3. Accounting standards, policies, concepts and principles, including the adjustment of estimates and errors

Introduction

3.1. This module explains how accounting standards, policies, concepts and principles are applied in charity accounting. Charities should refer to sections 2, 3 and 10 of FRS 102 for more information.

3.2. Accounting policies provide the basis on which the accounts are prepared and explain the accounting treatment of material transactions or items in the accounts. The concept of materiality is an important consideration when selecting accounting policies. Materiality relates to the financial information provided in the accounts and an item is material when its omission or misstatement could influence the economic decisions that users make on the basis of those accounts.

3.3. This module sets out:

- what are accounting standards, policies, concepts and principles;
- length of the reporting period;
- presentation currency;
- going concern;
- materiality;
- offsetting;
- source of reporting and accounting disclosure requirements;
- alternative measurements to fair value;
- selection of accounting policies;
- compliance with the SORP;
- changes in accounting policies;
- changes in accounting estimates;
- correction of a prior period error; and
- disclosure of accounting policies, changes in estimation techniques and prior period errors.

What are accounting standards, policies, concepts and principles?

3.4. Accounting standards set out the basis for recognising and measuring assets, liabilities, income and expenses and for their disclosure in accounts. Charities preparing accounts in accordance with accounting standards will normally, in so doing, meet the relevant legal requirements for their accounts to give a true and fair view of their financial position and activities.

3.5. Accounting policies are the principles, bases, conventions, practices and rules by which transactions and items are recognised, measured and presented in the accounts. The accounting policies that a charity adopts must follow the requirements of FRS 102 unless the effect of not following a particular requirement would be immaterial, or in very rare circumstances, where to do so would conflict with the objectives of providing information useful for economic decision-making by users of the accounts and/ or the legal obligation for the accounts to give a 'true and fair' view.

3.6. The SORP supplements FRS 102 and has been developed in light of the special factors prevailing or transactions undertaken within the charity sector.

3.7. In certain jurisdictions, it is a legal requirement for charities preparing their accounts on an accruals basis to adhere to the methods and principles of this SORP. Charities should refer to the guidance issued by the charity regulator in their jurisdiction(s) of registration to find out whether they are subject to a legal requirement to follow this SORP.

3.8. Accounting policies are supplemented by estimation techniques where judgement is required in measuring the value of income and expenditure and of assets and liabilities. It is essential that the accounts are accompanied by an explanation of the bases and estimation techniques used in their preparation.

3.9. Charity accounts must be prepared on a timely basis and be presented in a way that makes financial information understandable to users who have a reasonable knowledge of charity financial management and/or accounting and a willingness to study the information with reasonable diligence.

3.10. The accounts must present financial information that is relevant, reliable, comparable and complete. Information should not be excluded simply because it is complicated; however, the preparer should also balance the cost of obtaining information with the benefit it provides both internally to management and externally to funders and other stakeholders.

3.11. Transactions and events must also be accounted for with prudence and presented in a way that represents their substance and not merely their legal form. This will require the exercise of judgement and may on occasion require the disclosure of more information than specifically recommended in this SORP.

Length of the reporting period

3.12. All charities must prepare a set of accounts annually and they should normally have a 12-month reporting period. If the accounts are prepared for a shorter or longer reporting period, the charity must disclose:

- that the reporting period is for less than or more than 12 months;
- the reason for the shorter or longer accounting period;
- the fact that the comparative amounts presented in the accounts (including the related notes) are not entirely comparable; and
- this SORP also requires a charity to state the legal authority it has for the change to its reporting period.

Presentation currency

3.13. The presentation currency is the currency in which the accounts are denominated. A charity should normally prepare its accounts in the currency of the jurisdiction of its administration unless it operates predominantly by generating and spending its cash in a different currency. Where a charity operates predominantly in a different currency, it should prepare it accounts in that currency.

Going concern

3.14. Charities normally prepare their accounts on the basis of being a going concern. The trustees must make their own assessment of their charity's ability to continue as a going concern to assure themselves of the validity of this assumption when preparing their accounts. In making this assessment, a charity's trustees should take into account all available information about the future for at least, but not limited to, 12 months from the date the accounts are approved.

Materiality

3.15. FRS 102 and this SORP set certain accounting treatments and disclosures in the context of their materiality. Charities, in preparing their accounts, should therefore give particular consideration to material items or transactions as their omission or misstatement could influence economic decision-making by the user of the accounts and any assessment of the stewardship of charitable funds. An omission or misstatement of a material item may result in the accounts failing to give a true and fair view.

3.16. Materiality needs to be considered in the context of the accounts and depends on:

- the size of the item or error;
- the nature of the item or error;
- the impact of its omission or misstatement on the reported gross income or total expenditure and net assets; and
- the impact of its omission or misstatement on particular analysis headings within the statement of financial activities, balance sheet and, where applicable, statement of cash flows and on the disclosures made in the notes to the accounts

3.17. Charities should only disclose accounting policies that apply to material items or transactions. Charities should avoid providing unnecessary information for non-material items or transactions.

3.18. Although FRS 102 and this SORP need only be applied to material items or transactions, it is inappropriate to make, or leave uncorrected, immaterial departures from this SORP to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

3.19. This SORP specifies when a charity must always consider a particular item or transaction material, for example the disclosure of related party transactions. Also, as a matter of emphasis, SORP modules may make particular reference to materiality.

Offsetting

3.20. A charity must not offset assets and liabilities, or income and expenses, unless required or permitted by this SORP or FRS 102. Offsetting does not include making provisions for the impairment of stock or for bad debts. Similarly, a charity reports any gains and losses on the disposal of its fixed assets by deducting the carrying amount of the asset and related selling expenses from the proceeds of the disposal.

Source of reporting and accounting disclosure requirements

3.21. This SORP distinguishes the accounting treatment(s) and the disclosures required in the notes to the accounts that:

- apply to all charities;
- apply only to those charities required to have a charity audit (termed 'larger charities' in this SORP);
- are required by FRS 102; or
- are required by this SORP due to charity law or in order to provide a higher standard of transparency and disclosure in the interests of funders, donors and users of charity accounts.

3.22. In preparing the charity's accounts, the charity must:

- apply the relevant requirements of FRS 102;
- apply the recommendations of this SORP; and
- select accounting policies that comply with FRS 102 and this SORP.

Alternative measurements to fair value

3.23. For certain items in the accounts FRS 102 permits a choice between measurement at historical cost or fair value. FRS 102 also requires donated services and facilities to be measured at the value of the gift to the charity. Where a balance sheet heading contains items measured at both historical cost and fair value, it is important to identify the accounting bases the charity has adopted in the relevant note.

Selection of accounting policies

3.24. Charities must refer to FRS 102 and the modules contained in this SORP when selecting their accounting policies for the treatment of particular items, transactions or events in the accounts.

3.25. If FRS 102 does not address the matter, then charities adopting FRS 102 should refer to the hierarchy of sources set out in section 10 of FRS 102.

3.26. In extremely rare circumstances a charity may conclude that compliance with a particular requirement of FRS 102 or this SORP would conflict with the objective of providing information useful for economic decision-making by users of the accounts and/or a legal obligation for the accounts to give a true and fair view.

3.27. Charities must not depart from either FRS 102 or the SORP simply because it gives the user a more appealing picture of the financial position or the results of the charity.

Compliance with the SORP

3.28. For a charity to state that its report and accounts are compliant with this SORP, both its trustees' annual report and its accounts must be prepared fully in accordance with the reporting and accounting recommendations of this SORP. To state that their accounts have been prepared in accordance with this SORP, a charity must:

- consider those SORP modules that apply to the activities, transactions and circumstances of the reporting charity;
- comply with applicable format requirements and accounting treatments specified by this SORP and provide those disclosures that this SORP specifies 'must' be provided;
- make any additional disclosures required by the FRS 102; and
- only depart from the requirements of this SORP or the FRS 102 if necessary for the accounts to give a true and fair view.

3.29. This SORP uses the term 'must' to indicate those recommendations that are likely to affect the ability of the accounts to give a true and fair view if not applied to material transactions or items. Where the SORP states that an item is always material or the recommendation is one which 'must' be followed, non-adherence to that recommendation is a departure from this SORP.

3.30. The SORP also identifies particular recommendations that 'should' be followed. These recommendations are aimed at advancing standards of financial reporting as a matter of good practice. While charities are encouraged to follow all the SORP's recommendations, a failure to follow a 'should' recommendation is not regarded as a departure from this SORP.

3.31. Where the SORP states that a particular accounting treatment or disclosure 'may' be adopted, this provides an illustration of an approach to a particular disclosure that a charity may choose to adopt or identifies that an alternative accounting treatment or disclosure of a transaction or event is allowed by the SORP. Charities may choose whether such examples or alternative treatments are adopted at their discretion.

Changes in accounting policies

3.32. FRS 102 requires accounting policies to be applied consistently for similar transactions, events and conditions and between reporting periods.

3.33. A change to an existing accounting policy is only justified if:

- it is required due to a change in FRS 102 that applies to the reporting period; or
- it results in the accounts providing reliable and more appropriate and relevant information about the effect of transactions, other events or conditions that affect the reported financial position, financial performance or cash flows of the charity or group.

3.34. A change in an accounting policy must be applied retrospectively to comparative information for all prior periods to the earliest date for which it is practicable, except where an accounting standard requires or permits an alternative treatment on its first adoption.

Changes in accounting estimates

3.35. Changing an accounting estimate as a result of new information or developments is not the same as correcting an error. Similarly, a change in an estimation technique used or in a model used when a reliable measure of fair value is no longer available is not a change in accounting policy. Adjusting for changes in accounting estimates and estimation techniques results in a change to the transaction value or carrying amount of the asset or liability in the current reporting period; no adjustment is to be made in respect of prior reporting periods.

Correction of a prior period error

3.36. Charities must correct material errors resulting from an omission or misstatement in a prior period by either restating the comparative amounts for the prior period(s) in which the error occurred, or by restating the opening balance of the asset or liability for the item(s) for all prior periods for which comparative information is presented to the earliest date for which it is practicable.

Disclosure of accounting policies, changes in estimation techniques and prior period errors

3.37. In order to comply with the Application of Financial Reporting Requirements (FRS 100) and FRS 102 the notes to the accounts must:

- state whether the accounts were prepared in accordance with this SORP;
- state whether the accounts were prepared in accordance with FRS 102;
- set out the accounting policies used that are relevant to an understanding of the accounts and the measurement bases used in preparing them: and
- this SORP requires a charity to state whether the accounts were prepared in accordance with applicable charity and/or company law in the jurisdiction(s) of registration.

3.38. All charities must explain if there are material uncertainties related to events or conditions that cast significant doubt on the charity’s ability to continue as a going concern. In making their explanation, charities should provide:

- a brief explanation as to those factors that support the conclusion that the charity is a going concern; and
- a balanced, proportionate and clear disclosure of any uncertainties that makes the going concern assumption doubtful; or
- if the accounts are not prepared on a going concern basis, this fact must be disclosed, together with the basis on which the trustees prepared the accounts and the reason why the charity is not regarded as a going concern.

3.39. Where there are no material uncertainties about the charity's ability to continue, this should be stated.

3.40. Charities must also state:

- that the charity is a public benefit entity;
- the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the accounts;
- the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next reporting period; and
- in respect of those assets and liabilities where there is a significant risk of material adjustment within the next reporting period, the notes must include details of their nature and their carrying amount as at the end of the reporting period.

3.41. Where there has been a material departure from the requirements of FRS 102, the notes to the accounts must:

- state that the trustees have concluded that the accounts present a true and fair view;
- confirm that it has complied with FRS 102 or applicable legislation, except that it has departed from a particular requirement of FRS 102 or applicable legislation to achieve a fair presentation; and
- explain the nature of the departure, including the treatment required by FRS 102 and the reason why that treatment would be so misleading in the circumstances that it would conflict with the requirement to give a true and fair view, and the treatment adopted.

3.42. Where charities have made a material departure from a recommendation of this SORP that must be followed, FRS 100 requires that the notes to the accounts must:

- provide a brief description of how the accounts depart from the recommended practice set out in this SORP;
- for any treatment that is not in accordance with the SORP, the reasons why the treatment adopted is judged more appropriate to the charity's particular circumstances;
- give brief details of any disclosures required by this SORP that have not been provided, and the reasons why they have not been provided; and
- this SORP requires that if the departure was necessary for the accounts to give a true and fair view, the effect of the departure must also be quantified.

3.43. Where a material departure from the requirements of FRS 102 is also a departure from requirements of this SORP, a combined note may be provided.

3.44. Where charities have changed an accounting policy, the notes to the accounts must disclose:

- the nature of the change in accounting policy;
- the reasons why applying the new accounting policy provides reliable and more relevant information; and
- to the extent practicable, the amount of the adjustment for each line item in the accounts affected for the current period, each prior period presented and the aggregate amount of the adjustment relating to periods before those presented.

3.45. If it is not practicable to disclose the amount of the adjustment, charities must give an explanation of the adjustment.

3.46. The notes must disclose the nature of any change(s) to accounting estimates and the effect of the change on assets, liabilities, income and expenses for the current period. If it is practicable for the charity to estimate the effect of the change in one or more future periods, the charity must disclose those estimates.

3.47. If a charity identifies material prior period errors, it must correct them and disclose in the notes to the accounts:

- the nature of the prior period error;
- for each prior period presented in the accounts, to the extent practicable, the amount of the correction for each account line item affected; and
- to the extent practicable, the amount of the correction at the beginning of the earliest prior period presented in the accounts.

3.48. If it is not practicable to disclose the amount of the correction relating to prior period errors then an explanation must be provided.