CHARITIES SORP (FRS 102)

Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland

INFORMATION SHEET 7: UK Charitable Community Benefit Societies and withdrawable, non-transferable share capital

Publication date: 2022

Background

The Charity Commission for England and Wales (CCEW), the Charity Commission for Northern Ireland (CCNI), and the Office of the Scottish Charity Regulator (OSCR) comprise the joint SORP-making body for charities and as such are required by the Financial Reporting Council (FRC), in accordance with its Policy on Developing Statements of Recommended Practice (SORPs), to keep the Statement of Recommended Practice (SORP) under review.

As part of this work, the joint SORP-making body may issue information sheets which seek to clarify the application of the SORP or particular recommendations contained within the SORP. Information sheets may also cover matters not addressed in either FRC standards or the SORP, but which are relevant to charity reporting and on which the joint SORP-making body considers additional advisory guidance to be necessary. Information sheets do not amend the SORP, are advisory in nature and are released to assist preparers, auditors and examiners of accounts.

It should be noted that information sheets do not form part of the SORP, nor are they reviewed by the FRC and therefore they do not carry the authority of the SORP. They do not introduce new standards for the preparation of financial statements or impose particular interpretations of statutory prescriptions or recommendations of the SORP.

References to reporting standards are correct at the date of publication. Where this information sheet predates changes to accounting standards and a conflict is thereby created, or other developments lead to a conflict, the affected clarifications offered in this information sheet cease to have effect.

1. Context: Purpose of Information Sheet

1.1. This information sheet has been developed by Co-operatives UK in partnership with the SORP-making body to assist practitioners in implementing the Charities SORP (FRS 102) in relation to the preparation of accounts for Charitable Community Benefit Societies (hereafter referred to as Charitable Societies) with reference to their use of withdrawable, non-transferable share capital.

1.2. Withdrawable, non-transferable share capital as used by Community Benefit Societies is known commonly as 'community shares' but will be referred to in this information sheet as 'share capital'.

1.3. Community Benefit Societies may pay interest on share capital to the owners of the shares who are legally 'members' of the society.

1.4. Charitable Community Benefit Societies are a subset of Community Benefit Societies which are registered, but not regulated, by the Financial Conduct Authority (FCA) and subject to the Co-operative and Community Benefit Societies Act 2014. Charitable Societies registered prior to 2014 are also known as Industrial and Provident Societies (IPSs) or simply Registered Societies. In Northern Ireland Charitable Societies register with the FCA but under the separate Co-operative and Community Benefit Societies Act (Northern Ireland) 1969.

1.5. The FCA has issued **'Guidance on the FCA's registration function under the Co-operative and Community Benefit Societies Act 2014'**[1] which provides a comprehensive overview of the society law and the registration conditions for all societies.

1.6. The Co-operative and Community Benefit Societies Act 2014 requires societies to prepare accounts that show a true and fair view. The Charities SORP states that "the accounting recommendations of this SORP apply to all charities in the UK that prepare accounts on the accruals basis to give a true and fair view". Therefore, Charitable Societies must prepare their accounts in accordance with the requirements of the Charities SORP.

1.7. In England and Wales they are classed as an 'exempt charity', with purposes recognised as such by HMRC. Classed as exempt charities in England and Wales they are not regulated by the Charity Commission in England and Wales (CCEW). They are regulated by the Scottish Charity Regulator (OSCR) in Scotland.[2] Charitable Societies in Northern Ireland register with the Charity Commission for Northern Ireland.

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[1] Guidance on the FCA's registration function under the Co-operative and Community Benefit Societies Act 2014

[2] Memorandum of Understanding between OSCR and the FCA

1.8. Share offers of withdrawable, non-transferable share capital by societies are unregulated by the Financial Services and Markets Act 2000. A voluntary regulation scheme is overseen by the Co-operative and Community Capital Committee, a member group of Co-operatives UK, the trade body for co-operatives and community businesses.

1.9. This information sheet has been developed by Co-operatives UK with input from the Charities SORP committee. It aims to provide necessary clarity that the accounting recommendations in the Charities SORP apply to all Charitable Societies and provide advice on the requirements of FRS 102 and the recommendations of the SORP relating to Charitable Societies using share capital.

2. Background: Issuance of share capital

2.1. There are around 170 Charitable Societies currently registered of which 35 have issued share capital through public share offers.[3]

2.2. They join around 440 societies which have issued over £150 million in community shares to over 112,000 community investors over the last decade.[4]

2.3. Section 22.6 of FRS 102 states that “Members’ shares in co-operative entities and similar instruments are equity if: (a) the entity has an unconditional right to refuse redemption of the members’ shares…”.

2.4. Section 6.25 of the FCA’s Registration Guidance states that a condition of registration for all societies is that “in the event the society cannot afford to pay the declared maximum rate of interest, interest payments are reduced, or no interest is paid at all, without compensation in subsequent years”[5].

2.5. Charitable Societies must use pre-approved Model Rules to register their society and specific clauses relating to Charitable Societies are built into the governing documents in line with the FCA’s Registration Guidance above. For example, the Co-operatives UK Model Rules articulate that “the board may suspend payments of interest temporarily or indefinitely by informing members of the suspension”.

2.6. As Charitable Societies have the unconditional right to suspend both withdrawals of share capital and interest payments, share capital, and the payment of interest on share capital, are therefore both equity and must be accounted for accordingly.

[3] Co-operatives UK - Co-op Economy Dataset
[4] Understanding a Maturing Community Shares Market 2020
[5] Guidance on the FCA’s registration function under the Co-operative and Community Benefit Societies Act 2014

2.7. Most of the Charitable Societies have offered interest payments in their initial share offer documentation in line with the guidance above and it is common practice to allow for a patient period between 2-5 years before interest payments are made.

2.8. The FCA's Registration Guidance outlines that "the maximum rate of interest paid on shares is declared in advance of the period for which it is intended to be paid, whether in its rules or elsewhere".[6] However, in keeping with the condition that interest can only be paid if the society can afford to do so, it is common practice for the settlement of the interest payments offered to be agreed by members at an Annual General Meeting (AGM), held within 6 months of the year end upon the presentation of draft annual accounts. Some members can also choose to waive the settlement of their interest payments or accept a lower than offered rate.

2.9. Accounting for these interest payments in the preparation of Charitable Societies' annual accounts is still a nascent issue with questions arising relatively recently. This information sheet aims to provide advice to assist practitioners and thereby offer a standardised approach and so avoid a diversity of practice developing in this field.

3. Share capital as unrestricted funds

3.1. This information sheet clarifies that share capital, withdrawals and interest payments should all form part of a Charitable Society's unrestricted funds. A Charitable Society should not use restricted funds to enable share withdrawals or payment of share interest.

3.2. A Charitable Society may still choose to designate share capital for specific purposes and this could be described in the accompanying narrative and/or Trustees' Annual Report to give members reassurance on the application of their capital investment. Consideration should be given to the original share offer document and the intentions expressed therein on the project plans for investing the members' share capital.

3.3. Trustees have discretion to designate other unrestricted funds in line with the society's charitable purposes but consideration should be given to whether this designation impacts on the ability of the society to enable withdrawals of share capital and settlement of interest payments as described in the society's share offer document and rules.

[6] Guidance on the FCA's registration function under the Co-operative and Community Benefit Societies Act 2014

4. Statement of Financial Activities (SoFA) – accounting for share interest

4.1. Interest on shares should be included in the SOCIE (as below) and should not be included under the expenditure on charitable activities in the SOFA. As illustrated in the annex, share interest paid can be captured as a transfer in funds.

4.2. Interest paid should only be accounted for in the accounting period in which it is paid out.

5. Balance sheet (funds section)

5.1. Section 15.19 of the SORP says: "Charitable companies are usually established as companies limited by guarantee. However, in rare cases, charitable companies may have issued share capital provided those shares have no right to receive a dividend or other distribution attached to them. Charitable companies that have issued share capital must modify the 'Funds of the charity' heading of the balance sheet to disclose called up share capital."

5.2. This information sheet augments this guidance to clarify that Charitable Societies should also present their members' share capital in the **'funds of the charity'** heading of the balance sheet as a component of unrestricted funds.

5.3. 'Called up share capital' is a Companies Act concept; in line with the Co-operative and Community Benefit Societies Act, share capital in societies should be presented as 'share capital' or 'members' shares' with an accompanying explanatory note to the accounts.

6. Statement of Changes in Equity (SOCIE)

6.1. Section 15.20 of the SORP says "Provided no new share equity is issued, a charitable company preparing its accounts under FRS 102 need not provide a separate statement of changes in equity for the reporting period. Charitable companies with equity must provide details of equity as set out in section 4 of FRS 102."

6.2. As share capital and interest payments in Charitable Societies are considered equity, a Statement of Changes in Equity (SOCIE) is mandatory for Charitable Societies if there are any movements in share capital in the accounting period. If the only movement in equity is the share interest payment, it is sufficient to disclose this in the SOFA as a transfer between funds.

6.3. The SOCIE is intended to capture the carrying value of share capital at the end of the period. As per the illustrative example in the annex, the SOCIE should include:

- the opening balance
- new share capital issued
- share capital withdrawn
- shares cancelled (upon death of a member)
- shares withdrawn and subsequently gifted back to the society (donated to the society)
- any interest paid out or credited to members' share accounts.

6.4. There are two ways that the settlement of interest offered can be made:

- Interest is paid in cash and accounted for as an equity payment in the SOCIE in the accounting period in which the cash payment is made.
- Interest is paid by the issue of new shares. This is accounted for in the accounting period in which the new shares are issued and shown as a movement in equity in the SOCIE, increasing (crediting) share capital and reducing (debiting) the revenue account.

7. Notes to the accounts

7.1. A Charitable Society must ensure that the 'legal status of the charity' section of the notes is accurate, including name and registered number of the society, charity number (if relevant), legal form and registrar (FCA).

7.2. It should also be made clear that in the event of the Charitable Society's dissolution, the liability of members is limited to the value of their share capital.

7.3. There should be an accounting policy note describing the way in which share capital and interest on shares have been accounted for.

7.4. The notes to the balance sheet should provide particulars relating to the issuance of shares comprising the balance sheet figure, interest payable (indicative or actual interest paid), the nature or any indications to the use of those funds and any trustee decisions made, if any, in respect of future plans for withdrawal of share capital.

7.5. As per paragraph 4.12 of FRS 102, the notes should also include a brief summary of the conditions of members' share capital such as the withdrawable, non-transferable nature of the shares and the rights attached to the shares.

7.6. It is recommended that to comply with the SORP's requirements, paragraph 9.17, that the note on Related Party Transactions discloses:

- The number of shares owned by each trustee or other related party
- The amount of interest paid to each trustee or other related party.

8. Trustees' Annual Report

8.1. The Trustees' Annual Report provides an opportunity to add narrative or clarification to any movements of members' share capital as well as the usual reporting on activities, outcomes and strategy. The report should also state the net surpluses of the society and propose what proportion has been reinvested in the society, used for the benefit of the community, or donated to other organisations similar objects.[7]

8.2. Additional consideration should be given to the members' expectations based on the aspirations outlined in the original share offer document and business plan. If there have been any significant deviations from these aspirations, evidence should be provided as to the rationale and any evidence of member consultation and/or engagement on these changes.

8.3. The annual report should also communicate any decisions made at the Annual General Meeting during the period on the position and ability of the society to pay interest or enable withdrawals. The position on payment of interest and withdrawal of share capital should be articulated in relation to the original share offer document i.e. has the society's financial position been in line with projections and has society been able to meet member expectations. If the decisions take effect in a future reporting period then this discussion could be included in the section on 'plans for future periods'.

8.4. Section 6.11 of the FCA's Registration Guidance states that a society should only allow the withdrawal of shares if "it has trading surpluses that exceed or match the value of the shares being withdrawn" and "the directors (trustees) believe the society can afford to pay its debts"[8]. The annual report should in the context of this requirement include the approach the trustees have taken in the year to enable withdrawals of share capital. This could be through either through designation of reserves of unrestricted funds or the decision to offer new share capital which provides the funds to enable existing members to withdraw their shares.

- It should also include a description of the membership strategy of the society, this may include discussion of membership changes over the

[7] Community Shares Handbook Section 6.3
[8] Guidance on the FCA's registration function under the Co-operative and Community Benefit Societies Act 2014

period and plans to attract additional members and/or share capital. It should also include any strategic decisions or projects which require the society to raise additional share capital through another, more specific, offer of shares.

Annex

The following tables are illustrative of the recommendations provided in this Information Sheet. They include the Statement of Changes in Equity and Reserves (SOCIE), Balance Sheet and Statement of Financial Activities (SoFA).

Note that the interaction of the fund balances found in the Statement of Financial Activities and the balance sheet differs from the presentation found in charities without equity items and this is due to the SOCIE. The balance sheet therefore needs to be read in conjunction with both the SOCIE and SoFA.

Because interest payable on shares, and donations of shares, are shown as a movement in funds in the SoFA, the SOCIE is not necessary where there is no movement in share capital to report.