



Association of Charitable Foundations

ACCOUNTING STANDARDS BOARD CONSULTATION:

The Future of Financial Reporting in the UK and Ireland REVISED FINANCIAL REPORTING EXPOSURE DRAFTS FRED 46 / FRED 47 / FRED 48

COMMENTS FROM

THE ASSOCIATION OF CHARITABLE FOUNDATIONS

APRIL 2012

1. About ACF

1.1. The Association of Charitable Foundations (ACF) is the umbrella membership organisation for independent charitable grant-making trusts and foundations in the UK. ACF's priorities include encouraging philanthropy and enabling trusts and foundations to achieve good practice in grant-making.

2. About our members

2.1. ACF's membership of over 320 organisations is comprised largely of registered charities, which operate by making grants (giving money) to other charities and civil society organisations, as well as to individuals in need. A large majority of our members finance their grant-making, at least in part, from the income received from their endowments, which are held in a wide variety of investment assets, including equities, bonds and property.

2.2. Our members range in size from large foundations with paid staff disbursing over £20 million per annum to small volunteer-run trusts disbursing less than £100,000 each year. Collectively they hold over £25 billion of investment assets and give over £1.5 billion each year to a wide range of charitable causes.

2.3. Our members interact with the accounting framework in three different roles:-

- Preparers of charity accounts – as charities our members prepare their accounts in line with the requirements of the Charities SORP;
- Users of charity accounts – when members make grants to other charities the information contained in the accounts of those charities is analysed as part of the decision-making process. Frequently this review is carried out by grants officers, who are not finance professionals;
- Investors – foundations review fund and company accounts as they manage their endowment assets.

3. Consultation Response – General Points

3.1. ACF is responding to this consultation primarily with regard to the impact of these proposals on charity accounts.

3.2. The two key issues on which ACF wishes to respond in relation to the ASB consultation document (Part One: Explanation) are:

- Section 4: Application of Proposals to Public Benefit Entities
- Section 5: The Financial Reporting Standard for Smaller Entities.

As the Part One consultation document contains no specific questions on these aspects, **our response is primarily concerned with issues beyond the eight consultation questions**. We do not have any detailed submission to make on any of those questions. Our submission is thus structured around other issues.

3.3. Although these comments are specifically concerned with the Exposure Draft of FRED 46-48, our comments should be seen in the light of ACF's April 2011 response to the ASB's consultation on the UK GAAP/IFRS convergence process and our June 2011 response on the draft FRSPBE.

3.4. In those earlier responses we said:

- *Our members are concerned about charity accounts not just in terms of the impact on their own trusts and foundations, but also because trusts and foundations make many of their grants to other charities. Charitable trusts are thus major users of the accounts of other charities which they may review in detail as part of their grant-making decision process.*
- *ACF and its members have invested considerably in training for grant-makers to read and understand charity accounts under the present framework. We recognise that some retraining will be needed as part of the IFRS convergence process, but it is essential that the framework for charity accounting remains as clear and consistent as possible.*

These points continue to be at the heart of ACF's position on the Future of Financial Reporting in the UK and Ireland.

4. Format of FRED 46/47/48 and Application to PBEs

4.1. In general terms, ACF welcomes the new draft standards – the structure and presentation is much clearer than before.

4.2. We also welcome the decision to incorporate relevant issues from the FRSPBE into the main standard – the draft FRS 102. This is much clearer and avoids the risks of confusion and conflict between a main standard and a supplementary standard. Incorporating the financial reporting requirements for both for-profit and not-for-profit (NFP) entities in the same primary standard makes good sense. Moreover, there are many borderline cases (e.g. entities operating as mutuals, co-operatives and social enterprises which are technically for-profits but which operate more like NFPs) and a single standard is very helpful in these instances. Charities have much interaction with these wider third sector entities.

4.3. However, we are perplexed that many points in the draft FRS 102 drawn from the FRSPBE still seem to use an approach of stating a requirement in the main text and then

amplifying it in appendices – e.g. appendices I and II to section 34 on “funding commitments”. This format does not seem to be widely used elsewhere in the standard. We would prefer to see all material on a specific accounting issue covered in one place in the standard (if necessary with points of detail placed in footnotes). It also not clear why some paragraphs drawn from the PBE standard still have “PBE” on the start of the paragraph number, which could signal that the provision is *only* applicable to PBEs. Since a wide range of entities can be in receipt of government grants (for example) this nomenclature seems unhelpful now that standards are integrated.

4.4. We welcome the ASB’s ongoing confirmation that the new FRS 100-102 deal with “high level” issues and that issues of detail specific to certain sectors should rightly continue to be dealt with by SORPs as set out in paras 8-9 of FRED 46. For charities, therefore, the Charities SORP will continue to be the main point of reference and we welcome this.

4.5. Nevertheless, whilst the draft FRS 102 (FRED 48) is much better than earlier documents in stating principles rather than detailed rules, we consider there are still some places (see our comments below) where the draft standard goes too far in attempting to address specific scenarios and examples, which would be better left to the SORPs.

4.6. Whilst we welcome the incorporation of PBE issues into the main standard, we remain concerned that the ASB is still using this term “Public Benefit Entity” in a very unhelpful way, and we would ask for consideration of an “alternative term Entity”. The “PBE” term suggests that those sections of the standard using the term are specific to those entities which meet the test of “public benefit” as enshrined in law, but the definition of a PBE on page 10 of FRED 46 and page 279 of FRED 48 is much broader.

4.7. The term “public benefit” has a very specific meaning in charity law – and hence as part of the body of law more generally. In England and Wales the term is now defined (albeit only by reference to case law) in section 4 of the Charities Act 2011 – moreover, the term has been tested by charity cases in the Upper Tribunal (Tax and Chancery) and the understanding could change. In Scotland a slightly different definition of “public benefit” is applied by section 8 of the Charities and Trustee Investment (Scotland) Act 2005. A further definition (not yet implemented and potentially to be amended) appears in sections 3 and 4 of the Charities Act (Northern Ireland) 2008.

4.8. It is thus very confusing to ask NFPs to engage in two separate understandings of the term “public benefit” – one for the purposes of charity law and regulation (which has been in use for the best part of 400 years) and a newer but different understanding for the purposes of financial reporting. We would point out that there are already specific requirements on *public benefit reporting* which are mandatory as part of the narrative disclosures on the Trustees’ Annual Reports of registered charities¹. We do not think many charities and their professional advisers will find it easy to understand that *reporting as a public benefit entity* under financial standards is a completely different issue.

5. The Structure/Tiers and Application of the FRSSE

5.1. We are somewhat perplexed that the latest announcements claim to “eliminate the tier system” (ASB press announcement 30 January 2012) because all that seems to have changed

¹ See www.charitycommission.gov.uk/Library/about_us/public_benefit_reporting_shu.pdf for a detailed study undertaken for the Charity Commission on this requirement.

in terms of the tiers is the removal of the concept of “public accountability” in requiring application of full IFRS. It still appears that there will be three tiers of financial reporting in the UK:

- Full IFRS for listed entities
- The new standard (FRS 102) for medium and larger entities (over £6.5M income etc²)
- The FRSSE for smaller entities.

5.2. Whilst this latest shift is helpful, it still leaves the potential for two or three different frameworks for financial reporting, and we are concerned about the impact of this on charities. As indicated above, ACF members have an interest both as *preparers* of financial statements for their own charities and as *users* of the financial statements of other charities in the course of considering grant applications.

5.3. We are concerned at the risk of fragmentation which could lead different charities to prepare financial statements on different underlying principles, depending on which tier was applicable – our aim is that as far as possible the *rules should be unified* for entities of different sizes. Simplification for smaller charities is welcome, but not if it means a totally different underlying framework (FRSSE as opposed to FRS 102).

5.4. We would point out that there is in fact a *fourth tier* permitted for charity accounts whereby non-company charities up to £250,000 income may prepare receipts and payments (R&P) accounts with statement of assets and liabilities, rather than financial statements following any of the above³. The contrast between R&P accounts and accruals accounts complying with accounting standards and the Charities SORP is already, at times, an issue of significant confusion amongst preparers and users of small charity accounts (ACF members assisted with a study of this issue in 2008⁴). So, there is a strong case for consistency in all sizes of charities preparing accounts that seek to give a true and fair view rather than a fragmentation by tiers.

5.5. In particular, there are only just over 1,000 charities in the UK with incomes over £6.5M compared to at least 200,000 charities below this⁵. Even if half of the 200,000 are very small charities using the R&P basis, this still leaves *around 100,000 charities which would be applying the FRSSE as opposed to just 1,000 or so following FRS 102*.

5.6. We therefore feel the *future of the FRSSE* is absolutely critical to the whole process.

5.7. We welcome the ASB’s commitment that a new FRSSE will be issued to take effect at the same date as FRS 102, and the indication in para 22 of FRED 46 of the FRSSE changes that will be needed are helpful. In principle we have no problem with these proposals. However, is the ASB suggesting that there will be no other changes to the FRSSE for convergence? Surely at the very least, the FRSSE needs to be updated to use the same

² We use the reference to £6.5M income as a shorthand for the three criteria (income, assets, employees) be considered in determining whether an entity is “small” for reporting purposes.

³ This is mentioned briefly in the table at para A2.19 of the draft FRS 100, but our point is that the charity accounts R&P regime is effectively a *fourth tier*.

⁴ Available at <http://www.shu.ac.uk/assets/pdf/cvsr-ReceiptsPaymentsAccountsStudyJune2008.pdf>

⁵ Estimates based on data from the Charity Commission (England and Wales) and OSCR (Scotland), extrapolated to include exempt and excepted charities in England & Wales and charities in Northern Ireland.

terminology as FRS 102 (receivable, inventories etc) in reflection of the IFRS underlying concepts, but we are unclear whether other more fundamental changes are needed.

5.8. We would therefore like to see a proper review process for the FRSSE *proceeding in parallel* with the main review process. It is vital that SORPs – the Charities SORP in particular – can be drafted to require *broadly the same principles for charity accounting whether the entity is above or below £6.5M income*. If a new FRSSE only appears shortly before the convergence date this will be very difficult.

5.9. We note that this is also affected by the future of the EU proposals and the possibility of a new regime for micro-entities – though in the latter case there is potentially scope for harmonisation with the existing regime for R&P accounting by the smallest charities.

5.10. With regard to the system of tiers we would also welcome clarity as to the circumstances in which an entity can “opt up” to full IFRS. Whilst very few charities would choose this, we believe there are a few internationally orientated charities, or charities with listed debt, which might welcome this possibility. At present, a charity’s accounts *must* be prepared under UK GAAP⁶, as is made clear in para A2.19 of the draft FRS 100. But it is not quite clear where the ASB accepts this position or whether the ASB will be recommending the Government to amend those provisions. We see considerable risks if a charity were allowed to “opt up” to full IFRS and thereby to ignore the Charities SORP.

6. Funding Commitments/Accounting for Multi-Year Grants

6.1. We welcome the revised approach of section 24 (grants) in requiring the same treatment for grant commitments whether they relate to government grants or other grants.

6.2. However, we are somewhat perplexed that para 34.63 suggests that the following section on “incoming resources from non-exchange transactions” only applies to *other resources* from non-exchange transactions. There is in law no fundamental difference between a grant and a donation – the former term is more often used for institutional awards and the latter more for funding from individuals but these terms are by no means universal. Many grant-making foundations making a small grant towards a larger project will describe it as a donation. We feel it would be clearer for the issues in section 34 on non-exchange transactions to be merged into section 24 which might be re-titled “grants and donations”. This would also include the appendices of section 34 insofar as they need to be retained, but (as explained above) we would prefer to see the appendices incorporated into the main text.

6.3. A major issue for many grant-making foundations exists around multi-year grants and whether or not the full amount has to be expensed at the beginning (i.e. as a constructive obligation) – we have commented on this in earlier consultations. At present, many foundations recognise multi-year grant commitments at the outset in order to comply with FRS 12 as reflected in paras 154-160 of the Charities SORP (2005). However, others have introduced stricter arrangements for annual reviews of long term grants and hence only recognise such grants on an annual basis, on the grounds that genuine discretion is retained from year to year. Both of these policies are clearly permissible at present.

⁶ This applies either under the Companies Act 2006 s.395(2) for charitable companies, or as a result of the Charities Accounts and Reports Regulations 2008 for non-company charities in England and Wales and in any case under the Charities Accounts (Scotland) Regulations for charities registered with OSCR.

6.4. ACF feels that any attempt by the standard to formulate specific rules on such issues is unhelpful and the details should be left to the relevant SORPs – provided they follow the basic principle in para 2.20 of the draft FRS 102 that a liability is recognised when a *legal obligation* or a *constructive obligation* exists. We feel it is vital that the new standard continues to endorse the principle of considering “substance over form” when deciding the correct accounting treatment for such transactions.

6.4. The fundamental criterion for whether or not future grant commitments are recognised as constructive obligations must continue to be based on the actual grant conditions and the reasonable expectations of the recipient. Conditions which remain in the discretion of the grant-maker point to non-recognition of the future grant as a liability, whilst conditions which are purely in the hands of the recipient point to recognition (unless there are strong reasons why the recipient is unlikely to be able to meet the conditions). This principle seems to be clearly endorsed by paras 24.3A and PBE34A.3.

6.5. In terms of drafting, there seem to be considerable overlaps on donated services between paras PBE34B.10 and PBE34B.17. However, as suggested above, we would prefer to see all these issues merged into a single section on grants and donations.

6.6. There also seem to be material drafting differences between the various definitions of a *performance condition* in the standard, which have the risk of creating serious accounting discrepancies. We draw attention to:

- para 24.5B
- para 34A.4
- para 34A.5
- para 34B.13
- the glossary (p278).

6.7. Under the glossary definition of performance condition as “a requirement that specifies that the resource is either to be used by recipient as specified, or if not so used be returned to the donor” almost every grant would be classed as being subject to a performance condition. This would mean no grants would be recognised until they had been *paid over and fully applied* by the recipient on the intended purpose. This cannot be right. Moreover, this conflicts with para 34A.5 which states that “a mere restriction on the purpose for which funds are to be used does not in itself create a performance-related condition”. This is clearly the correct approach, but it conflicts with the definition in the glossary (which we believe to be incorrect).

6.8. We suggest the definition of *performance condition* was given correctly in the ASB’s 2007 *Statement of Principles – Interpretation for PBEs* (para 4.32) – that defined the term in the sense that is widely used in grant-making:

- “A performance-related grant has the characteristics of a contract in that the terms of the grant require the performance of a specified service with the payment being conditional on the service provided.”

6.9. The explanation in para 116 of the Charities SORP may also be helpful – though – as before we would prefer that FRS 102 should focus on principle and leave SORPs to deal with the detailed application in specific sectors. We suggest that the definition above is sufficient for the FRS.

7. Concessionary Loans

7.1. We welcome the choices now available in FRS 102 (as compared to what was in the FRSPBE) and on balance we feel the valuation requirements are now reasonable.

7.2 We also feel the disclosure requirements are now reasonable provided the point in para 34.98 allowing similar concessionary loans to be disclosed in aggregate applies to all the preceding points.

8. Timetable for Implementation

8.1. We endorse the proposed revised implementation date on 1 January 2015. We do not wish to see this slip further given that so many issues are “on hold” pending the completion of this process (it has already moved a year since our previous submission in June 2011).

8.2. However, it is vital that the final version of the new FRS 102 *and* the final version of the FRSSSE are available in sufficient time to permit issue of a new Charities SORP a year ahead of the implementation date, to tie up with these standards.

Association of Charitable Foundations
04/2012