F.a.o. Peter Godsall, Esq.
Accounting Standards Board
5th Floor,Aldwych House
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London WC2B 4HN

1 February 2010

Dear Sir,

Public consultation on the future of the Charities SORP and other Public Benefit SORPs post UK-GAAP

We have pleasure in submitting our response to the above consultation. CARA is a registered charity aiming to facilitate the proper use of charitable resources and the fulfilment of public accountability for them. Although CARA is somewhat on the small side to be responding to such a macro issue, the writer has a particular interest in the subject – having been closely involved in the development of the charity sector's regulatory regime whilst working at the Charity Commission as its inhouse Accountancy Policy Adviser (1991-7) principally concerned with all aspects of the public accountability of charities and since then providing compliance advice on the other side of the fence, as it were.

Now that it has become clear from the Consultation Document and recent 'stakeholder' events in the charity sector that we can't have an updated version of the Charities SORP 2005 for some years until the ASB has put in place its proposed UK NPO financial reporting standard to bridge across to the commercially oriented IFRS, after having converged and discarded its UK standards, we would like to ask whether the ASB will give due consideration here to the existing EU Code of Conduct for NPOs. That Code, which member-States have since 2005 been in process of implementing, includes the concept of high quality annual accountability to a (preferably sector-regulated) standard underpinned where feasible by the public registers, quality labels and official incentives (eg, government grants, tax benefits, &c) envisaged by the EC as the best way to protect Europe's growing voluntary sector from an increasing risk of misuse for terrorist and other criminal activities.

Given that the Charities SORP, like all other UK Industry/Sector SORPs, can have no standing at all under IFRS, due to the latter's pronounced commercial bias, but that generally accepted Public Benefit standards for governmental use around the world have already been derived from IFRS by the IPSAS Board under IFAC since 2002, as a voluntary code of best practice in public accountability, the question that must be asked here is: would a UK NPO standard now be just 'reinventing the wheel'? Or if it were to be based on IPSAS, then what's wrong with just rebasing the Charities SORP itself (also the more specialised SORPs for the social housing and further/higher education sectors) on the already charity-friendly IPSAS?

At a stakeholder event held in Dublin (12 January) we heard that while the ASB will take into account the Standards already developed elsewhere on Public Benefit accountability, other EU member-States have not been converging their national Standards with IAS, although Germany is now considering something to be based on the IFRS for SMEs. There does, however, seem to be a consensus on securing the future of the Charities SORP in some form, given that it has become the keystone of the world's leading regulatory regime for charities in the public interest. As such it embodies generally accepted quality standards for charity accountability, governance and transparency. All it would need now to achieve global standing is to be rebased on suitable international standards – meaning not IFRS for commercial use, nor therefore IFRS for SMEs, for the same reason, but its Public Benefit derivative in the form of IPSAS.

Meanwhile the Consultation Document proposes that under IFRS the UK will have a size-based three-tier structure for compliance purposes in future. The IASB's newly developed IFRS for SMEs will become an <u>option</u> for 'small' entities within Tier 3 instead of the FRSSE (which we

note that the ASB proposes to retain 'for the foreseeable future'), while full compliance with EU-adopted IFRS is to be an option for 'non-publicly accountable' entities within Tier 2 instead of compliance with the IFRS for SMEs. (We note that this is within the UK company law option as an alternative to compliance with UK standards for all unlisted companies other than *charities.*)

However, it is unfortunate that the ASB and DBIS define 'publicly accountable' for this purpose to exclude completely the charity sector's existing size-based regime of regulated public accountability. (Compare this with the definition of "public interest" audit used by the FRC for professional audit regulation, in line with EU requirements, where charities are not excluded, though only a handful of them reach £100m turnover.) The ambiguous definition at paragraph 2.3 of the Consultation Document could easily be avoided by describing the deposit-taking/fiduciary and/or listed entities in question as having "market accountability". That would then leave "public accountability" to refer to charities and other reporting entities (eg, in the public sector) that really are accountable to the public at large.

What is more, 'public benefit' entities and 'not-for-profit' entities are wrongly lumped together by the ASB as if they were a single group, implying that the NPO Standard that the ASB has in mind may require significant modification in places - just as the Charities SORP has always needed to do with UK-GAAP for application to charity accountability.

The Consultation Document lists what the ASB sees as the key issues arising for 'public benefit entities', acknowledging that IASB Standards 'are not designed to apply to public benefit entity activities' and that the Charities SORP (as with all UK SORPs) lacks international standing – despite its obvious leadership in the field of charity regulation. But global Standards designed to regulate profit-accounting to inform decision-making by investors in the capital markets as the primary class of accounts-user clearly cannot and do not address the need to focus on the proper application of donors' contributions and on benefit-provision that are central to public-benefit accounting. As indicated above, those needs are already addressed by a completely independent derivation from the IASB Standards: IPSAS.

It is also worth mentioning that the IPSAS Board's standards have always been fully converged with IFRS from the very outset – in sharp contrast to what the Consultation Document says at paragraph 3.4 in noting that the UK Government 'adopts it own standards', thus ignoring IPSFRS (and keeping company with the USA in that respect).

Whilst intrinsically charity-friendly, IPSFRS would of course need a certain amount of 'tailoring' for use by charities - mainly just to exclude governmental tax-levying powers from the sources of voluntary funding catered for in IPSFRS. However, such tailoring is nothing like as extensive as is needed in the Charities SORP to make UK-GAAP suitable for application by the UK charity sector generally. The IPSAS Board has previously declined to add such tailoring to its agenda in the absence of dedicated funding.

What is reassuring to the sector here is that in offering to develop a UK Standard on Public Benefit accounting by NPOs the ASB would also continue 'franking' new versions of the Charities SORP once rebased on it. But the ASB would surely need to build on the success of the IPSAS Board here, as well as that of the USA's FASB with its 1993 Standards on NPO accounting (principally SFAS 116 and 117), now subsumed within Topic 958 of the FASB's July 2009 Codification of all extant US Standards.

We note that the ASB seeks public comment on the likely benefits, costs and other effects, ie, positive and negative, for four options that we are being asked to choose from:

1. A **Public Benefit Entity Framework** – similar to the ASB's own "Interpretation for Public Benefit Entities" of its "Statement of Principles for Financial Reporting", which aspired to a 'one size fits all' philosophy of public accountability with no fundamental incompatibilities between accounting for distributable profits and accounting for activities to provide public benefit, but which does not descend into the detail of specific accounting treatments at all;

2. A **Public Benefit Standard** (the ASB's own preference) – setting out where different accounting treatments (from those of IFRS) are needed for public benefit NPOs;

3. **Separate Standards on public benefit issues** (the approach adopted in the USA since 1993) – for example a standard on contributions, one on fund-accounting, one on the presentation of the primary accounting statements, etc;

4. **Supplementary text in UK GAAP** in the form of Application Notes, or else separate paragraphs in relevant Standards, eg, Fixed Assets (FRS15), on measuring the 'service potential' of assets held to facilitate public benefit activities; or Business Combinations (FRS6/7), on acquisition-accounting versus merger-accounting in situations where there is no valuable consideration such as is intrinsic to the commercial world, so that the concept of 'purchased goodwill' (whether positive or negative) is clearly inappropriate.

The key question here is which of the four options can best address the fundamental issues that have never been satisfactorily resolved under UK-GAAP and the Charities SORP to enable charity trustees to show in their annual accounts and reports that they have duly satisfied their common law *duty of care* to ensure a 'proper application' of all their charity's resources for the public benefit and in line with any terms of trust imposed by donors, given that such trust terms are legally enforceable under English common law – even if not so enforceable under the civil law on which most jurisdictions around the world are based.

Such unresolved issues include

- the charity law focus on the <u>propriety</u> of all expenditure incurred in the year (as distinct from the commercial focus on a bottom line of 'distributable profits' (FRS3) and the constraints of the tax law rules and shareholders' rights);
- the radically different income-recognition rules applicable to the SoFA presentation of the related income and costs of charitable activities funded under a commercial contract or a 'performance-related' grant-funding agreement as distinct from any other special-purpose grant-funding agreement under trust law;
- the commercial income-recognition rules for 'matching' government grants for capital expenditure (and by analogy also such grants from non-government sources) against the related annual depreciation of 'wasting' assets thus acquired for operational use (SSAP4);
- the need, for transparency's sake, for *proportional* (ie, line-by-line) consolidation, in respect of all resources under <u>shared control</u> (as distinct from sole control), of the accounts of associated and consortium corporate joint venture) undertakings (FRS9);
- the distinctions between unsolicited and solicited general-purpose voluntary funding, between the proceeds of this year's and prior years' fund-raising activities and between the costs of fundraising for the current year and 'fundraising for the future' (eg, legacy-marketing; building a donor-database, etc.).

There would also be a need to ensure that charities are not burdened with unnecessary costs through being prevented from using merger-accounting, given the IFRS-SME's requirement for all 'business combinations' to be accounted for as acquisitions, if it were to happen that the SORP had to supplement the IFRS-SME (in place of the FRSSE) rather than a newly developed NPO standard or perhaps IPSFRS as now existing.

To this we should then add a further need for the SORP to interpret the SME's requirement for disclosure of the remuneration of 'key management' in the context of charity accountability, given that the charity trustees remain ultimately responsible under charity law in respect of the decisions of all such (non-trustee) management staff even where carrying delegated executive powers.

Then there is the new tendency of auditors to invoke IAS 27's charity-unfriendly requirement for consolidation in the inappropriate case where a charity is controlled by a non-charitable public body as its sole trustee (eg, as with the NHS, where trustee-control over some £2bn of charity

assets is said to be at issue) despite the rigorous constraints of charity law that make it unlawful to use charity trusteeship to subordinate the controlled charity. That problem has been clearly addressed and resolved by the IPSAS Board in excluding from consolidation any undertaking administered solely as trustee …

The Consultation Document goes on to ask whether the 'issues' arising for NPOs should be addressed by means of a 'one-stop shop' standard (as with SORP 2005) or a supplemental standard (more like the HE/FE SORP approach). This is also related to the key issue emerging from the extended series of regional and stakeholder consultation events held by the Charity Commission and OSCR in recent months as part of the SORP Review process: the sector's clear preference for a 'one-stop shop' for all charity accountability, based on 'think small first' and adding to a simple, basic set of best-practice requirements those more exacting requirements that are consequential only for larger and more complex charities in the public interest.
Given that most charities are below the £500,000 gross income threshold for a professional audit to confirm that their accounts do show the required 'true and fair view', with perhaps as many as 90% of them (relatively few being charitable companies) free to prepare cash-based annual accounts that are outside the scope of the ASB and are in fact entirely unregulated in England & Wales (but not in Scotland), there may be a case for expanding the scope of the Charities SORP itself by making it a not a supplement to Financial Reporting Standards set by the ASB but a Regulator's Code of Practice for charity administration and annual reporting generally. That could then dovetail with or even form part of the above-mentioned EU Code of Conduct for NPOs in due course. The Code itself should be seen in the context of the EC's proposed total exemption from its *company law directives* for all 'micro-entities', the size limits for which are

- gross assets: Euros 500,000;
- turnover: Euros 1 million (not: gross income);
- employees: 10 (ie, average for the year).

That prospect will be relevant only for the many charities that are below the £1m gross income threshold for filing a Summary Information Return with the Charity Commission.

We would be happy to amplify any of the above points upon request.

Yours faithfully,

Greyham Dawes
- Executive Director, C.A.R.A*
(*Charity Administration, Resourcing & Accountability – registered charity No.1117929, an English limited company)