borne by another party for the provision of assistance the intangible income should not be included in the SOFA.<sup>48</sup> Volunteers do bear costs but these are personal and SORP 2000 does not regard them as fitting into this category. For instance travel expenses are an incidental part of volunteering (and are often reimbursed) and wages foregone do not result in an actual financial payment. It will therefore not be necessary to calculate the value of help from volunteers.<sup>49</sup>

### **Recognition of Liabilities**

A liability arises when a charity is under obligation to make a transfer of value to a third party. The liability and related expenditure should be recognised in full in the charity's accounts as soon as the obligation arises.<sup>50</sup> A liability may also arise from a constructive obligation rather than a legal obligation. What then is a constructive obligation for this purpose? The term is defined in the Glossary in Appendix 1. Paragraph 6 of that Appendix defines a constructive obligation thus:

“An obligation that derives from an entity's actions where:

- (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
- (b) as a result the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.”

However, if a charity has entered into commitments which are dependent upon *explicit* conditions being met before payment is made, there may not be a liability until those conditions are met. This section may be particularly helpful to grant-making charities, as it has not always been clear previously when a legal or constructive obligation exists.<sup>51</sup>

Grants payable for more than one year should be treated as wholly falling within the first year if a valid expectation has been created in the recipient that they will, as a

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<sup>48</sup> SORP, para 99.

<sup>49</sup> CC 62, para 24.

<sup>50</sup> SORP 2000 paras 119-130; and see CC 62, para 25.

<sup>51</sup> CC 62, para 26.

matter of course, receive the full value of the grant (a constructive obligation). This will not apply where the recipient has to fulfil further or continuing conditions to obtain future instalments. If there is no such constructive obligation, then only the expenditure incurred in that year should be shown in the accounts<sup>52</sup>.

### **Costs of Generating Funds**

There is no longer a specific category for fund-raising costs. This has been replaced by a wider category called "costs of generating funds".<sup>53</sup> This last mentioned category covers not only fund-raising costs but also costs related to, for example:

- (i) investment management;
- (ii) cost of goods sold in charity shops;
- (iii) negotiating a contract or applying for a grant: and
- (iv) publicity intended to raise the profile of the charity (though not educational publicity in direct furtherance of the charity's objects).<sup>54</sup>

### **Disclosure and Non-disclosure of Grants**

#### **Disclosure of Grants**

The requirements for disclosing grants are set out more fully than is possible here in paragraphs 138-146 of SORP 2000. The emphasis in those paragraphs is on providing the analysis and explanation necessary to understand how the grants made by a charity relate to its objects.<sup>55</sup>

As in the SORP 1995, disclosure is required where grant making is material to the charity. To some extent this will depend on the size of the charity and the importance of grant making in its overall operation. However, if a charity makes grants totalling at least 5% of its total resources expended in that year, it should

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<sup>52</sup> CC 62, para 27.

<sup>53</sup> SORP 2000, paras 132-134.

<sup>54</sup> CC 62, para 28.

<sup>55</sup> CC 62, para 29; and see SORP 2000, para 140.

regard grant making as material.<sup>56</sup>

The analysis should clearly indicate whether grants are for individuals or institutions and should disclose the total number of the grants and value given for different charitable purposes.<sup>57</sup> The charity should decide upon classifications which are appropriate for an understanding of its policy.

For example institutional grants may be grouped into categories covering social welfare, medical research and the performing arts etc. Similarly grants to individuals<sup>58</sup> may be grouped in categories covering, for example, the welfare of people in financial need or help to people seeking to further their education.<sup>59</sup>

Where fewer than 50 material institutional grants have been made in the year, these additional details should be disclosed in respect of *each* grant. Otherwise the disclosure should cover at least the 50 largest institutional grants or any larger number which is necessary for the proper understanding of the charity's grant making activity. There is no requirement to disclose any grants which are below £1000 in total.<sup>60</sup>

### **Non-Disclosure of Grants**

The rules for non-disclosure of grants have been changed.<sup>61</sup> Non-disclosure is regarded as exceptional and should only occur when disclosure could seriously prejudice the charity or the recipient institution.

The total number, value and general purpose of non-disclosed grants should be given in the notes to the accounts and, before approving accounts, trustees should provide the Charity Commission with full written details of the non-disclosed grants and the detailed reasons for non-disclosure. The trustees report should confirm that this has

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<sup>56</sup> CC 62, para 30; and see SORP 2000, para 139.

<sup>57</sup> SORP 2000, paras 141 and 142.

<sup>58</sup> One for the direct benefit of the individual.

<sup>59</sup> SORP 2000, para 142.

<sup>60</sup> SORP 2000, para 143.

<sup>61</sup> SORP 2000, para 146.



been done.<sup>62</sup>

### **Support and Management Costs**

#### **Support Costs in the Furtherance of the Objects of the Charity**

Support costs are those costs (such as staff and office costs) wholly or mainly incurred directly in support of expenditure on the objects of the charity. This will include those costs incurred as an integral part of a charity's project work, or its payment of grants, but exclude those incurred in the general management and administration of the charity or in fund-raising. Where applicable and material, support costs should be shown separately in the SOFA.<sup>63</sup>

#### **Expenditure on Management and Administration**

Expenditure on management and administration of the charity will normally include both direct and indirect costs.<sup>64</sup>

Direct costs include such items as internal and external audit, legal advice for trustees and costs associated with constitutional and statutory requirements, as for example, trustee meetings and the preparation of statutory accounts.<sup>65</sup>

There should also be an apportionment of indirect costs involved in managing and administering the charity (as opposed to directly pursuing its charitable activities). This will include a proportion of management (and other staff) time and the overhead costs connected with it for example, office and communications costs.<sup>66</sup>

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<sup>62</sup> SORP 2000, para 146.

<sup>63</sup> SORP 2000, paras 147-150.

<sup>64</sup> SORP 2000, para 151.

<sup>65</sup> SORP 2000, para 151.

<sup>66</sup> *Ibid.*

### **Related Party Transactions**

This section is one which certainly needs to be highlighted. It is innovatory in ambit and touches on an important area of topical importance: transactions where actual or potential conflicts of interest arise.

Previously SORP 1995 had a section on transactions with trustees and other connected persons. That section has now been rewritten so as to deal with what are called related party transactions.<sup>67</sup>

### **Language of Definition**

A related party transaction is one where the charity has a relationship with another party or parties ("a related party") which might inhibit it from pursuing its own separate interests.<sup>68</sup>

"Related parties" are comprehensively defined in the Glossary contained in Appendix 1 to the SORP 2000. The list of parties designated by the Glossary include : a charity trustee or other person who is "related to the charity";<sup>69</sup> and those persons who are either "connected with a charity trustee" or to a person "who is related to the charity".<sup>70</sup> All the words in quotes are themselves further defined. The definitions include institutions and bodies as well as individuals and one charity can be related to another charity.

### **Transparency**

Transparency is particularly important where the relationship between the charity and the other party or parties to a transaction suggests that the transaction could possibly have been influenced by interests other than those of the charity. It is possible that the reported financial position and results may have been affected by such transactions and information about these transactions is therefore necessary for

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<sup>67</sup> 2000, paras 157-165.

<sup>68</sup> SORP 2000, para 157.

<sup>69</sup> This term is defined in the Glossary.

<sup>70</sup> The Glossary spells out who fall into the category of persons connected with charity trustee or to a person related to the charity.

the users of the charity's accounts.<sup>71</sup> Only material transactions need to be disclosed but transactions rank for disclosure whether or not they are at arm's length.<sup>72</sup>

### **Examples of Related Party Transactions**

Related party transactions potentially include (subject to the exceptions set out below) the following :

- (a) purchases, sales, leases and donations (including donations which are made in furtherance of the charity's objects) of goods, property, money and other assets such as intellectual property rights to or from the related party;
- (b) the supply of services by the related party to the charity, and the supply of services by the charity to the related party;<sup>73</sup>
- (c) any other payments and other benefits which are made to trustees under express provisions of the governing document of a charity or in fulfilment of the charitable objective.

### **Required Disclosure**

The required disclosure<sup>74</sup> encompasses the following:

- (a) the name or names of the transacting related party or parties;
- (b) a description of the relationship between the parties (including the interest of the related party or parties in the transaction);
- (c) a description of the transaction;
- (d) the amounts involved;

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<sup>71</sup> SORP 2000, para 160.

<sup>72</sup> SORP 2000, para 162.

<sup>73</sup> "Supplying services" includes providing the use of goods, property and other assets and financial arrangements such as making loans and giving guarantees and indemnities.

<sup>74</sup> Disclosure can be given in aggregate for similar transactions: see SORP 2000, paras 164 and 166(b) for details.

- (e) outstanding balances with related parties at the balance sheet date and any provisions for doubtful debts from such persons ;
- (f) any amounts written off from such balances during the accounting year; and
- (g) any other elements of the transactions which are necessary for the understanding of the financial statements.<sup>75</sup>

### **Exceptions**

Some related party transactions are such that they are unlikely to influence the pursuance of the separate independent interests of the charity. These need not be disclosed unless there is evidence to the contrary. Seven examples are given:

- (i) donations received by the reporting charity from a related party, so long as the donor has not attached conditions which would, or might, require the charity to alter materially the nature of its existing activities if it were to accept the donation (but any material grant by the reporting charity to a charity which is a related party should be disclosed);
- (ii) minor or routine unremunerated services provided to a charity by people related to it;
- (iii) contracts of employment between a charity and its employees (except where the employees are the charity trustees or people connected to them);
- (iv) contributions by a charity to a pension fund for the benefit of employees;<sup>76</sup>
- (v) the purchase from a charity by a related party of minor articles which are offered for sale to the general public on the same terms as are offered to the general public;
- (vi) the provision of services to a related party (including a charity trustee or person connected with a charity trustee), where the related party receives the services as part of a wider beneficiary class of which he is a member, and on the same terms as other members of the class (for example, the use of a village hall by members of its committee of management, as inhabitants of

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<sup>75</sup> SORP 2000, para 163.

<sup>76</sup> See also SORP 2000, para 172.

the area of benefit); and

- (vii) the payment or reimbursement of out-of-pocket expenses to a related party (including a charity trustee or person connected with a charity trustee.)<sup>77</sup>

### **Remuneration Benefit and Expenses Paid to Trustees and Persons Connected with the Charity**

All transactions with trustees or persons connected with them, including remuneration and other benefits paid to them, should be regarded as material, and should be separately and individually disclosed regardless of size, unless one of the exceptions listed under the immediately preceding head applies. The legal authority under which any remuneration was paid (for example a provision in the charity's governing document) and the reason it was paid should also be disclosed. Where neither the trustees nor any persons connected with them have been paid this should be stated.<sup>78</sup>

The rules regarding the disclosure in the notes to the accounts of expenses incurred by individual trustees, and met by the charity, have not been changed. Their aggregate amount, their nature (for example travel, subsistence, entertainment etc) and the number of trustees involved should be disclosed.<sup>79</sup>

### **Inalienable and Historic Fixed Assets**

The rules for capitalising inalienable<sup>80</sup> and historic<sup>81</sup> fixed assets have been changed in accordance with Financial Reporting Standard No 15. However, these assets may be excluded from the balance sheet if reliable cost information is not available or significant costs are involved in obtaining the extra information compared with the

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<sup>77</sup> SORP 2000, para 165 subparas (a)-(g). But see also as to charity trustees expenses SORP 2000, paras 167-169.

<sup>78</sup> SORP 2000, para 166.

<sup>79</sup> SORP 2000, para 167. Expenditure not related to services provided by the trustee need not be disclosed: *ibid* para 168 for examples.

<sup>80</sup> SORP 2000, Appendix 1 defines inalienable assets which include permanent endowment assets.

<sup>81</sup> Also defined in SORP 2000, Appendix 1, para 15. Many great country houses held by the National Trust or some charitable trust fall under this rubric.

benefits obtained.<sup>82</sup> The Charity Commissioners acknowledge that this is a complex area and envisage that trustees with significant inalienable and historic fixed assets will want to take professional advice.<sup>83</sup>

Information on all inalienable or historic assets (whether or not they have been capitalised) should be given in the notes to the accounts or in a separate, publicly available publication (unless publication would prejudice the efficient working of the charity, for instance by materially increasing the risk of vandalism).<sup>84</sup>

### **Special Sections Explaining Additional and Optional Requirements for Some Charities**

The main text of SORP 2000 deals with normal accounting practice for charities producing full accruals accounts. Some charities will have to meet additional requirements and others may have the option of preparing briefer reports and accounts.

There are special sections which explain the additional or optional requirements for (1) consolidation of subsidiary undertakings<sup>85</sup> (2) accounting for associates, joint ventures and joint arrangements<sup>86</sup> (3) charitable companies<sup>87</sup> and (4) accounting for smaller charities.<sup>88</sup>

Space precludes detailed consideration of them here. But a future issue of the *Review* will, one hopes, further consider at least one or two of these special cases.

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<sup>82</sup> SORP 2000, para 211.

<sup>83</sup> See CC 62 para 44. For more details see SORP 2000, paras 208-217.

<sup>84</sup> SORP 2000, para 215.

<sup>85</sup> SORP 2000, paras 299-319.

<sup>86</sup> SORP 2000, paras 320-330.

<sup>87</sup> SORP 2000, paras 331-343.

<sup>88</sup> SORP 2000, paras 344-358.