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Dear Mr Godsall

Policy Proposal: The Future of UK GAAP

The Charity Commission and the Office of the Scottish Charity Regulator act together as the joint SORP-making body for UK charities and our response to your consultation is made in that capacity. Your recent consultation document setting out the ASB's policy proposals for 'The Future of UK GAAP' was considered by our SORP Committee at its last meeting and our response incorporates the views and advice we have received from that Committee.

We and our SORP Committee strongly support the ASB's proposal to develop a Public Benefit Entities Standard based on IFRS for SMEs, supported by a sector-specific Charities SORP. We believe this standard should be a 'stand-alone' standard rather than one which simply addresses the differences for our sector. We believe that it is important for all efforts to be made to develop the standard in an accessible style reflecting the needs of our constituency. The ASB also need to be aware of the call for a proportionate approach in the context of smaller charities which predominate in our sector. We would encourage the ASB to give full consideration during drafting of particular treatments or disclosures that might be disapplied in the context of smaller charities.

There is also concern that using the term 'Public Benefit Entities' to describe the wider not-for-profit sector is problematic in that charity law in both our jurisdictions gives particular meaning to the term 'public benefit' and is the defining characteristic of charitable activity.

Our response to the specific questions raised in your consultation document is attached as an appendix to this letter. If particular issues arise from this response, we and our SORP Committee would welcome the opportunity to discuss these further with you.

Yours sincerely

Andrew Hind
Chief Executive
Charity Commission

Jane Ryder
Chief Executive
Office of the Scottish Charity Regulator

cc: Andrew Lennard
Alan O'Connor

Appendix

ASB Consultation on 'The Future of UK GAAP'

Response from the Joint Charities SORP-making Body

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?

Charities operate for the public benefit and receive substantial financial support from both individual donors and through the public purse and as such should operate in an accountable and transparent manner. However, that accountability needs to be gauged in the context of the information needs of stakeholders. 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. In may be that the nature of the 'public accountability', as used in the consultation document, is closer to a concept of 'market accountability' in that full IFRS meets the information needs of institutional and other informed investors. We believe there would be merit in ASB exploring this link with market and investor needs more fully as this project develops.

Accountability as it applies to the charity sector can best be addressed through the development of an appropriate standard for our sector and supported by a Charities SORP. Our view is that the proposed 'Public Benefit Entity Standard' supported as necessary by a Charity SORP is likely to provide a model that is more likely to provide accountability in a manner that is relevant to our sector's stakeholders needs.

Sector stakeholders already express concerns about complexity and accessibility of financial reporting and the application of full IFRS would potentially add to those concerns. It is therefore important to remember the need for a proportional approach. The vast majority of charities are small and the application of full IFRS would also place a burden on them beyond their financial and technical resources.

We therefore strongly support the view that the concept of 'public accountability' should be defined in terms of those sectors for which full IFRS has been primarily designed, that is, entities whose debt or equity instruments are traded in a public market.

We also believe it will be necessary to ensure that definition of 'holding assets in a fiduciary capacity' to be further considered to ensure that assets held as charity trustee fall outside this definition.

ASB Consultation on 'The Future of UK GAAP'

Response from the Joint Charities SORP-making Body

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

In our view 'Tier 1' should be limited to those entities that issue listed debt or equity and to deposit takers. Whilst charities should operate in an accountable and transparent manner that accountability would not be achieved through the adoption of full IFRS for the reason set out in our response to Question 1. Accountability as it applies to the charity sector can best be addressed through the development of an appropriate standard for our sector and supported as necessary by a sub-sector SORP.

There are a small number of charities that have issued listed debt. In such cases, we concur that their accountability to the markets should be achieved through the application of full IFRS in 'Tier 1'. However, such charities also have accountability to their charity stakeholders and should apply the methods and principles of any future 'Public Benefit Entity Standard' and the Charities SORP in relation to those aspects of their affairs and activities not directly addressed by commercial standards.

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?

Provided 'public accountability' is defined in relation to entities issuing listed debt or equity and deposit takers then we concur that consistent accounting policies within a group is generally appropriate. However, the cost to groups with a large number of subsidiaries needs to be considered and in our view it is important to question the degree to which capital markets rely on information obtained from entity as opposed to group accounts.

We are aware of the view held by some public sector accountants that charities may be operated as a subsidiary of a public body. Whilst we do not concur with this view, we feel that entity accounts of charities should follow the proposed 'Public Benefit Entity Standard' and the Charities SORP rather than IFRS where a public body or other non-charitable body is perceived to control the charity and not the accounting policy adopted by any perceived non-charitable parent entity.

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.

ASB Consultation on 'The Future of UK GAAP'

Response from the Joint Charities SORP-making Body

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

Our preference is for the development of a 'Public Benefit Entity Standard' supported by a Charities SORP within the 'Tier 2' arrangements which would apply generally to charities.

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.

Provided the ASB retains the right to make amendment should a particular treatment later prove to be better suited to UK accounting needs then wholesale adoption of IFRSs for SME would appear to be a pragmatic initial way forward for the for-profit sector. We understand that IFRS for SMEs will be adopted into UK GAAP and as part of UK GAAP the ASB will retain the right to amend the adopted standard to meet UK needs if this should prove necessary.

However, the direct adoption of IFRSs for SME for the UK charity sector would not provide an appropriate solution (please also see our responses to Questions 10, 11 and 12) due to the unique nature of certain issues applying to charity sector accounting, many of which have been helpfully identified in section 3 of the consultation.

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 proposed 'Public Benefit Entity Standard' based on IFRSs for SME.

'Public accountability' for charities has been developed by the Charities SORP through distinctive reporting in the annual report and a specific accounting regime, underpinned by charity law, which facilitates the application of UK GAAP to the charity sector. This has led to a greater emphasis on narrative reporting, an approach supported by feedback from the series of SORP roundtables, rather than a more complex set of accounting disclosures and requirements whose relevance relates primarily to capital markets. We do not believe that requiring large charities to adopt full IFRS would result in increased accountability in a way that would have meaning for their stakeholders. For these reasons, we concur that charities should fall within 'Tier 2' and apply the 'Public Benefit Entity Standard' that will address their needs. The application of the standard should be supported, as at the present time, by a Charities SORP.

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

We recognise that the adoption of IFRS will create considerable learning and training needs, the costs of which may present a perceived burden on small business. Against that it is hard to envisage a dual system of standards operating in the UK indefinitely.

In the context of smaller charities, we anticipate a move to IFRS will create similar challenges. In England and Wales and Scotland 97% of registered charities have an income below £1m (186,000 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.

However, our preference is not to retain the FRSSE. We believe that charities in the UK need to report under a single accounting framework. That framework is best addressed through a 'high- level' 'Public Benefit Entity Standard', with its application for the charity sector addressed through a Charities SORP. The proposed 'Public Benefit Entity Standard' and the Charities SORP both need to recognise the size distribution of charities in the UK and therefore give full consideration to the applicability of particular requirements and disclosures to small charities.

If the FRSSE is to be retained beyond a short transition period then guidance is likely to be needed to interpret this commercially developed standard for charity sector application and to provide recommendations on transactions and arrangements not directly addressed by the FRSSE. It would therefore be essential to retain a UK GAAP based Charities SORP to enable the FRSSE to be appropriately and consistently interpreted and applied by smaller charities during any transition period. The maintenance of the FRSSE and two charity specific SORPs, one applying UK GAAP and the other applying to the proposed 'Public Benefit Entity Standard', would in the longer term add further complexity and cost in addition to the loss of some comparability between charities.

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?

It would be undesirable to retain two accounting frameworks, UK GAAP and IFRS, beyond a short transition period. A commitment to the maintenance of UK GAAP would possibly be inherent in any long-term retention of the FRSSE as would the maintenance of a UK GAAP based Charity SORP. We therefore agree the FRSSE should be replaced by IFRS for SME or in the case of charities by an accessible stand-alone 'Public Benefit Entity Standard' applicable to charities as soon as practicable.

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

SORPs should continue where it can be demonstrated that a particular industry or sector has particular accounting or reporting issues that require the clarification or interpretation of standards.

The analysis of the feedback from the recent series of Charity SORP roundtables prepared by academics from Queen's University Management School, Queen's University, Belfast notes that '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'. The series of 28 separate SORP Roundtable events was attended by over 1000 sector representatives and nearly 700 questionnaires where returned. This together with records of roundtable discussions provides both empirical and qualitative evidence of stakeholders views on the relevance and importance of the Charities SORP to the charity accounting framework in the UK.

Charities, particularly smaller charities, often rely on volunteers. Volunteers fill the roles of trustee, manager, treasurer or book-keeper and often independent examiner. The support for the Charities SORP stems from it providing a 'one-stop shop' of manageable length drafted in an accessible style. It reduces the need to read separate accounting standards and provides formats and guidance on the types of transaction and situations charities are likely to encounter. The SORP Roundtable events also articulated a demand to further simplify the language of the SORP and gear it more towards smaller charities preparing accruals accounts.

The messages we have received from the SORP Roundtable events may also have relevance to the ASB as this project develops, for example, the need to consider the scope for excluding more complex disclosures for charities below certain thresholds and the need to carefully consider the language and style used within the 'Public Benefit Entity Standard' so as to ensure maximum accessibility

That said, we believe there will still be the issues of form and content of charity accounts and particular disclosures that may not be addressed by even a 'Public Benefit Entity Standard'. Indeed, it appears likely to us that given the very broad constituency that a 'Public Benefit Entity Standard' will need to cover and the range of issues to be addressed that a 'high-level' approach may be necessary. This would give further weight to retaining a Charities SORP within the new framework.

The Charities SORP has also been extremely helpful to practitioners in bringing together accounting standards, legal requirements and narrative reporting into a single document. In particular, a need will still exist to draw together the proposed standard and charity law across the three legal jurisdictions of the UK. A SORP will also remain relevant to users who value the accessibility it provides. The value of the Charities SORP in advancing and maintaining standards of financial reporting in the public interest has been well demonstrated. In our view the SORP will remain necessary in helping our sector make the transition to a framework based on IFRS.

We are also aware that some concerns exist that the diversity within the public benefit sector is such that a single 'Public Benefit Entity Standard' might not be able to address. Within the charity sector separate SORPs exist for Registered Social Landlord and Higher and Further Education. Whilst a single standard might promote consistent treatment, we are aware that a single 'Public Benefit Entity Standard', in whatever form this takes, might be insufficient to capture this diversity without substantially compromising the key principles of financial information.

In our view, this risk should not prevent the scoping of these issues. If certain issues prove to require different treatment within particular sub-sector then this would simply point to the need for the retention of a SORP for those sub-sectors. Also diversity might point to the standard being developed at a high-level and again this would point to the need for SORPs to address application issues within particular sub-sectors. We do not believe these potential difficulties should be used as an excuse not to develop a 'Public Benefit Entity Standard'.

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 strongly support the ASB's proposal to develop a 'Public Benefit Entity Standard'.

Section 3.15 of your consultation recognises many of the issues that are distinctive to the public benefit sector. The ASB's 'Interpretation for Public Benefit Entities of the Statement of Principles for Financial Reporting' recognised that public benefit entities have different objectives, different operating environments and different operating requirements'. However, whilst this provided a valuable source in assisting our sector interpret commercially developed standards, it provided no substitute for the recommendations provided by the Charities SORP.

The need to interpret commercially developed standards will be as great, perhaps even greater, in the context of IFRS. In our view this need will be best served by the development of a 'Public Benefit Entity Standard' that:

- Provides a 'one-stop shop' approach capable of providing a single coherent and accessible standard for the charity sector. We do recognise that the constituency covered by this proposed standard is very broad and that the number of issues to be addressed are numerous. This may point to a high-level standard that is supported in its application by SORPs.

- Recognises the vital importance of narrative reporting and sets principles for the annual report as well as accounting accounts. Again, we recognise that a high-level standard may point to narrative reporting continuing to be addressed directly by relevant SORPs.

- Is accessible and relevant as possible, and uses the existing international accounting standard designed for small and medium sized enterprises as its model.

- Recognises the need for a proportionate approach in the context of smaller charities. In particular, due consideration of particular treatments or disclosures that might be disapplied in the context of smaller charities.

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 with a single standard covering at a high level the requirements for preparing a true and fair accounts using IFRS for SMEs as the basis for this work. The advantage of a one-stop shop approach as provided by the SORP lies primarily in giving our constituency a single reference point which will assist preparers in apply the standard, help enable implementation and also provide greater accessibility to preparers of charity accounts and trustees.

Given the breath of the issues to be addressed and the broad constituency that fall with the current definition of public benefit entities, we believe it will prove essential for SORPs to continue to provide guidance to the various sub-sectors applying the proposed standard. We have set out in our response to Question 11 the criteria we believe must be met to ensure the successful development of a 'Public Benefit Entity Standard'.

It is essential that the burden of implementation is minimised and proportionate. These objectives can be best achieved through the development of a high-level, stand-alone 'Public Benefit Entity Standard' supplement by SORPs which focus on particular sub-sector needs.

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?

We concur with all items included in the table included within your consultation. Inevitably as the project proceeds further issues will almost certainly be identified and others will arise with a detailed examination of the SME standard itself. As previously highlighted to the ASB in correspondence, we believe successful development will be dependent on working closely with the charity sector and the Charities SORP Committee. This liaison should provide a safeguard against the risk of any failure to indentify key issues which will need to be addressed. Some issues may simply be an expansion of those already identified, for example, accounting for volunteering and donated resources might be regarded as a sub-set of 'revenue from non-exchange transaction' which is already identified within the consultation.

The list might usefully include heritage assets given the recent issuing of 'FRS 30' although again this might be regarded as a sub-set of 'Valuing assets' which is again already identified. Similarly, whilst the issue of recognition of liabilities arising from multi-year grant liabilities is included, it should be noted that similar recognition issues can arise in relation to the point of recognition appropriate for promises of donation to charities.

There are also a number of high-level factors that impact on how charities operate that may impact on how commercially developed standards should apply. The identification of these high-level factors may assist the ASB when considering the application of IFRS to charities. These factors include:

- **No owner interest:** At the point that money or assets are gifted to a charity it ceases to be the property of the donor and is impressed with charitable trusts. The charity itself has no owners since private benefit, except where it is incidental or a by-product of the charity's work or is otherwise specifically authorised, is not permitted. A charity pays no dividends or profit shares to non-charitable owners.

- **Public money and fundraising:** Charities hold public money whether received by way of gift, in exchange for goods or services, or by way of charitable appeal, subscription, or from investments. All the funds, however acquired, may impressed with charitable trusts or limited in its use, by constitutional provisions, to particular activities. A particular and distinctive form of fundraising is an appeal seeking financial support by way of gift from donors, whether public bodies, corporate bodies, private businesses or private individuals or other charities. These public appeals and the nature of money held for the public benefit are unique to charitable activities.

- **Public interest and tax relief**. Charities are not restricted to only providing goods and services which are not provided either by the public bodies or by commerce. Charities promote civic endeavour for the public benefit and enjoy certain tax privileges unavailable to public bodies or commerce. There is therefore a legitimate public interest, articulated through Parliament and government, in the conduct of charities benefitting from tax relief. This is because these tax reliefs are not intended to promote economic behaviour but charitable endeavour.

- **For public benefit:** Charities are established expressly for exclusively charitable purposes for the public benefit. The law defines what charitable purposes are and public benefit is explicitly focussed on the beneficiaries of the charity who may or may not have donated to that charity. Whilst the charity has a beneficiary focus, those same beneficiaries have no ownership rights over the charity but their interests (both current and future beneficiaries) are the focus of the charity's endeavours.

- **Charities are independent and the trustees act solely in its interests:** Charity trustees are responsible in law for ensuring that the charity's activities are within its charitable purposes and for the public benefit and funds are not spent in breach of trust, otherwise they risk personal liability for any loss. Charity trustees are not owners because the charity's assets are not their own, neither are they normally employees (as private benefit is forbidden unless expressly authorised), nor are they normally beneficiaries (unless a beneficiary on the same basis as the general class of beneficiaries).

Another issue that will require consideration and close liaison is the interplay with the legislative framework for charities in the differing jurisdictions of the UK. ASB must give careful consideration to the lead time necessary for legislative amendments and the interplay between statutory disclosures and the standard. An example might be related party transactions and legislative requirements in relation to trustee remuneration and expenses.

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?

We welcome the ASB's recognition that there may be a continuing need for guidance to supplement a 'Public Benefit Entity Standard'. We believe that this view is overwhelming supported within the charity sector. The feedback received from the recent series of Charity SORP roundtables events indicated that 'it is clear that the SORP product is overwhelmingly supported by stakeholders'.

We believe the SORP-making process and a SORP's 'certification' by the ASB helps underpin the authority of any SORP and promotes its adoption by the relevant sector. It would therefore be extremely disappointing if the ASB withdrew from providing a statement confirming such guidance was consistent with UK GAAP or, in the future, the 'Public Benefit Entity Standard'. Such action would reduce the authority of such guidance and impact on compliance. In so far as any 'Public Benefit Entity Standard' will form part of UK GAAP it appears to us that the provision of a statement by the ASB remains procedurally possible. In our view such a statement is also extremely desirable.

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 SORP Committee recognises that a move to IFRS will place a considerable cost burden on charities. Costs will be incurred in training and in initial periods through time spent in applying new standards to the preparation of accounts. 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.

It is important that this cost burden is minimised. As previously identified, the development of a stand-alone 'Public Benefit Entity Standard' will help ensure issues relevant to the charity sector are addressed. However, this standard will need to be supported by a Charities SORP if relevance and accessibility are to be ensured. The Charities SORP in providing accessibility can also help ensure costs of this change are minimised by addressing issues in the context of a charity framework.

The Charities SORP has the potential to make a significant contribution to the transition to a new IFRS framework. Indeed, without the retention of a Charities SORP, the implementation of the proposed 'Public Benefit Entity Standard' will be significantly impeded. As explained more fully in our response to Questions 8, the profile of the charity sector in the UK is heavily skewed towards the small where in-house accountancy skills are often in short supply. The Charities SORP, in addition to addressing transactions common to charities where standards are silent, has provided accessibility to accounting standards themselves.

Some concerns remain that IFRS will result in greater complexity making financial reporting less relevant to charity sector stakeholders. ASB need to be aware of this risk. As mentioned in our response to Question 11 above these risks can be mitigated by:

- Ensuring the drafting of the standard is accessible and relevant as possible, and uses the existing international accounting standard designed for small and medium sized enterprises as its model. To be accessible to our sector, we would encourage a plain-English drafting style be adopted as far a possible.

- Recognising the need for a proportionate approach in the context of smaller charities. In particular, due consideration of particular treatments or disclosures that might be disapplied in the context of smaller charities.

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

Adoption of the IFRS framework for financial years beginning on or after 1 January 2012 is optimistic particularly once development and consultation time is considered. The development of a stand-alone 'Public Benefit Entity Standard' will take time unlike the adoption of IFRS for SMEs by commercial companies which is designed to be adopted without significant modification.

Moreover, if the standard is to be support by a Charities SORP, then further development and consultation time will need to be built into the programme. Legislative changes are likely to be needed to the charity frameworks within the legal jurisdictions of the UK. Any such legislative changes will also require consultation and perhaps parliamentary time. It is very unlikely that this could all be achieved within the time-line proposed.

However, it would be undesirable for implementation of the proposed 'Public Benefit Entity Standard' to lag too far behind the transition date for other entities. Moreover, in that many charities have non-charitable subsidiary companies, it could result in charities having to apply two accounting frameworks within the context of a single group. Delay might also send an inappropriate message to the charity sector suggesting that their reporting framework was being given less priority than commercial entities.

A long delay would also put pressures on SORP-making bodies to revise and reissue their current SORPs. From our perspective, it would be undesirable and costly to prepare and issue an updated SORP based on current UK GAAP with a limited shelf-life. Experience has shown that it takes a couple of years for a new SORP to fully bed-in and therefore any interim revision, pending the development of the proposed 'Public Benefit Entity Standard', may well be counter productive. Moreover, a new SORP creates compliance costs for our sector and therefore a single-stage move to an IFRS based standard is desirable.

It is also important for the ASB to liaise and communicate a clear plan and timetable to avoid ongoing uncertainty. This timetable must recognise the need to co-ordinate with relevant government departments where legislative changes will be needed to implement proposals. END