Exposure Draft

Financial Reporting Council

September 2017

FRED 68

Draft amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*

Payments by subsidiaries to their charitable parents that qualify for gift aid

The Financial Reporting Council (FRC) is responsible for promoting transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

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Contents

Summary

(i) The FRC's overriding objective in setting accounting standards is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.

(ii) The FRC has recently consulted on amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* that were proposed as part of its first triennial review. The proposals were set out in FRED 67 *Draft amendments to FRS 102 – Triennial review 2017 – Incremental improvements and clarifications*. The FRC intends to finalise the proposals in this FRED (FRED 68 *Draft amendments to FRS 102 – Payments by subsidiaries to their charitable parents that qualify for gift aid*) together with those in FRED 67.

Draft amendments to FRS 102

(iii) The FRC has been made aware of significant differences in accounting treatment arising in practice, in relation to the accounting for gift aid payments made by a subsidiary to its charitable parent. Such payments are made during the nine months following the relevant reporting date, and are a distribution to owners but a donation for tax purposes. Although the gift aid payment is made after the reporting date, the tax effects automatically relate to the earlier period.

(iv) For a subsidiary of a charitable parent, these draft amendments to FRS 102 propose to require the tax effects of a gift aid payment that it is probable will be made in the nine months following the reporting date to be taken into account at the reporting date. This will reflect the fact that in most cases such entities will minimise their liability for corporation tax as a result of making gift aid payments.

(v) In addition it has been clarified that:

- (a) the gift aid payment, as a distribution to owners, shall not be accrued at the reporting date (unless a deed of covenant is in place) and shall be recognised in equity; and
- (b) the tax effects of the gift aid payment shall be recognised in profit or loss.

(vi) These draft amendments will improve the consistency of reporting between entities and the relevance of information provided to users.

Invitation to comment

1 The FRC is requesting comments on FRED 68 by 20 October 2017. The FRC is committed to developing standards based on evidence from consultation with users, preparers and others. Comments are invited in writing on all aspects of the draft standard. In particular, comments are sought in relation to the questions below.

> **Question 1**
>
> Do you agree with the proposed amendments to FRS 102 and that this will improve the relevance of information provided to users of the financial statements? If not, why not?
>
> **Question 2**
>
> In relation to the Consultation stage impact assessment do you have any comments on the costs and benefits identified? Please provide evidence to support your views of the quantifiable costs and benefits of these proposals.

2 Information on how to submit comments and the FRC's policy in relation to responses is set out on page 11.

[Draft] Amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*

[Draft] Amendments to Section 29
Income Tax

1 The following paragraphs sets out the [draft] amendments to Section 29 *Income Tax* (inserted text is underlined).

2 Paragraph 29.14A and a sequentially numbered footnote are inserted (subsequent footnotes are renumbered sequentially) as follows:

29.14A As an exception, when:

(a) an entity is wholly-owned by a charitable[*footnote] **parent**;

(b) it is probable that a gift aid payment will be made to the charitable parent within nine months of the reporting date; and

(c) that payment will qualify to be set against profits for tax purposes,

the income tax effects of that gift aid payment shall be recognised at the reporting date. The income tax effects shall be measured consistently with the tax treatment planned to be used in the entity's income tax filings. A deferred tax liability shall not be recognised in relation to such a gift aid payment.

[*footnote] In this context charitable refers to an entity that has been recognised by HMRC as being eligible for certain tax reliefs because of its charitable purposes.

3 Paragraph 29.22A is inserted as follows:

29.22A As an exception to paragraph 29.22, an entity shall present the tax expense (income) effects of distributions to **owners** in profit or loss.

The Corporate Reporting Council's Advice to the FRC to issue FRED 68 *Draft amendments to FRS 102 – Payments by subsidiaries to their charitable parents that qualify for gift aid*

Introduction

1 This report provides an overview of the main issues that have been considered by the Corporate Reporting Council in advising the Financial Reporting Council (FRC) to issue FRED 68 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Payments by subsidiaries to their charitable parents that qualify for gift aid*.

2 The FRC, in accordance with the *Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc) Order 2012* (SI 2012/1741), is a prescribed body for issuing accounting standards in the UK. The *Foreword to Accounting Standards* sets out the application of accounting standards in the Republic of Ireland.

3 The FRC has established the Corporate Reporting Council as the relevant Council to assist it in the setting of accounting standards.

Advice

4 The Corporate Reporting Council is advising the FRC to issue FRED 68 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Payments by subsidiaries to their charitable parents that qualify for gift aid.*

5 The Corporate Reporting Council advises that these proposals will improve the consistency of reporting between entities and the relevance of information provided to users.

6 When these draft amendments are finalised, the Corporate Reporting Council's Advice to the FRC in respect of these amendments will be added into FRS 102.

Background

7 The FRC has been made aware of significant differences in accounting treatment arising in practice in relation to the accounting for payments made, or expected to be made, by a subsidiary to its charitable parent that will qualify for gift aid (expected gift aid payments). This includes charitable parents that are exempt charities, eg they are not regulated by the Charity Commission, but have another principal regulator.

8 Many charitable entities, including registered providers of social housing and higher education institutions, carry out trading activities through a non-charitable subsidiary. Any profits from the non-charitable subsidiary can then be distributed to the parent charity in a tax-efficient manner as a donation which is eligible for corporation tax relief under the gift aid rules. Such payments are made during the nine months following the relevant reporting date.

9 Although such payments are donations for tax purposes, legally they are a distribution from the subsidiary to its owners (see ICAEW Technical release TECH 16/14BL REVISED *Guidance on donations by a company to its parent charity*).

10 The FRC understands that previously it was common for such payments to be accrued at the reporting date and for the subsidiary to be treated as effectively tax exempt. The introduction of FRS 102, as well as the fact that the payment is a distribution, has caused some charitable groups to revisit this treatment.

Draft amendments to FRS 102

11 The Corporate Reporting Council notes that FRS 102 does not directly address all aspects of the accounting for expected gift aid payments. In such circumstances paragraphs 10.4 and 10.5 require entities to use judgement in developing an accounting policy. In doing so, entities should first have regard to any requirements dealing with similar and related issues.

12 The expected gift aid payment will be a distribution to owners. FRS 102 contains some specific requirements that are relevant to distributions to owners, for example paragraph 22.17 requires distributions to owners to be recognised in equity.

13 Dividends are a form of distribution to owners. FRS 102 contains a number of requirements that apply to dividends, which should be regarded as applicable to other distributions to owners (unless more specific requirements apply) including gift aid payments.

14 Therefore paragraph 32.8 shall be applied to expected gift aid payments, which shall not be recognised as a liability at the reporting date if the payment becomes an obligation after the reporting date. In practice, this is likely to mean that unless a legal obligation for the subsidiary to make a payment to the parent has been created by, for example entering into a deed of covenant, no liability for expected gift aid payments can be recognised at the reporting date.

15 A consequence of this is that the subsidiary will have taxable profits and need to recognise a tax expense because paragraph 29.14 prevents the tax effects of dividends being recognised before the dividend itself has been recognised.

Information relevant for users

16 In accordance with paragraph 10.4, the Corporate Reporting Council considered the relevance of the resulting information to users. As the subsidiary is wholly-owned there will be few external users of its financial statements, however there will also be an impact on the consolidated financial statements for the charitable group. In the *Statement of Principles for Financial Reporting – Interpretation for Public Benefit Entities* (issued in June 2007 and withdrawn with effect from 1 January 2015), the Accounting Standards Board (ASB) expressed the view that the defining class of user for the financial statements of a public benefit entity is its funders and financial supporters. Therefore, the Corporate Reporting Council has considered the information which funders and financial supporters of a charity might find relevant in assessing the performance of the charity.

17 The Corporate Reporting Council considered that there was scope to improve the usefulness of the information relating to gift aid payments arising from the requirements of FRS 102; in particular, the recognition of a tax expense that is unlikely to be paid and may result in accounting that is confusing to some users of the financial statements. There is a case for making a pragmatic exception to the requirements of FRS 102 in order to address this and the Corporate Reporting Council considered a number of options.

18 The Corporate Reporting Council considered whether to provide an exemption from paragraph 32.8 of FRS 102 to allow the recognition of a liability for an expected gift aid payment at the reporting date. However, it noted that a liability could be recognised in certain circumstances, for example if a deed of covenant was in place, and did not consider an exception was warranted for this type of distribution to owners.

19 However, the Corporate Reporting Council advises that the recognition of a current tax expense, when it is probable that the taxable profits will be relieved by an expected gift aid payment, does not represent the practical effect of the tax relief and does not provide relevant information to users. Unusually, the tax effects of a gift aid payment from a

subsidiary to a parent charity made within nine months of the reporting date automatically provide relief against the taxable profits of the previous period, therefore the Corporate Reporting Council advises making an exception to paragraph 29.14 of FRS 102 in order to allow the tax effects of the expected gift aid payment to be recognised at the reporting date, provided certain conditions are met. This will provide more relevant information to users.

Related accounting requirements

20 In addition, it is proposed than an amendment be made to Section 29 *Income Tax* to clarify that the tax effects of distributions to owners shall be presented in profit or loss, rather than the same component as the underlying transaction. This is also consistent with an amendment proposed to IAS 12 *Income Taxes*. Therefore the tax relief arising from the expected gift aid payment will be presented in profit or loss.

Effective date

21 The Corporate Reporting Council advises that these draft amendments be finalised with the proposals in FRED 67 *Draft amendments to FRS 102 – Triennial review 2017 – Incremental improvements and clarifications*. Therefore it is proposed that these draft amendments have an effective date of accounting periods beginning on or after 1 January 2019, with early application permitted provided that all of the amendments are applied at the same time (ie including those arising from the proposals in FRED 67). As it is intended that these amendments are finalised with FRED 67, no separate amendment to Section 1 *Scope* of FRS 102 is proposed.

Consultation stage impact assessment

Introduction

1 The Financial Reporting Council (FRC) is committed to a proportionate approach to the use of its powers, making effective use of impact assessments and having regard to the impact of regulation on small enterprises.

2 The proposals in this FRED are expected to be finalised with the proposals in FRED 67 *Draft amendments to FRS 102 – Triennial review 2017 – Incremental improvements and clarifications*. Therefore the impact of these proposals will be considered as part of the finalisation of the Regulator Assessment of those proposals.

Draft amendments to FRS 102

3 These proposals will only affect public benefit entity groups that include non-charitable subsidiaries that distribute profits to the parent charity as a donation qualifying for gift aid. As there are currently significant differences in the accounting treatment being adopted, the extent of the impact will depend upon the approach taken to date.

4 These proposals will not have any significant effect on the cost of preparing financial statements as no new information is required, nor any complex calculations, but will ensure that relevant information is provided to the users of the financial statements.

Conclusion

5 Overall, the FRC believes that the draft amendments to FRS 102 will have a positive impact on the relevance of information provided in the financial statements and improve consistency of reporting by public benefit entity groups and the entities within those groups.

This draft is issued by the Financial Reporting Council for comment. It should be noted that the draft may be modified in the light of comments received before being issued in final form.

For ease of handling, we prefer comments to be sent by e-mail to:

ukfrs@frc.org.uk

Comments may also be sent in hard copy to:

Jenny Carter
Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

Comments should be despatched so as to be received no later than 20 October 2017.

The FRC's policy is to publish on its website all responses to formal consultations issued by the FRC unless the respondent explicitly requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure. The FRC does not edit personal information (such as telephone numbers or postal or e-mail addresses) from submissions; therefore, only information that you wish to be published should be submitted.

The FRC aims to publish responses within 10 working days of receipt.

The FRC will publish a summary of the consultation responses, either as part of, or alongside, its final decision.

FRC

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