Annex B: Charity Commission and Office of the Scottish Charity Regulator response as the Joint SORP-making Body for UK Charities to the ASB's consultation on the 'Revised Financial Reporting Exposure Drafts'

1. Objective of Financial Reporting Standards

Q1: The ASB is setting out the proposals in this revised FRED following a prolonged period of consultation. The ASB considers that the proposals in FREDs 46 to FRED 48 achieve its project objective: To enable users of accounts to receive high-quality, understandable financial reporting proportionate to the size and complexity of the entity and user's information needs. Do you agree?

1.1. The final suite of standards provides a proportionate approach to aligning UK GAAP with international practice. In our view, the ASB has shown commendable pragmatism in its approach, for example in its treatment of Financial Instruments.

1.2. The framework, including the PBE SORPs, is capable of delivering high quality financial reporting provided a small number of significant issues affecting PBE accounting are addressed. We have set out in appendix A of this response what we consider to be the essential amendments to FRED 48 necessary to provide a workable financial reporting framework for charities.

2. Disclosure requirements for Financial Institutions

Q2: The ASB has decided to seek views on whether:
As proposed in FRED 47: A qualifying entity that is a financial institution should not be exempt from any of the disclosure requirements in either IFRS 7 or IFRS 13; or
alternatively: A qualifying entity that is a financial institution should be exempt in its individual accounts from all of IFRS 7 except for paragraphs 6, 7, 9(b), 16, 27A, 31, 33, 36, 37, 38, 39, 40 and 41 and from paragraphs 92-99 of IFRS 13 (all disclosure requirements except the disclosure objectives).
Which alternative do you prefer and why?

2.1. Only a small number of charities will fall within the definition of an investment institution and it will be appropriate for such charities to adopt the particular disclosure requirements that will apply to the generality of financial institutions. Where a bank or collective investment scheme is operated by a charity then it is important for that entity to meet reporting requirements required of both a financial institution and a PBE.

2.2. We also welcome the decision to update the SORP for Authorised Funds as regulations made under the Charities Act require charitable common investment funds to adopt this SORP as they provide collective investment services for other charities.

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3. <u>Cross references to EU- adopted IFRS</u>

Q3: Do you agree with the proposed scope for the areas cross-referenced to EU- adopted IFRS as set out in section 1 of FRED 48? If not, please state what changes you prefer and why.

3.1. We have no comments on this question.

4. <u>The definition of a financial institution</u>

Q4: Do you agree with the definition of a financial institution? If not, please provide your reasons and suggest how the definition might be improved.

4.1. We are uncertain whether the definition of a financial institution seeks to include entities which provide an insurance brokerage service. Charities or their subsidiaries may, on occasions, provide insurance brokerage services for their beneficiaries. In our view, it would not be proportionate to include entities undertaking retail insurance broking activities within the definition of a financial institution particularly if client assets were not held.

4.2. In furthering their charitable aims, charities operate micro credit activities overseas to assist beneficiary groups. Such initiatives are intended to develop sustainable activities and to lift beneficiaries out of debt to attain better living conditions. These micro credit activities are in furtherance of charitable purposes and we would seek their specific exclusion from the definition of a financial institution.

4.3. On occasions, charities with common trustees pool their investment funds. These internal arrangements are intended to reap economies of scale in investment rather than engage in investment business for profit and again it would not be proportionate for such arrangements to create a need to report as a financial institution.

5. <u>Specialist activities</u>

Q5: In relation to the proposals for specialist activities, the ASB would welcome views on:
a) Whether and, if so, why the proposals for agricultural activities are considered unduly arduous? What alternatives should be proposed?
b) Whether the proposals for service concession arrangements are sufficient to meet the needs of preparers?

5.1. We have no comment on the issues raise (a) or (b). However, we do have significant concerns relating to parts of the standard that determine the recognition basis for non-exchange transactions (grants and donations) in Public Benefit Entities. The proposals in FRS 102, as they stand, will introduce a radical change to the way in which restricted income and funding commitments with repayment conditions are recognised in charity accounting.

5.2. We have set out in appendix A of this response what we consider to be the essential amendments to the proposals in FRS 102 necessary to provide a workable financial reporting framework for charities.

6. Retirement benefit plans

Q6: The ASB is requesting comment on the proposals for the financial statements of retirement benefit plans, including:
a) Do you consider that the proposals provide sufficient guidance?
b) Do you agree with the proposed disclosures about the liability to pay pension benefits?

6.1. We have no comment on this question.

7. Related party disclosure requirements

Q7: Do you consider that the related party disclosure requirements in section 33 of FED 48 are sufficient to meet the needs of prepares and users?

7.1. We have no comment on the application of related party disclosure requirements for transactions involving for-profit entities. However, in the context of charities holding funds on trust and operating using trading subsidiaries, the disclosure of related party transactions between the subsidiary and the parent charity is important to the users of the financial statements. Research conducted by IPSOS MORI for the Charity Commission in 2010 found that donors and financial supporters want to know how the charity has spent their money and what activities the charity has undertaken. The extent to which subsidiaries are used by the charity to further its activities and the transactions between the parent charity and a subsidiary provides important information to donors on how the charity has spent their money.

7.2. FRS 101 is to apply to the accounts of a qualifying entity which is not a financial institution. FRS 101 would apply to the individual accounts of ultimate parent charity and its subsidiaries. It is therefore important that paragraph 8 (l) of FRS 101 disapplies the disclosure exemption in relation to transactions between a parent charity and its subsidiaries. This would also ensure that FRS 101 is consistent with charity law which, in requiring the approval of a charity regulator to specified transactions between a subsidiary and a parent charity, highlights a public interest in such transactions.

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8. Effective date

Q8: Do you agree with the effective date? If not, what alternative date would you prefer and why?

8.1. We welcome both the certainty that a specific implementation date of 1 January 2015 brings and the ASB's undertaking that there will be a minimum of an 18 months transition period between the issuing of standards and the implementation of new UK-Irish GAAP. We also welcome the provision that early adoption by entities covered by a PBE SORP will not be permitted until the relevant PBE SORP has been developed in accordance with the new standards.

8.2. The future of the FRSSE is important to the charity sector as 99% of charities are eligible to use the FRSSE. The research carried out for the Charities SORP Committee (reported in December 2010) found that overall 30% of charities eligible to use the FRSSE currently opt to use the FRSSE.

8.3. The next Charities SORP will seek to address the needs of all charities whether they adopt the FRSSE or FRS 102. We are aware that new EU accounting directives that will apply to both small and micro-entities may result in the development of a revised FRSSE. We also note that a further consultation is planned on options for the FRSSE's future development.

8.4. We appreciate that the timing of any revision to the FRSSE is dependent on the adoption of new EU accounting directives into UK law. However, there would be distinct advantages in co-ordinatinating changes to UK standards if at all possible so that the implementation dates of the new FRSSE and FRS 102 were the same. As you will appreciate, a revision of the FRSSE would result in a need for changes to be made to the Charities SORP and possibly charity law regulations. Such changes would be problematic and may be seen by the charity sector as very disruptive if they were to follow shortly after the publication of a new SORP in 2014/15.

9. Alternative view

Q9: Do you support the alternative view, or any individual aspect of it?

9.1. We do not agree with the alternative view that the primary objective of accounts is going concern with stewardship as a secondary consideration. Stewardship reporting has particular importance in the context of financial reporting by charities. Research conducted by IPSOS MORI for the Charity Commission in 2010 found that '96% (of respondents) say it is important to them that charities provide information about how they spend their money' and '89% also say that it is important to them that charities explain in a published report what they have actually achieved.' Nor do we see the FRSSE, FRS 101 and FRS 102 being inconsistent with providing information in accessible format.

9.2. However we do agree with the alternative view that when reviewing the FRSSE, FRS 101 and FRS 102 the ASB should aim to further remove unnecessary complexity and clutter by aiming to reduce the number of disclosures required.

9.3. For example, the opportunity could be taken now to remove the disclosure requirements relating to mergers PBE34.87 (c) and (d) which require considerable analysis of limited benefit to the users of the accounts. We also agree that the reporting of defined benefit pension schemes includes extensive and detailed disclosures that is of limited value and often not understood by the user of charity accounts. Also the requirement to disclose unrecognised commitments (34.61) appears to require unnecessary details since such items are not commitments as they are not legal or constructive obligations but represent future intentions and not transactions.

9.4. Preparers might also be encouraged to avoid immaterial disclosures with a reference to materiality being added to paragraph 8.1 of FRS 102 to state that 'notes provide narrative descriptions or disaggregations of *material* items presented'.

9.5. We would welcome a full review of the disclosure requirement of UK GAAP to ensure that disclosure requirement are set in the context of an agenda of eliminating unnecessary complexity and cutting clutter. However, we would not wish to see further delay in the introduction of a new framework or until such time as the IASB has completed and published its review of the IFRS for SMEs.