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Your Ref:
Our Ref:

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Dear Sirs,

Conceptual Framework for Financial Reporting – the Reporting Entity

The Charity Commission for England and Wales 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 welcome the opportunity to respond to the consultation on the reporting entity and we support the consideration given to not-for-profit entities in the exposure draft. The clear distinction between a situation of control and benefit from a situation such as trusteeship, where control is exercised without benefit, is a key distinction which we welcome.

We would recommend that in addition to considering the details of how control of an entity is defined at standards level, consideration is also given to defining benefit. The basis for conclusions makes it clear that cash flows to the controlling entity are the key criterion of benefit. This is a form of direct benefit where the actions of the controlled party are directed to the gain of the parent entity. However in the not-for-profit context where bodies give grants to charities there is no stream of dividends or profit and so no cash flow benefit arises. Similarly there may be no cash flow from the activities undertaken by a wholly charitable subsidiary to the charity parent which exercises trusteeship over it.

In the charity context the key benefit is the service provided or service potential that exists for the beneficiary. Cash flows may come about for those charities that trade but the majority of UK charities do not trade. Whilst this additional criterion of service provided and service potential need not be added to a commercial standard we would recommend that the IASB consider it when developing the application to not-for-profit entities (phase G).

We would also welcome a distinction between direct benefits, which provide evidence of control, from incidental or indirect benefits which are a by-product of the activities of another economic

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agent, for example from the activities of a charity providing benefits to its beneficiary group in furtherance of its wholly charitable objects.

In our view indirect or incidental benefits are insufficient to provide evidence of control. For example on occasion a charity bears the name of its founding contributor, a person or a corporate body, as an indication of its origins and as an acknowledgement of philanthropy. By having the corporate name in the charity's title this is may be viewed as a form of advertising for corporate philanthropy but this private advertising benefit is incidental to the work of the charity. The charity, in providing grants and undertaking other charitable activities, directs itself to fulfilling its charitable aims. Any advertising of the philanthropist is an incidental and indirect benefit because the charity does not target its charitable work on the customers of the philanthropist or corporate body but on its beneficiaries.

The detailed responses to each of the consultation questions are in an annex to this letter. Should you have any enquiry on our response or wish to discuss its contents please contact me.

Yours faithfully,



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Response to the consultation questions

Question 1. Do you agree that a reporting entity is a circumscribed area of economic activities whose financial information has the potential to be useful to existing and potential equity investors, lenders, and other creditors who cannot directly obtain the information they need in making decisions about providing resources to the entity and in assessing whether the management and governing board of that entity have made efficient and effective use of the resources provided? If not, why?

We support the definition given of a reporting entity and welcome the substitution of the term 'economic activities' in place of 'business activities'. The definition incorporates a boundary and a link between the economic activity and the primary stakeholder. In the case of charities our UK research programme, involving over 1,000 stakeholders, identified funders and financial supporters as the primary stakeholder group for charities. This group is analogous to investors.

Question 2. Do you agree that if an entity that controls one or more entities prepares financial reports, it should present consolidated financial statements? Do you agree with the definition of control of an entity? (see paragraphs RE7, RE8 and BC18-BC23) If not, why?

We agree that where one entity controls another then consolidated financial statements should be prepared. At the level of the standard we would wish to see a provision that where the applicable law does not require intermediate consolidated accounts, for example where subsidiaries of a group control other subsidiaries, then there is then no requirement for producing consolidated financial statements at that intermediate level.

We agree with the definition of control where an entity controls another entity when it has the power to direct the activities of that other entity to generate benefits for (or limit losses to) itself. The definition links power with benefit and has causality where control is exercised to obtain benefit (or limit losses) for the controlling entity. This concept is as equally applicable to private not-for-profit economic activity and government activity as it is to commerce. However the concept of benefit will require a broader definition than cash flows (and resulting dividends, profits, interest and similar return) in the context of government, charity and other not-for-profit activities.

Question 3. Do you agree that a portion of an entity could qualify as a reporting entity if the economic activities of that portion can be distinguished from the rest of the entity and financial information about that portion of the entity has the potential to be useful in making decisions about providing resources to that portion of the entity? (See paragraphs RE6 and BC10) If not, why?

We agree with the principle that a portion of an entity may be identified separately, where appropriate, for reporting. In the context of a corporate group, the separate reporting may relate to a subsidiary. In the context of charities under common trusteeship this principle may extend to each charity, or each fund held on trust, or to individual branches of a charity (large national charities may often have geographical branches and these may be part of the charity or have a separate legal status but with common trustees). This level of reporting would provide accountability concerning the particular funds used to funders and financial supporters.

Annex to Charity Commission response: Conceptual Framework for Financial Reporting – the Reporting Entity

We would anticipate that the most likely application of this principle would be in segmental reporting to meet the requirements of investors, management or the requirements of foreign jurisdictions. In the UK charity context charities are required to analyse separately in the notes to the accounts the material trusts held and report in aggregate in the performance statement and balance sheet on the total funds held, distinguishing between unrestricted and restricted funds.

Question 4. The IASB and FASB are working together to develop common standards on consolidation that would apply to all types of entities. Do you agree that completion of the reporting entity concept should not be delayed until those standards have been issued? (See paragraph BC27) If not, why?

We agree that the framework should be established at principle level, the thinking from which then shapes the standards being revised or developed. The thinking of the IASB will also assist that of the UK Accounting Standards Board as it considers how best to develop a framework for not-for-profit accounting in the UK based upon IFRS.