CHARITY COMMISSION'S RESPONSE TO QUESTIONS POSED BY ASB CONSULTATION ON 'THE FUTURE OF UK GAAP'

Question 1 – Which definition of Public Accountability do you prefer: the Board's proposal (paragraph 2.3) or the current legal definitions (paragraph 2.5)? Please state the reasons for your preference. If you do not agree with either definition, please explain why not and what your proposed alternative would be?

We concur with the approach to 'public accountability' contained within the consultation paper. The financial accountability due to investors in capital markets is best served by the application of the full suite of International Financial Reporting Standards Standard ('IFRS') within 'Tier 1' of the proposal.

Charities should clearly be accountable but this will be better achieved through the development of a standard that address the particular transactions common in charities and the particular reporting needs of stakeholders, in particular narrative reporting which explains purposes, objectives, activities and the results which flow from them.

Whilst the application of full IFRS might meet the needs of global capital markets and investors, it would not enhance the accountability of charities to their stakeholders. Information needs differ across sectors and we need to recognise the particular accounting and reporting issues that are encountered within the charity sector are best addressed through a sector specific standard and the Charities SORP. We are also aware from the recent series of SORP roundtables and future of UK GAAP events of sector concerns about the complexity and accessibility of financial reporting. The perception exists that the application of full IFRS would only add unnecessarily to complexity without any significant advantage to stakeholders in terms of the relevance of the information provided.

The definition of 'public accountability' that includes 'holding assets in a fiduciary capacity' needs further consideration in order to ensure that assets held on trust by charity trustees fall outside the definition. We would also question whether 'micro-credit' schemes that are operated in developing countries, where typically loans are no more than a few hundred pounds, should fall within the definition of 'publicly accountability'.

Question 2 – Do you agree that all entities that are publicly accountable should be included in Tier 1? If not, why not?

We concur that the application of full IFRS within 'Tier 1' should be limited to those entities that issue listed debt or equity and to commercial deposit takers.

As explained in our response to 'Question 1', the accountability of charities to its stakeholders can be better achieved in the way proposed by the consultation paper, that is, through the development of a 'public benefit entity' standard, within 'Tier 2', and supported, as currently, by a Charities SORP.
The small number of charities that have issued listed debt should fall within 'Tier 1' of the proposal and apply full IFRS reflecting their accountability to capital markets. However, it will be important that an obligation also exists for such charities to apply the proposed 'public benefit entity' standard and Charities SORP for charity specific transactions addressed by this framework. In so doing accountability to both capital markets and charity stakeholders can be achieved.

Question 3 – Do you agree with the Board's proposal that wholly-owned subsidiaries that are publicly accountable should apply EU adopted IFRS? If not, why not?

In the event of a charity being deemed a subsidiary of an entity applying full IFRS, for example, a public body, it will be vital for the 'subsidiary' charity to apply the proposed 'public benefit entity' and Charities SORP. The subsidiary charity's primary accountability lies to its own stakeholders and therefore it should apply the proposed 'public benefit entity' and Charities SORP.

Question 4 – Do you still consider that wholly-owned subsidiaries that are publicly accountable should be allowed reduced disclosures? If so, it would be helpful if you could highlight such disclosure reductions as well as explaining the rationale for these reductions.

Please see our response to 'Question 3' above.

Question 5 – Do you agree with the Board's proposal that the IFRS for SMEs should be used by 'Tier 2' entities?

We concur that that IFRS for Small and Medium-sized Entities ('SME') should be used by 'Tier 2' entities. However, as identified by the consultation paper, IFRS based standards are not designed to apply to public benefit entities and therefore 'Tier 2' should be supplemented by the proposed 'public benefit entity' standard, and a Charities SORP, in order to meet the reporting needs of the charity sector.

Question 6 – Do you agree with the Board's proposal that the IFRS for SMEs should be adopted wholesale and not amended? If not, why not? It would be helpful if you could provide specific examples of any amendments that should be made, as well as the reason for recommending these amendments.

As identified in our response to 'Question 5', IFRS based standards are not designed to apply to public benefit entities and therefore 'Tier 2' will need to be supplemented by the proposed 'public benefit entity' standard. Section 3.15 identified the key areas where IFRS for SME will need to be supplemented.
Looking outside the charity sector, it may well be prudent for the ASB to retain the right to amend, on an exceptional basis, as application over time may identify a particular treatment or disclosure which is better suited to UK accounting needs.

Question 7 – Do you agree with the Board's proposal that large Non-Publicly Accountable Entities should be permitted to adopt the IFRS for SMEs? Or do you agree that large entities should be required to use EU adopted IFRS? Please give reasons for your view.

We concur with this approach in that it will enable charities to adopt the more relevant proposed 'public benefit entity standard' based on IFRSs for SME. A 'public benefit entity standard' supplemented by a Charities SORP has greater potential to address the specific reporting and accountability needs of our sector.

Question 8 – Do you agree with the Board that the FRSSE should remain in force for the foreseeable future?

A move to IFRS based standards will create considerable learning and training needs within our sector which clearly will have considerable cost implications in the early periods of adoption. However, we also recognise that maintaining two frameworks in the longer term may equally create difficulties both in terms of maintaining two regimes and from the resulting dichotomy in reporting so created.

In England and Wales 95% of registered charities have an income below £1m (162,000 charities). These smaller charities often lack expert accountancy resources and are commensurate in size to the 'micro entities' identified by the European Union. The framework therefore needs to fit the requirements of smaller charities.

The FRSSE is written for small commercial entities and does not address many of the issues central to charity reporting and therefore has limited application unless supported by a sector SORP.

We support allowing a transition period, particularly for smaller charities. However, our SORP Committee and the feedback we have picked up from the sector based 'Future of UK GAAP' events indicated concerns about moving forward with two accounting regimes running in parallel. The difficulty in maintaining two regimes, the training implications and potential loss of comparability have all been highlighted to us as potential issues. Concerns also arise over the risks of a protracted convergence period, with different sized charities moving to IFRS based standards at different times, and the uncertainty that this may create.

On balance, we would prefer all charities that prepare accounts to give a 'true and fair' view to follow the same framework, but for there to be a transition period to enable smaller charities adequate time to adjust to a new IFRS based framework.

Question 9 – Do you agree that the FRSSE could be replaced by the IFRS for SMEs after an appropriate transition period, following the issuance of the IFRS for SMEs?

As we have explained more fully in our response to 'Question 8', on balance, we support a single framework based on IFRS for SME after an appropriate transition period.

A successful transition to an IFRS based standard will be greatly assisted by the development of a Charities SORP based on the IFRS framework and by the ASB adopting a proportionate approach to the development of the proposed 'public benefit entity' standard. For example, where a requirement is set by the standard then consideration should always be given to the relevance of the requirement to smaller charities.

Question 10 – Do you agree with the Board's current views on the future role of SORPs. If not, why not?

A series of 28 separate SORP Roundtable events has provided considerable empirical and qualitative evidence of the importance of the Charities SORP to our sector in applying accounting standards. The events were attended by over 1000 sector representatives and near 700 questionnaires where returned. A report of findings 'Charity Reporting and Accounting - Taking Stock and Future Reform' was prepared by Queen's University Management School is downloadable from our website. The report states 'it is clear that the

SORP product is overwhelmingly supported by stakeholders. The SORP was seen to be driving improvements in accounting and reporting; and encouraging appropriate structures and discipline in charities by focussing the attention of trustees on key issues'.

It is our view that the Charities SORP will be central to the successful transition to IFRS based standards. We welcome the proposal to develop a 'public benefit entity' standard but we suspect that the diversity of the constituency that standard addresses will necessitate application guidance for our sector.

Even with a 'public benefit entity' standard in place, it is likely that there will still be the issues such as the form and content of charity accounts and charity specific disclosures to be addressed. There will also still be a need to draw together the proposed standard, charity law across the three legal jurisdictions of the UK and the narrative reporting that is so central to our sector.

A Charities SORP will therefore remain relevant to those in our sector who value the accessibility the SORP provides and the availability of comprehensive guidance in a single document. In our view, the SORP will be central in any successful transition to an IFRS based framework.

Question 11 – Do you agree with the Board's proposal to develop a public benefit entity standard as part of its plans for the future of UK GAAP? If not, how should (converged) UK GAAP address public benefit entity issues?

We support the ASB's proposal to develop a 'public benefit entity' standard.
Your consultation paper presents the very strong case for a 'public benefit entity' standard and gives recognition to the special features of 'public benefit' entity accounting which apply particularly to charities.

We have significant reservation about the description of the standard as a 'public benefit entity' standard. Public benefit is the primary test of charitable status and to apply this term to the wider non-for-profit sector which will even include entities with distribution powers, albeit limited, is potentially misleading. We would therefore ask the ASB to either reconsider the remit of the proposed standard or to consider alternative terminology that more closely described the proposed constituency and recognised the conflict of the current terminology with the legislative framework in England and Wales.

Question 12 – If you do agree with the proposal to develop a public benefit entity standard, should the standard cover all the requirements for preparing true and fair view accounts or should it cover only those issues where IFRS or the IFRS for SMEs needs to be supplemented for the public benefit entity sector?

We strongly support the 'stand alone' approach that a single 'public benefit entity' standard would provide. A need to refer to more than one standard would increase complexity and therefore compliance cost. The size profile of the charity sector in England and Wales points strongly to the need for simplicity and accessibility wherever possible and this objective is more likely to be achieved in the context of a single 'stand-alone' standard.

However, given the range of issues to be addressed and the broad constituency of entities cover by the term 'public benefit', we recognise that issues are likely to need to be addressed at a relatively high level. This gives weight to the argument for a Charities SORP which would then provide the additional guidance to ensure successful application of the standard by our sector.

It is essential that the burden of implementation is minimised and proportionate and these objectives can best be achieved through a single standard supplement by a Charities SORP. The standard, if it is to be successfully implemented by our sector, will need to:

- Be a single 'stand alone' standard providing a coherent and accessible standard which is supplemented, in the charity sector, by a SORP addressing its application in the context of charity law.

- Recognise the vital importance of narrative reporting - and provide scope for guidance within a SORP if not directly addressed by the standard.

- Be accessible and relevant as possible and based on IFRS for SMEs.

- Recognise the need for a proportionate approach in the context of smaller charities.

Question 13 – Do you agree the issues listed in the above table are distinctive for the public benefit entity sector and should therefore be covered in a public benefit entity standard? What other issues might the proposed standard include?

The consultation paper recognises the main features that distinguish charity accounting. The Charities SORP committee has given particular consideration to this issue and their comments have been forwarded to you separately by us in our role as the joint SORP-making body for UK charities.

At a macro level charities can be distinguished from for profit entities in that they are established for exclusively charitable purposes for the public benefit. Charity trustees are responsible in law for ensuring that a charity's activities are within its charitable purposes which must be for the public benefit. This environment impacts on the operational objectives and the reporting framework which need to reflect the legal framework in which charities operate and their operational objectives which focus on generating public benefit.

Question 14 – The Board accepts there may be a continuing need for guidance to supplement a public benefit entity standard in sectors such as charities, housing and education. Where this is the case, do you think the Board should provide a Statement confirming the guidance is consistent with UK GAAP, including the public benefit entity standard?

The authority of the Charity SORP is currently derived from the process for its development, ASB franking and adoption in law of the SORP's methods and principles. ASB franking provides assurance and underpins its authority and promotes its adoption. It would be extremely disappointing and potentially damaging to compliance if ASB withdrew from this franking role.

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Question 15 – If you are an entity whose basis of preparing financial statements will change under these proposals, what are the likely effects of applying those new requirements? Please indicate both benefits and costs and other effects as appropriate. If you are a user of financial statements (such as an investor or creditor) what positive and negative effects do you anticipate from the implementation of the proposals set out in this paper?

The Commission maintains a register of charities in England and Wales. It receives and displays the accounts of all registered charities with an income of over £25,000.

The transition to an IFRS based standard will place a considerable cost burden on the sector in familiarising itself with the new framework and in training costs. Against this we recognise that in the long-term the retention of a separate body of UK GAAP might not be a practical option for the ASB or indeed in the long term interests of our sector. In the long term it would be untenable for the charity sector to adhere to a completely separate accounting framework to that used in other sectors. In the long term this would limit the transfer of accounting skills into the sector. An IFRS based standard also has the potential to provide a catalyst to promote consistency internationally in public benefit and particularly charity accounting.

The focus must therefore be on minimising the cost impact on the sector and maximising the accessibility of the framework developed. In our view, this can best be achieved through the development of a 'stand alone' 'public benefit entity' standard supported by a Charities SORP. The standard and the SORP need to tackle the issues of accessibility and proportionality. As we have highlighted earlier in our response, each requirement should be considered in terms of its relevance to smaller charities and requirements disapplied where the relevance to small charities is not demonstrated.

Question 16 – What are your views on the proposed adoption dates?

An adoption date for financial years beginning on or after 1 January 2012 appears very optimistic. A 'public benefit entity' standard has yet to be developed or consulted on. The timetable also needs to allow for an IFRS based Charities SORP to be developed and consulted on. Changes would also be needed to the legislative framework which again would require both a legislative window and consultation. A time-line urgently needs to be put together that reflects these interdependences.

We are however also aware that a long delay might create pressures for a revision to the current UK GAAP based SORP. We would not wish to introduce a new SORP prepared under UK GAAP which had only a short shelf life and would be withdrawn with the implementation of the IFRS based framework. Also if the implementation of the IFRS framework were delayed for charities but implemented for commercial entities concerns might arise as to the priority being given to public benefit accounting.

END