

LETTER OF COMMENT NO. 3



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Your Ref:

Our Ref:

nkd/AccPolicy

Date:

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Dear Sir.

Preliminary Views on Financial Statement Presentation

The Charity Commission is established by law as the regulator and registrar of charities in England and Wales. Our aim is to provide the best possible regulation of these charities in order to increase charities' efficiency and effectiveness and public confidence and trust in them.

We are supportive of the work of the 'Monitoring Group' (Chairs of AASB, CASB, NZFRSB and UKASB) and in common with them wish to take the opportunity to comment as the IASB develops its thinking for for-profit commerce since the intention is then to modify that framework for not-for-profit entities at a later date. In the development of the for-profit framework a concern remains that in a desire for consistency insufficient weight will subsequently be given to the particular requirements of reporting not-for profit entities.

Our response to the preliminary views focuses on those questions which have a bearing on the potential for developing a not-for profit variation of the financial statement presentation. We applaud the research the Board has undertaken in understanding the needs of users and the criticisms of users of the current formats. We note the observation that further research (paragraph 1.18a) would be needed to see how the presentation requirements and practices apply to not-for-profit entities. The Commission, together with our partner the Office of the Scottish Charity Regulator, has been undertaking our own research on stakeholder requirements with over 20 events held to date and further events planned across the UK. Events have been tailored to funders, financial supporters, preparers, auditors and other stakeholders to understand how financial reporting by UK charities can better meet user needs and we have had views from over 600 participants to date. This work has included reviewing the form and content of the performance statement and balance sheet. A comprehensive report on the findings of our research is to be provided by Queen's University, Belfast and it will have an important application in further developing the UK Statement of Recommended Practice for accounting by charities.

There are parallels between the IASB's own preliminary views and the preliminary feedback we have obtained. Key areas of similarity are:

- The early views from the funders of UK charities is that they want to how a charity's
 activities are financed and by whom. This desire matches that of the preliminary view
 (paragraph S4) where an emphasis is put on the way an entity funds of finances its
 activities.
- Also funders seem keen to know not just what activities a charity has undertaken, as reported on the face of the performance statement, but wish to see a breakdown of those costs on a natural basis (preliminary view paragraph S11).
- That where practicable, after allowing for the unique requirements of UK trust law and the
 reporting of the nature of charitable funds held, the performance statement is as
 comparable to the commercial model as possible. The development of a Statement of
 Comprehensive Income and the potential to include the equity element within it provides a
 useful model for adaption.
- The need to improve the understandability of the statements with an emphasis on clarity and simplification where practicable. The complexity of accruals accounting and the extensive notes have been a source of critical comment, especially the length of the pension disclosure for defined benefit pension schemes.

A general observation is that the new Statement of Comprehensive Income format provides a very logical and clearer analysis but is rather long. There may therefore be a need for a summary of key figures in the accompanying management commentary (paragraph 1.21f) to assist the reader.

Response to the consultation questions

- 1. We support the objectives as set out but disaggregation will always involve an element of professional judgment and the contribution of the auditor in ensuring that material items are appropriately disclosed or by way of emphasis of matter the reader is alerted to material non-disclosure.
- 2. The illustrative example Toolco shows how the differentiation of operations from financing brings clarity. The differentiation of the activities undertaken by the charity from its fundraising activities is an approach already adopted in UK charity accounting. The SORP requires charities to disclose the nature of their activities on the face of the performance statement or analysed by way of note. This ensures the reader knows what charity actually does with its funds.
- 3. Equity is a separate class of investment in a business and the IASB is rightly guided by the users of commercial accounts on this matter. The attraction of including equity within the statement from a not-for-profit perspective is that a single comprehensive statement in a commercial context, inclusive of equity, conceptually matches the single performance statement already used by UK charities. The separation of an Income and expenditure Account and a Statement or Recognised Gains and Losses in UK GAAP brings complexity and requires a higher technical understanding. A single statement offers a potentially simpler solution.

- 5. We favour a management approach at the potential price of consistency. In the circumstances of UK charities our research indicates that users want to see sufficient flexibility within the performance statement for each charity to reflect its operational character and this will involve a different approach to analysing operational activities. Standardisation is more realistic with financing activities such as fundraising or investing activities such as for-profit subsidiaries. A management approach will require analysts to undertake additional work and sector benchmarking may be a more complex exercise but we would argue that the transparency of the accounts and competitive pressure, in the case of charities for funds, would lead to a degree of comparability.
- 14. We are supportive of the analysis within the proposed Comprehensive Income Statement. Our research indicates that users want to be able to clearly identify key figures such as whether a charity has net incoming or outgoing resources (loosely an equivalent to net income) and to identify total income and total spend. We welcome the component approach which will provide a template: operational, investment and financing which can be adapted to a not-for-profit context.
- 16. We welcome the disaggregated approach. It is one already adopted in the SORP for UK charities and enables the reader to distinguish the core work (or business) of the charity from fundraising or investing activities. The Toolco example goes a stage further by matching the income and related expenses and throwing a subtotal. Although some respondents to our research favour this approach, it has not been a request for change made by many. The proposed approach offers clarity in identifying the net contribution made to performance by each business component but does create a longer and more complex presentation.
- We can see the logic behind analysing assets and liabilities in order of liquidity which helps the reader understand the financial position of the entity and its capability to remain a going concern.

Should you have any enquiry on our response or wish to discuss its contents please contact me.

Yours faithfully.

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