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Shared experience.

Hospital charities and reflections on the revised SORP

For many in the charity sector, the new Charities Statement of Recommended Practice ("SORP 2015") was anticipated with bated breath. They were expecting key changes to accounting treatment as well as additional disclosure requirements.

Overall from the experience of our clients, the transition has been free of major challenges. The changes to the trustees' annual report were relatively few, with many of our clients having opted to incorporate greater impact and balanced reporting and enhanced risk management disclosures within their annual report even prior to the adoption of the new SORP.

One year on, we have seen a variety of methods of implementing the new SORP accounting and disclosure requirements in the "numbers" part of the financial statements in our hospital charity clients. We have taken the opportunity below to share the insights gained from our experience and knowledge of hospital charities with the aim of sharing good practice in this area. There may still be opportunities for hospital charities to enhance their accounting and disclosures in their accounts in light of emerging practice.

Legacies

One of the key changes brought about by the revised SORP was that the level of certainty required before income could be recognised changed from "virtually certain" to "probable", thereby potentially leading to earlier income recognition for some charities in relation to certain income streams such as legacies. The new SORP includes criteria when a legacy receipt would be deemed "probable". This includes when probate has been granted, the executors have established that there are sufficient assets in the estate (after settling liabilities) to pay the legacy, and that any conditions attached with the legacy are either within the control of the charity or have been met.

For some charities, there haven't been any significant changes in the accounting treatment as a result of SORP 2015. However, there are still some potential pitfalls that need to be manoeuvred. Firstly, probate should be granted before a legacy can be recognised. This is usually an administrative requirement, but the probate process ensures that the charity will have sufficient information to meet the other recognition requirements. This is because a valuation of the estate and an opportunity to object to the validity of the will are provided as part of the legal process of probate. Secondly, if there is a life tenancy, where assets are held for the charity subject to a third party having an interest for the remainder of their lifetime, the legacy cannot be recognised until the conditions are within the control of the charity (i.e upon the death of the life tenant).

For those hospital charities that heavily rely on legacy income and in receipt of a large number of legacies each year, a detailed assessment of income recognition on each individual legacy may be administratively onerous and time consuming. SORP 2015 recognises this, and offers a pragmatic solution to legacy income recognition in the form of the "portfolio approach". This allows charities to use historical settlement rates to estimate the likely receipts for their current portfolio of legacies. However, this can only be applied to immaterial legacies, and so all material legacies would need to be considered based on their individual circumstances.

That said, the portfolio approach is unlikely to be a new concept for many hospital charities in receipt of a large number of legacies. Many use it for management reporting purposes as it is a more pragmatic approach to legacy income recognition during the year. What the new SORP does is to give charities permission to use this estimation technique for statutory reporting providing it is only applied to immaterial legacies.

Based on the new rules in SORP 2015, charities should not only take the opportunity to rethink their approach to legacy income recognition to ensure that they are compliant, but also to see if there are opportunities to ease the administrative burden in managing and recording a large portfolio of legacies for both management reporting and statutory financial statements through the use of the portfolio approach. The charity's auditors should be consulted about estimation techniques and materiality in consideration of the portfolio approach.

Staff costs

Many hospital charities often do not employ staff directly given their size. Instead, the staff of the charity are employed by the NHS Trust and a cost element is recharged to the charity. Usually, even those hospital charities that are independent of their NHS Trusts, the Trust is likely to be a related party of the charity.

The SORP requires that "the information provided for staff costs and employee benefits must also include any expenditure on staff working for the charity whose contracts are with and are paid by a related party" (paragraph 9.28). Thus, when staff costs are incurred by the NHS Trust on behalf of the charity, the charity needs to consider the disclosure of the costs in the same way as it would disclose staff costs paid directly by its financial statements. This includes the disclosures for average staff numbers, higher paid employees and key management personnel. If the NHS Trust does not recharge the costs to the charity, disclosure requirements will still apply, albeit that the transaction is now a donation in kind from the Trust to the charity for the staff.

The SORP also encourages charities to think more carefully about making additional disclosures around staff pay, for example around the disclosure of the remuneration of the Chief Executive specifically (paragraph 9.32). These requirements play a key role in ensuring transparency about the remuneration of staff. Given the media scrutiny in relation to senior pay in charities and the interest of the general public, it is important for the charity to ensure adequate and appropriate disclosure in relation to staff costs.

Investment properties

Hospital charities may hold property which is let to their NHS Trust at a commercial rental rate. Under the previous SORP, such a property would have been typically held as an investment property within the financial statements of the charity.

In the new SORP, the guidance states charities that let property out to further their own charitable purposes should be accounted for as a tangible fixed asset. This has resulted in a change in classification of property for some hospital charities, particularly when the charity's property is used to provide space for the NHS Trust to use.

If a property is partly used as a commercial investment property and partly used to provide a service to a charity's own beneficiaries, the charity should apportion the property between tangible fixed assets and investment properties unless such an apportionment is impractical. In which case, the whole property should be accounted for within tangible fixed assets.

By recognising property within tangible fixed assets, charities have the option to hold the property at cost or at a valuation, although a depreciation charge will be incurred each year. Whereas, investment properties will need to be held at market valuation and thus any gains and losses on revaluation will need to be accounted for each time a revaluation takes place.

Comparative information

Under the previous SORP, only the total funds for the comparative period were required to be disclosed on the Statement of Financial Activities (SoFA). The new SORP changed this by requiring comparative information for the classes of funds present on the SoFA to be shown either on the face of the SoFA or in a prominent place within the notes to the financial statements.

We have observed many different ways of complying with this requirement to present comparative information for the SoFA split between the various funds. The practicality of the various options will of course depend on the complexity of the funds structure of the charity.

Some charities have included a comparative SoFA in its entirety as one of the notes to the financial statements. Others have included extra columns on the SoFA to disclose the information, and without careful thought as to the presentation of this, the figures can be more difficult to understand for users. An alternative way to comply without increasing the size of the financial statements significantly could be via an additional total underneath each note where the note breaks down the SoFA figure between funds. This approach works best where each figure on the SoFA is referenced to a relevant note. Many charities have opted to do this because it does not result in significant additional volume to the financial statements and presents the information prominently where it can easily be compared to the current year figures. An example of this is shown below.

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Other income

			2016	2015 Restated
	Unrestricted	Restricted	Total	Total
	£'000	£'000	£'000	£'000
Other income	88	73	161	154
2015 Restated	154	-	154	

In summary

We have highlighted the key changes to hospital charity financial statements as a result of the new SORP. We have shared the different approaches that charities have taken to comply with the new requirements, and organisations may wish to revisit these areas in light of emerging practice. Overall, the new changes result in greater transparency, but there are also opportunities to ease the administrative burden on hospital charities in order to make the production of financial information more efficient.

Now that the new SORP has been implemented, hospital charities should also keep one eye on the future for reporting changes in the pipeline that will impact the financial statements. For example, charities with fundraising operations that have their financial statements audited will have to include various additional disclosure in their trustees' report. This will include the charity's approach to fundraising, use of professional fundraisers, conforming to recognised fundraising standards, any fundraising-related complaints, etc. These changes apply for accounting periods commencing on or after 1 November 2016, so the year to 31 December 2017 will be the first year these requirements will apply for most hospital charities.

Similarly, the Charity Commission closed a consultation on the SORP in December 2016, with a view to updating it and producing an improved SORP in 2019. This may include further changes to the financial statements, in addition to clarifying certain areas of the current SORP. For example, a one-page "key facts summary" in the financial statements was consulted on, which would include key items such as total income, charitable expenditure and a "pence in the pound" calculation of charitable expenditure as a percentage of total income. Once the consultation results are published later in 2017, charities may want to consider how this would be implemented at an early stage to prepare themselves for new disclosures that may be required in the future.

How we can help

If you have any further questions, please speak to your usual Buzzacott contact or our specialist below:

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