Selection 3: Accounting for investments

20. Total return (investments) – (England and Wales only)

Introduction

20.1. This module applies to charities established in England and Wales that hold investments as permanent endowment and adopt a total return approach to the investment of those funds. This module reflects the requirements of charity law and regulations in England and Wales where a statutory power exists that enables charities to adopt a total return policy for the investment of permanently endowed funds. FRS 102 does not deal with specific issue of charities with permanent endowment funds invested on a total return basis.

20.2. Trust law requires the trustees of a permanently endowed fund to be even-handed in the way that they allocate investment returns between current and future beneficiaries. Under standard trust rules, income generated from endowed investments must be spent on the purposes of the fund for current beneficiaries and any capital gains or losses must be allocated to the capital of the endowment held to produce income for the benefit of future beneficiaries.

20.3. When a total return approach to investment is adopted, the permanently endowed funds are invested to produce an investment return without regard to whether that return is in the form of income (for example, dividends or interest) or capital appreciation.

20.4. The investment return forms a component of the endowment fund known as the ‘unapplied total return’. The trustees then periodically determine how much of the ‘unapplied total return’ is released to income for spending and how much is retained for investment as a component of the endowment. This allocation must be made equitably to balance the need for income to meet current requirements and to hold funds as part of the endowment to produce investment returns for the future.

20.5. Under a total return approach to investment, the endowment has two distinct components:

- the value of the original and any subsequent gifts made to the capital of the endowment (which cannot normally be spent) which is termed the ‘value of the trust for investment’; and
- the ‘unapplied total return’ which represents the accumulated investment returns from the investment of the endowment less any amounts which have been allocated to income.

20.6. A charity must have the relevant investment power to adopt a total return approach to investment. This power may be granted to endowed charities in England and Wales by an order of the Charity Commission made under section 105 of the Charities Act 2011 or exercised by trustees under section 104A of the Charities Act 2011 as amended by the Trust (Capital and Income) Act 2013. Charities exercising the power to invest on a total return basis under section 104A of the Charities Act 2011 must also refer to the Charities (Total Return) Regulations 2013 and the further guidance available from the Charity Commission’s website.

20.7. This module sets out:

- the accounting treatment;
- disclosures required in the notes to the accounts where permanent endowment is invested on a total return basis; and
- disclosures required in the trustees' annual report.

The accounting treatment

20.8. This SORP requires that the following accounting treatment must be used where a charity adopts a total return approach to the investment of endowment:

- income from the endowment's investments must be recognised as 'investment income' in the endowment column of the statement of financial activities (SoFA);
- investment gains and losses (realised and unrealised gains and losses) must be recognised as 'investment gains and losses' in the endowment column of the SoFA;
- any part of the unapplied total return that is allocated to income funds must be separately identified in the SoFA as an allocation between endowment funds and income funds either within the 'transfer' line or within the 'other income' section of the SoFA; and
- the amount of any unapplied total return fund must be included as a part of the relevant endowment together with the value of the trust for investment on the balance sheet.

20.9. Exceptionally, where investment losses exceed the amount of unapplied total return, the loss must be treated as a reduction in the value of the trust for investment component of the permanent endowment until such time as these losses are reversed.

Disclosures required in the notes to the accounts where permanent endowment is invested on a total return basis

20.10. This SORP requires that the notes to the accounts must provide the following information for each endowment fund that is invested on a total return basis:

- the amount of the value of the trust for investment which comprises the gift component of the endowment at the start of the reporting period;
- the amount of any additional gifts to the endowment fund during the reporting period added to the value of the trust for investment;
- the amount of any unapplied total return at the start of the reporting period;
- the amount of the investment return from the investment of the endowment for the reporting period;
- the amount of any allocations of unapplied total return to income funds;
- the amount of any recoupment to make good the value of the trust for investment;

- the amount of any allocation from the trust for investment to the unapplied total return;
- the amount of any unapplied total return at the end of the reporting period;
- the total amount of the endowment fund at the end of the reporting period; and
- details of the power of investment or the order that permits the charity to adopt a total return approach to investment.

20.11. Table 16 summarises how the disclosures required in the notes to the accounts may be set out.

Table 16: Example of the disclosure of a total return approach to investment of permanent endowment

	Trust for investment	Unapplied Total Return	Total Endowment
	£	£	£
At beginning of the reporting period:			
Gift component of the permanent endowment	X	-	X
Unapplied total return	-	X	X
Total	**X**	**X**	**X**
Movements in the reporting period:			
Gift of endowment funds	X	-	X
Recoupment of trust for investment	X	(X)	-
Allocation from trust for investment	(X)	X	-
Investment return: dividends and interest	-	X	X
Investment return: realised and unrealised gains and (losses)	-	X	X
Less: Investment management costs	-	(X)	(X)
Total	**X**	**X**	**X**
Unapplied total return allocated to income in the reporting period	-	(X)	(X)
Net movements in reporting period	**X**	**X**	**X**
At end of the reporting period:			
Gift component of the permanent endowment	X	-	X
Unapplied total return	-	X	X
Total	**X**	**X**	**X**

Disclosures required in the trustees' annual report

20.12. This SORP requires that a charity that has been granted the power to invest on a total return basis by a Charity Commission order (charities registered in England and Wales), or where the trustees have exercised the power granted under section 104A(2) of the Charities Act 2011, must provide the following additional information in the trustees' annual report:

- the date that the initial value of the trust for investment and the initial value of the unapplied total return was established;
- the policy used to identify the initial amounts of the trust for investment and any unapplied total return and the date this analysis was performed;
- an explanation of the policies used by the charity's trustees and the factors considered in determining the amount of the unapplied total return allocated to income (termed the trust for application) and any amounts allocated to the trust for investment in the reporting period;
- an explanation of the policies used by the charity trustees and the factors considered in determining the amount, if any, of the trust for investment (permanent endowment) allocated to the unapplied total return or any recoupment made from the unapplied total return into the trust for investment in the reporting period; and
- the name and professional qualifications of any person who has provided advice to the charity's trustees as to the amount that can be allocated to income and/ or the trust for investment from the unapplied total return in the reporting period.