

POLICY PROPOSAL: THE FUTURE OF UK GAAP

Who we are

1. The Churches' Legislation Advisory Service is an ecumenical body that brings together all the major churches in the United Kingdom (and, because the umbrella ecumenical bodies are members, many of the smaller churches as well), together with the United Synagogue. Our purpose is to represent the major churches in the United Kingdom on issues of secular law as they affect their interests. A note of our membership is annexed.
2. We welcome the opportunity to submit evidence to the ASB's consultation on the future of UK GAAP. Our comments are limited to Section 3 of the consultation: Financial Reporting for Public Benefit Entities. It should also be emphasised that we are concerned purely with charitable trusts: we do not address the issue of accounting by charitable companies established under the Companies Acts, since this is largely irrelevant to religious charities. We should also say that though we appreciate the opportunity to take part in this consultation, frequent changes in accounting regulations do create an additional burden for small charities which, on the whole, prefer to become used to a standard form of reporting so that the annual completion of their accounts becomes a familiar and straightforward exercise.

The current position

3. Under the provisions of the Statement of Recommended Practice 2005, charity accounts may be prepared either on the receipts and payments basis or the accruals basis, depending on the income of the charity and whether or not it has been set up as a company. Receipts and payments accounting, consisting of an account summarising all money received and paid out by the charity in the financial year and a statement giving details of its assets and liabilities at the end of the year, may be adopted where a non-company charity in England and Wales has a gross income of £250,000 or less during the year: in Scotland the threshold is £100,000. Non-company charities with a gross income of over £250,000 during the financial year and all charitable companies must prepare their accounts on the accruals basis to show a 'true and fair view' of their financial position, with a balance sheet, a statement of financial activities and explanatory notes.

The problem

4. Churches and religious organisations are almost without exception charities; however, the differences across the sector are enormous. As charitable trusts they range in size from the Church Commissioners for England, with net assets in 2008 of £4,364.5 million, or the Church of Scotland with an annual *central* income in 2008 of £125 million (which does not, of course, include the incomes of individual congregations), to tiny independent congregations whose incomes are below the threshold for registration with the Charity Commission for England and Wales.¹ The

¹ In Scotland, all charities must register with the Office of the Scottish Charity Regulator, whatever their size.

overwhelming majority of religious charities are at the small end of the scale. Large religious trusts operate to full commercial accounting standards – and do not question the necessity of so doing – but what is appropriate for a large organisation is not appropriate or necessary for a very small one.

5. A further issue is the range of accountancy expertise across religious charities. Large religious organisations have their own national accounts departments, and even individual parishes will try if at all possible to appoint a church treasurer who is professionally-qualified with one of the accountancy bodies. But that is not always possible; and in many small congregations the finances are handled by volunteers without any formal training who may not even have access to IT. One of the reasons why we decided to respond to the ASB consultation is precisely because we suspected that much of the document would be unintelligible to the non-accountant with little knowledge of technical terminology. This is in no way a criticism of the drafting of the consultation document; rather, it is recognition of the fact that the level of technical expertise among church treasurers varies enormously.
6. In our view, the panoply of accruals accounting in its most complex form is inappropriate to small religious charities (and, indeed, to small charities generally) and a more realistic standard is required. We are not suggesting that small churches and charities should not produce annual accounts *in some form*: the argument is not about the principle that all charities should produce accounts but about the level of detail that is appropriate in each case. The Methodist Church, for example, holds to the view that all its congregations, however small, should at least produce a Short Form Summary.
7. The current distinction between accruals accounts for large charities and receipts and payments accounts for smaller ones seems to us to be a reasonable one – though one could obviously have a discussion as to where the thresholds for accruals accounts should be set in future and, as noted above, those thresholds are already different in England and Wales and in Scotland. The recent change in the accruals accounting threshold for England and Wales from £100,000 to £250,000 was a recognition of the balance between the difficulties faced by non-professional treasurers of charitable trusts and the need for public accountability; and we should be unhappy if that increase in the threshold were reversed

The consultation questions

8. At 3.12 the Board offers four main options for dealing with public benefit issues under converged UK GAAP:
 - i. A public benefit entity framework, similar to the Interpretation, – covering principles but not specific accounting requirements;
 - ii. A public benefit (not-for-profit) standard – setting out where different accounting is required for public benefit entities;
 - iii. Separate standards on public benefit issues – for example a standard on contributions, a standard on fund accounting, a standard on the presentation of the primary statements, etc; and
 - iv. Supplementary text in UK GAAP – for example separate paragraphs, or Application Notes, in a fixed asset standard on measuring the service potential of assets, or in a business combinations standard on acquisitions at nil or nominal value or merger accounting.

The second of these is the Board's preferred option.

9. Arising from that, Questions 11 and 12 are as follows:

Q11 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 issues?

Q12 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?

10. If what the Board is proposing under option ii is, in effect, a new SORP for charities, then we would support that preference. Charities are used to working with SORP; and we would not wish to see any radical change that would require treasurers of small charities, especially, to have to get to grips with an entirely new accounting system.

11. If a new public benefit entity standard is to be developed, it would be sensible:

- so far as possible to build on the existing SORP;
- to make the standard as comprehensive as possible, so that treasurers and examiners of accounts will be able find all the necessary information in one document; and
- to make sure that the standard is comprehensible to an intelligent layman, given that those who will be having to apply the standard will not necessarily be qualified accountants.

12. From the Churches' point of view, this last point is particularly important. Inevitably, there are increasing demands on financial officers in local congregations, with the result that volunteers for those posts can often be very hard to find. Guidance can be self-defeating when it is full of jargon and technical terminology; and any positive help which the ASB can give in recognising and supporting the vital role played at local level by the treasurers of small charities – and, especially, the need to retain their services – would be extremely welcome.

13. The document includes a table with examples of issues that the ASB believes are distinctive to the public benefit sector and could therefore usefully be covered in a public benefit standard, as follows:

Accounting issues	What is different about public benefit entities
The presentation of the primary financial statements	<i>Specific requirements may be needed for issues such as restricted assets; classification of expenditure (by object, function or programme?); how residual interest should be presented, etc.</i>
Fund accounting	<i>How to report different kinds of funds (restricted and unrestricted), the effect of conditions when resources are received and the way in which they are subsequently treated.</i>
Revenue from non-exchange transactions	<i>Non-reciprocal transfers, such as income from donations, legacies and grants, including the impact of any restrictions and conditions that might be attached to these contributions.</i>

Valuation of assets, including impairment	<i>Assets are generally held to deliver services to members of the public that are often free or subsidised. The absence of any direct cash inflows to the entity may result in these assets being valued in terms of their service potential.</i>
Business combinations	<i>Acquisitions may take place at nil or nominal consideration and there may sometimes be an alternative to acquisition accounting.</i>
Financial instruments, e.g. soft loans	<i>How to account for loans that are made (or received) at a below market rate of interest to support the economic and social policy objectives of a public benefit entity.</i>
Liabilities	<i>How to report liabilities for non-performance related commitments to provide public benefits or obligations arising from multi-year grant awards made by grant-giving charities.</i>
Identifying the reporting entity	<i>The boundary of a reporting entity is determined by the scope of its control – but how does this principle apply in the not-for-profit context, particularly in terms of the indicators of control?</i>
PFI schemes and similar contractual arrangements	<i>How should not-for-profit entities account for PFI/PPP contracts and similar arrangements?</i>
Narrative reporting	<i>How to report the extent to which the entity is achieving its strategic objectives, particularly with regard to service delivery and, more broadly, to promote accountability.</i>

14. The consultation document then poses the question :

Q13 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?

15. Not all of these are relevant to religious charities. There are, however, particular problems for some religious charities in valuing assets: what value, for example, would one place on a large, crumbling, Grade 1-listed mediaeval church that is massively-expensive to maintain: is it an asset or a liability? In particular, Church of England churches are always consecrated and Church of England churchyards usually so – and consecrated ground is inalienable in English law.² What is the asset value of a listed building or of inalienable land? The Church in Wales has decided to include *unlisted* churches in its balance sheet (based on the value of recent sales of redundant unlisted churches) but to exclude *listed* buildings on the grounds that they are a financial liability. The Methodist Church, on the other hand, uses insurance values in calculating the value of its assets. We would suggest that any guidance on asset valuation should be approached with such factors in mind.

16. To take a current, live example of the difficulties which churches and charities face in valuing assets: the Methodist Church is currently in dialogue with the Charity Commission for England and Wales about anomalies in the present SORP requirements which allow different approaches to assessing the valuation of the

² The same applies to land consecrated to the use of the Church in Wales; though in that case, the removal of consecration from land or buildings other than burial grounds is easier than in England, since all it requires is a documented decision by the diocesan bishop.

charity's property assets for inclusion in the balance sheet. These range from cost to current value. Churches which have a low figure for cost valuation may not be troubled by the gross asset calculation which can determine whether or not an audit is required; however, using current value may mean that the church in question has to incur the cost and additional work of an audit. On the other hand, when a building is sold, the church with a carrying market value may not be greatly affected by any gain on sale being treated as income (which triggers the requirement for accruals accounts to be prepared), whereas a charity using cost valuation may find its 'income' from such capital receipts or gains does indeed cause it to cross the accruals threshold. While it may be argued these are the swings and roundabouts of accounting requirements, they do not result in the equality that would normally result from such a position. In reality, each charity so affected is being penalised by virtue either of having an historic cost figure or of not having one, as the case may be.

17. It should be emphasised that we are not asking for a special exception to be made in the case of religious charities – in our view, such anomalies ought not be applied to *any* charity – but anything that could be done to mitigate or remove them would be welcomed.
18. Section 3 of the consultation document concludes with the suggestion at 3.20 that 'there may still be a need for certain public benefit sectors to continue to provide supplementary guidance on how to apply the accounting requirements of a public benefit entity standard'.
19. We agree: we would expect the Charity Commission for England and Wales, the Office of the Scottish Charity Regulator and (when they are fully operational) the Charity Commission for Northern Ireland and the Charities Regulatory Authority in the Republic of Ireland to be fully engaged in developing appropriate guidance.
20. In that connexion, Q14 asks whether, in cases where guidance is published to supplement a public benefit entity standard in sectors such as charities, housing and education, *the Board should provide a Statement confirming the guidance is consistent with UK GAAP, including the public benefit entity standard?*
21. We would assume that in such circumstances the issuing body (most likely, in our case, one or other of the various statutory regulators) would have cleared its guidance with the Board before issuing it. However, a Statement confirming that it had done so could do no conceivable harm.

Ireland

22. We note the footnote on page 6 to the effect that 'throughout this policy statement the term "UK GAAP" is used to refer to financial reporting requirements in the United Kingdom and the Republic of Ireland'. We therefore assume that this is a joint consultation document and that the final outcome will cover both jurisdictions. Given that several of our member-Churches operate either on an all-Ireland basis or across the United Kingdom and Ireland as a whole, it would be unfortunate if radically-different charity accounting standards were applied north and south of the Border.

Frank Cranmer
Secretary, CLAS
29 January 2010

Annex: Members and Associate Members of CLAS

Archdiocese of Thyateira and Great Britain (Greek Orthodox Church)
Assemblies of God in Great Britain and Ireland
Association of English Cathedrals
Association of Grace Baptist Churches (SE)
Baptist Union of Great Britain
Baptist Union of Wales/Undeb Bedyddwyr Cymru
Church Communities UK
Church in Wales/yr Eglwys yng Nghymru
Church of Christ Scientist
Church of England
Church of Ireland
Church of Scotland
Churches Together in Britain and Ireland
Churches Together in England
Congregational Federation
CYTÛN
Elim Foursquare Gospel Alliance
Evangelical Alliance
Evangelical Presbyterian Church of England and Wales
Fellowship of Independent Evangelical Churches
Free Church of Scotland
Free Churches Group
General Assembly of Unitarian and Free Christian Churches
Independent Methodist Churches
London City Mission
Lutheran Council of Great Britain
Methodist Church
Mission to Seafarers
Moravian Church
Presbyterian Church in Ireland
Presbyterian Church of Wales/Eglwys Bresbyteriaidd Cymru
Religious Society of Friends (Quakers)
Roman Catholic Church in England and Wales
Roman Catholic Church in Scotland
Salvation Army
Scottish Episcopal Church
Seventh-Day Adventist Church
Union of Welsh Independents/Undeb yr Annibynwyr Cymraeg
United Free Church of Scotland
United Reformed Church
United Synagogue
Wesleyan Reform Union

[We should also note that the Association of Church Accountants and Treasurers is a Professional Member of CLAS – the Association obviously has a particular interest in this matter.]