**Charity Accounting Update**

Hello my name is John Caladine and welcome to this podcast on latest developments within the charity accounting world.

I’m sure if you listen to my previous podcasts you’ll be only too aware of my doubts as to whether the long awaited Charitable Incorporated Organisation, CIO for short, would ever arrive on the statute books. It has been promised for so many years, was eventually introduced in the Charities Act 2006. We still await the sets of regulations and orders which are to be made by the Home Office, to be called the Charitable Incorporated Organisations General Regulations etc.

The Charity Commission have published some helpful guidance in recent months, but if you look on their website much has still to be issued, and of course all of it has to be agreed by Parliament, and therefore it does still seem a long way off. What is becoming evidentially clear is that the CIO will only be of use to the smaller charity, looking for a legal structure other than being unincorporated and therefore offering limited liability protection. What has been announced, it should be noted, is that unlike a charitable company, the CIO will have no way to offer a debenture or secure a charge over its assets as the security for any borrowing. This means that if the CIO wishes to borrow money, the individual trustees may be called upon to give a personal guarantee. As you can appreciate, this therefore destroys altogether the whole purpose of a CIO, which was supposed to offer unlimited liability protection.

Any charity operating with property and seeking to borrow money will have to continue to use the existing company limited by guarantee charitable company route. I have of course said this to many clients over recent years, that it is very unlikely that the CIO will be of much use, other than for very small charity. If you are a small unincorporated charity and you are seeking limited liability protection, then certainly the CIO is the way forward, as and when the regulations become law. The CIO must have a constitution, in a form specified by the regulations, or as near to that form as the circumstances allow. The proposed regulations specify that the constitution should be in the form of one of the model constitutions as offered by the Charity Commission. Again, as you can tell, it is only really going to suit the small charity. So many of the charities I act for need bespoke constitutions to fit their particular needs and it would seem that the Charity Commission are not going to entertain much variation to the model constitutions. Like charitable companies, which have both members and trustees, the CIO also must have members and trustees. Depending on the type of CIO, the same individuals can be both members and trustees, or there can be a wider membership. Therefore we have the two model constitutions.

Firstly the foundation model, where the members and trustees are one and the same or at least the voting members are the same as the charity trustees. Secondly, the association model, which allows a wider membership including voting members other than the trustees. The reality is that using the CIO foundation model is very similar to an unincorporated charitable trust, which is run by a small group of people, usually the trustees, who make the important key decisions and have the power to do so. There may be no time limit on how long charity trustees can serve, and they will probably appoint new trustees. The CIO, which utilises the association model, will have a wider voting membership. These voting members will make certain decisions, such as amending the constitution. The members will usually delegate some, or all, of the work to the charity trustees, who perhaps will serve for fixed terms. The CIO will have to produce an Annual Report and accounts, as with charitable companies and unincorporated charities.

What is being offered, similar to unincorporated charities is that a receipts and payment account, rather than full accrual accounts can be reduced, if the total income is below £250,000 per annum. It is surprising that this figure is so high, bearing in mind the limited liability protection being offered, will financial institutions and creditors take comfort in a set of receipts and payments accounts? I suppose if no borrowing is involved, this will become acceptable.

It will be very easy for a company limited by guarantee to convert to a CIO, and thereby keep existing Gift Aid numbers and VAT numbers. The CIO will be allowed to have a subsidiary company to facilitate trading issues, although it is unclear to me at this time whether VAT groups will be allowed. There are of course issues if an unincorporated charity wants to become a CIO; there is no conversion process. A new CIO will have to be formed, an existing unincorporated charity will close and arrange to transfer its assets to the new CIO, therefore potentially new Gift Aid numbers will be required and transfer of the going concern will have to be made in relation to VAT registration. However, as I said earlier, I can only see that this suits the smaller charity and therefore that VAT will not become a major issue. Almost certainly, medium and larger sized charities will continue to operate as a company limited by guarantee. If by any chance there are still big charities out there, which are unincorporated, then they will have to make this important decision, whether to go with the CIO, with its limitations, or transfer to a company limited by guarantee, or just stay as they are.

It is interesting to note that the Scottish body, OSCR, are far more advanced and the CIO is already an option for new charities registering in Scotland, with others able to convert from the 1st January 2012.

I now come to the proposed new accounting framework for charities. In the commercial world, we have the Accounting Standards Board, ASB Consultation, on the move to a new accounting framework, based on the International Reporting Standards, IFRS. What is on offer is a proposed three tier package. Tier 1, which follows the European adopted IFRS, this really applies only to organisations with equity or debt traded on public markets and deposit taking businesses. But as is apparent, this actually only applies to a very small number of charities. Tier 2, this is a slim down version of the IFRS open to any organisation falling outside of Tier 1, of a standard called Financial Reporting Standard for Medium-sized Entities, FRSME. Tier 3, this applies to the existing UK Financial Reporting Standard for Small Entities, FRSSE.

So where do charities fit into this? We’ve had published recently the Financial Reporting Standard for Public Benefit Entities, FRSPBE, known as FRED 45. If charities discard Tier 1, for reasons already mentioned, then they have the option of either Tier 2 or Tier 3. It is suggested that Tier 2 is complicated by the FRSPBE, although there are problems with this, which we’ll come to later. There are many small or medium-sized charities, that will just stay with the FRSSE, that is, Tier 3. One point to consider with the Tier 2 standard, FRSME, is that it prohibits the re-evaluation of plant, equipment and property which is allowed in Tiers 1 and 3. Obviously if charities are to use Tier 2, this could be a distinct problem which will have to be addressed.

What the ASB proposed framework confirms, is the future role of the three public benefit SORPs, Statement of Recommended Practice, which already exist. These being for further and higher education, registered and social landlords and of course the charity SORP 2005. The next charity SORP will be written in the context of the proposed three tier framework. It is interesting to review the Financial Reporting Standard for Public Benefit Entities; this is indeed a document written to a very high level. It does not really seem to deal with a whole range of issues already addressed by the SORP. To me, it seems like an educational document and has nothing to do with practical reality of every day charity life, therefore, in my opinion there is plenty of scope for the charity SORP to remain.

The proposed standard does allow merger accounting, it also recognises a charity can invest and therefore make loans, at low market rates of interest, to further their purposes. One of the major issues in the charity accounting world has always been the recognition of income. I’m sure you are aware of the three terms; certainty, measurement and entitlement. The Reporting Standard for Public Benefit Entities calls these sources Income Non-Exchange Transactions, this provides a rather basic answer, and simply says that gifts are recognised when receivable and when it is probable that funds will be received. One of the big issues of the Public Benefit Standard as it stands is for charities operating shops that sell donated goods. Under the existing charity SORP, donated goods for resell are only recognised as income when actually sold. The new Public Benefit Standard will require donated goods to charities to be valued on receipt. This means that charity shops would need to value their stocks of donated goods at least at the year end. The ASB does recognise the difficulties, and suggests that potentially small value items can be valued by using estimation techniques. Well, where does that leave us? The Public Benefit Standard would only be mandatory at Tier 2 level and best practice at Tiers 1 and 3. Very confusing, but let us move on.

There is a Compliance Toolkit available from the Charity Commission called, Protecting Charities from Harm, which addresses issues of terrorism, due diligence, fraud and moving funds including international transfers. It does include a lot of good checklists and pro-formas to make complying much easier. I am sure you will also be aware that the Bribery Act 2010 is now in force and implies in general terms to charities. The Charity Commission have updated the Compliance Toolkit I just mentioned to include a section on the Bribery Act, which also gives links to other guidance. You may think that this does not apply to you, but even small gifts and hospitality, which could be innocently offered by the smallest of charities, may be caught by the legislation.

Finally, I have just become aware of the confusion over audit exemption. Obviously all charities with income over £500,000 per annum will have to have an audit. In addition, non-company charities with gross assets over £3.26m require a statutory audit, if their income exceeds £250,000 per annum. What is also now clear is that a company charity which has gross assets over £3.26m must also have an audit, irrespective of its level of income.

Thank you for listening to this podcast.