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CHARITIES BRIEFING



October 2009

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Editor's comment

This edition opens with a brief summary of the latest developments in the 'public benefit' debate. As our article states, the Charity Commission has published its first Public Benefit Assessment Reports, and the outcome of these has raised significant issues in the independent schools sector. While this may not be of immediate concern to most charities, public benefit does, of course, apply to all charities

The longest article in this autumn edition concerns the accounting treatment of heritage assets. As well as being the subject of many consultations, accounting approaches in this area have historically varied significantly. A new accounting standard, FRS30, sets out the accounting treatment and disclosures that will be required in the future.

We also take the opportunity to remind trustees of their legal responsibilities in respect of the disclosure of information to their auditors, as well as looking at how the performance of Trustee Boards can be maximised. Finally, as ever, VAT remains an area that - in our experience - can offer opportunities for cost savings for charities, and we show how income from membership subscriptions can be used to improve a charity's VAT position.

John Shuffrey

OFFICES

Bournemouth 01202 294281
1 St Stephens Court, St Stephens Road, Bournemouth,
Dorset BH2 6LA

Bristol 0117 915 1617
Beaufort House, 2 Beaufort Road, Clifton,
Bristol BS8 2AE

Edinburgh 0131 221 2777
Edinburgh Quay, 133 Fountainbridge,
Edinburgh EH3 9BA

Geneva +41 22 319 0970
12 Cours des Bastions, 1205 Geneva, Switzerland

Guernsey 01481 721374
PO Box 141, La Tonnelle House, Les Banques,
St Sampson, Guernsey GY1 3HS
Channel Islands

Harrogate 01423 568012
Sovereign House, 6 Windsor Court, Clarence Drive,
Harrogate, North Yorkshire HG1 2PE

High Wycombe 01494 464666
Fox House, 26 Temple End, High Wycombe,
Buckinghamshire HP13 5DR

Inverness 01463 246300
Kintail House, Beechwood Park, Inverness IV2 3BW

London 020 7841 4000
Lion House, Red Lion Street, London WC1R 4GB

Manchester 0161 200 8383
City Tower, Piccadilly Plaza, Manchester M1 4BT

Peterborough 01733 353300
Stuart House, City Road, Peterborough PE1 1QF

charities@saffery.com www.saffery.com

CHARITIES BRIEFING



UPDATE ON PUBLIC BENEFIT

01

The Charity Commission's first programme of public benefit assessments focussed on fee charging charities (including independent schools and residential care charities) and religious charities.

Two of the schools and one of the residential care charities failed their public benefit assessment, mainly on the grounds that, as charities which charged "high fees" they provided insufficient access to those who could not afford to pay the fees. One of the other residential care charities was found to be operating outside its objects. Our publication, Independent Schools Briefing, considers the implications for independent schools.

For most charities, the issue of public benefit should raise few concerns, although trustees of all charities should read the Commission's

guidance on public benefit and consider whether their charities meet the requirements.

This is a necessary minimum to enable charities to meet their public benefit reporting requirement. The details of the public benefit reporting requirement have been covered in previous editions of Charities Briefing.

What next?

Those charities which failed the assessment were given twelve months to come up with a plan, for agreement with the Commission, stating how they would address the shortcomings





set out in the Commission's findings. How long the charities then have to implement the plans and demonstrate sufficient public benefit is not stated nor is it entirely clear how charities who cannot meet the Commission's requirements due to financial constraints will be treated.

Another area of uncertainty is exactly what a high fee-charging charity needs to do to meet the public benefit requirement. The Commission has deliberately and understandably not set out precise criteria that would enable such a charity to know how much subsidised access it had to provide.

However, this does pose a problem for those charities which are judged not to have met the requirement. We shall see whether, in the end, this turns out to be similar to the type of exam where the pass mark is only finally

determined once a large number of the completed exam scripts have been marked.

It is also not clear at this stage whether the Commission's interpretation of public benefit and, in particular, its emphasis on the need for high fee charging charities to provide discounted fee arrangements, will meet with a successful legal challenge.

A number of leading charity lawyers have seriously questioned the Commission's approach to this aspect of public benefit.

The Commission plans to expand its review of public benefit to cover different types of charity. At the end of its report "Public Benefit Assessments: Emerging Findings for charity trustees from the Charity Commission's public benefit assessment work:2008-09" the Commission states:

"We expect to start the next phase of the assessment programme later this year, following a review of the costs of the programme, the benefits achieved and how these might affect future programmes.

"In the next programme we intend to include other types of fee-charging charities, some small charities and charities for which sub-principle 2d (any private benefits must be incidental) may be an issue.

"We will, on a wider front, develop public benefit assessments through our general casework, through working with professional and umbrella bodies and by carrying out public benefit research studies."

Future editions of Charities Briefing will cover key developments in this area.

DISCLOSURE OF INFORMATION TO AUDITORS

If you are a trustee (and therefore a director) of a charitable company which is subject to audit, then you have legal responsibilities in respect to the disclosure of information to the auditors.

The trustees/directors' report in the financial statements of a charitable company must include a statement that in the case of each director in office at the date the report is approved:

a) So far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and

b) He has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

A director will have fulfilled his responsibilities if he makes enquiries of his fellow directors and of the company's auditors for that purpose, and exercises due care, skill and diligence.

What is relevant audit information?

Relevant audit information means information needed by the charitable company's auditors in connection with preparing their report. This relates to both information requested by the auditors and information volunteered by employees, management and trustees.

Unfortunately there is no standard list of relevant information, as what is relevant to the audit will depend on the nature of each charitable company and its circumstances. However it will include:

- Full accounting records, reconciliations and estimates
- Minutes of board and management meetings



- Dealings with all regulatory authorities including H M Revenue & Customs
- Significant communications in respect to legal issues
- Events subsequent to balance sheet date

It is usual for auditors to meet with the audit committee, if there is one, or the Board at both the planning stage and the completion stage of the audit and these are opportunities to make sure that auditors are made aware of relevant audit information.

What is the extent of the director's duty?

Two separate elements need to be considered:

- The knowledge, skill and experience reasonably expected of a person carrying out the role of trustee/director
- The knowledge, skill and experience the director actually

has (when this exceeds the basic expectation).

This means that the extent of the director's duty will depend on his role and his background and knowledge.

For example the Chair of the Finance Committee, who may well be a qualified accountant, is likely to have a higher duty of care than a less involved trustee with no professional qualifications.

However, the basic objective test relating to the skills required to be a director still exists.

Consequences of a false statement to auditors

Where the trustees/directors report is approved, but the statement required to be given to the auditors is false, every director who either knew the statement was false, or was reckless as to whether it was false, and failed to take appropriate steps to prevent the report being approved, is guilty of an offence.

The term "reckless" should amount to something much more than negligence and will tend to involve willingness to knowingly "turn a blind eye". The sanctions which can be imposed for these offences are imprisonment for up to two years, an unlimited fine or both.

So what should trustees/directors do?

- Ensure that the existing processes in place for complying with obligations in respect to the preparation of true and fair accounts are robust
- The audit committee, or the Board of Trustees, should discuss the audit plan with the audit partner and any particular areas where information will be required
- Notify the chief executive and key management that they will be required to confirm they have processes in place to support the disclosure of relevant audit information to auditors.
- Consider the key findings reported by the auditors to those charged with governance and whether they indicate that relevant audit information may be unknown to the auditors
- Audit committee/trustee board to meet with the audit partner without management present to discuss any issues concerning the flow of information to the auditors
- Consider the draft management representation letter before approval

This list is not exhaustive and every situation will be different. However trustees need to be aware of their responsibilities and act with due care and the appropriate level of skill and diligence.



FRS30: HERITAGE ASSETS

The Accounting Standards Board's (ASB) project on the accounting treatment of heritage assets began in 2006, when a discussion paper entitled "Heritage assets: Can accounting do better" was published.

This discussion paper and following exposure drafts FRED40 and FRED42 suggested various more radical approaches to the treatment of heritage assets compared with the mixed approach allowed at the time by FRS15 (Tangible Fixed Assets) and the Statement of Recommended Practice (SORP) for charities.

FRS 15 took effect for accounting periods ending after March 2000.

At the time the ASB acknowledged that for some assets that were not capitalised in the past the cost of obtaining a valuation might outweigh the benefit to users of the accounts.

This therefore permitted the practice, whereby pre 2001 acquisitions were not capitalised and some post 2001 acquisitions were capitalised.

The ASB has now issued a new Financial Reporting Standard, FRS30, Heritage Assets, which concludes that the mixed approach is good enough, with enhanced disclosures and some relaxation of the measurement requirements of FRS15.

The key question the standard addresses is whether heritage assets ought to be recognised in the balance sheet, and if so whether this is at valuation or at cost.

The issues surrounding this include the practicalities of valuing a heritage asset where an entity has held it for a very long time, or a value is particularly difficult to obtain, and whether new assets should be recognised whilst assets held before 2001 are left "off balance sheet".

Definition

The ASB's definition of a heritage asset is "a tangible asset with historical, artistic, scientific, technological, geophysical or environmental qualities that is held and maintained principally for its contribution to knowledge or culture" (para 2, FRS30). This differs from the definition given in the discussion paper, in that it omits the final phrase "and this purpose is central to the objectives of the entity holding it."

This makes the definition broader than the discussion paper, bringing more



assets into the slightly more relaxed measurement regime of FRS 30. This may be useful in some cases eg a culturally important painting newly endowed on a school could satisfy this broad definition, even though the purpose of holding it would not necessarily be central to the objectives of the school.

Any other assets held should be capitalised in accordance with FRS15 (Tangible fixed assets).

FRS30 makes a distinction between operational assets and the assets meeting the definition given above. Operational assets, or assets used by the entity in its operations, are to be capitalised in accordance with FRS15, "notwithstanding historical or other heritage qualities" (summary, para 2).

This means that where an entity occupies a historic building then, since the building is in operational use and is not "maintained principally for its contribution to knowledge or culture" (para 2), this building is not a heritage asset and must be recognised under FRS15.

Previous consultations

In the previous discussions, the ASB had considered whether a full capitalisation approach would be appropriate, or indeed whether a non-capitalisation approach would be more consistent.

The ASB had initially rejected the mixed approach on the grounds that it represented two incompatible accounting policies, capitalisation and non-capitalisation, which were applied to the same class of asset. Only post 2001 additions were capitalised on the balance sheet.

A full capitalisation approach was favoured. However there were clear practical issues with this approach, including difficulties in obtaining valuations for certain assets and some collections being so large that valuations would have been so costly

and time consuming as to have been impractical.

New standard

FRS30 retains the recognition and measurement requirements in FRS 15. This requires heritage assets to be reported as tangible fixed assets in the balance sheet where information is available on cost or valuation.

There are however some relaxations to the measurement requirements of FRS 15. In particular, "Where this information [ie the cost or value of the assets] is not available, and cannot be obtained at a cost which is commensurate with the benefits to users of the financial statements, the assets will not be recognised in the balance sheet and the disclosures required by this standard should be made" (para 20).

Disclosures need not be made for "any accounting period earlier than the period immediately before the period in which this standard is first applied where it is not practicable to do so and a statement to the effect that it is not practicable is made", but otherwise a five-year history is to be disclosed.

FRS30 applies to accounting periods beginning on or after 1 April 2010.

Heritage assets can be included in the balance sheet at either cost or valuation. However, under FRS30 the assets need to be separated into those held at valuation and those held at cost.

The standard encourages the valuation approach to be followed, although there is no minimum revaluation period, and recognises that where assets have indefinite lives no depreciation needs to be charged.

For heritage assets received by donation the standard states that these should be included in income and assets at valuation, but recognises that there might be assets where the value cannot be practicably obtained,

and so in these cases reasons for the non-recognition need to be disclosed.

A summary of the enhanced disclosures required by the standard is as follows (para 6-15):

- The accounts should include details of the entity's policy on acquisition, maintenance, management and disposal of heritage assets, as well as details of records maintained and access to the assets.
- The accounting policy for heritage assets should include details of recognition and measurement. This should also include any limitations of the valuation, for example where provenance is not fully reflected in the value.
- Reasons should be given where any heritage assets are not recognised in the balance sheet either at cost or valuation, with an indication of the significance of those assets. Any additional useful information on these assets should also be disclosed.
- The cost or valuation of the assets, by class, showing which are recorded at valuation and which are at cost should be provided.
- For valued assets the date and details of the valuation should be disclosed.
- A summary should be given of transactions of heritage assets carried out during the year and for each of the four prior periods, including acquisitions, donations, disposals and any impairment recognised.



Addressing concerns and limitations

The Institute of Chartered Accountants in England and Wales (ICAEW) responded to the 2006 discussion paper raising a number of concerns.

The resources involved in valuing heritage assets could be significant and reduce funds for charitable purposes. FRS30 addresses this in part by firstly not insisting on a minimum period between valuations, and secondly not insisting on the valuation being carried out by an external valuer.

However, it does suggest that for assets held at valuation, 'the carrying amount should be reviewed with sufficient frequency to ensure the valuations remain current'. Where entities have significant collections of assets, valuations could still prove time consuming particularly as post 2001 collections grow.

An additional consideration for entities subject to audit is that they will need to supply their auditors with sufficient evidence to support valuations, and if these are performed in-house and infrequently, the auditors are likely

to need more corroborative evidence than if they are valued by an external valuer at regular intervals.

Further considerations included concern over the security of assets once their valuation and details are disclosed. The standard makes no allowance for this.

The definition of a heritage asset, as explained above, excludes operational assets, however, where the "contribution to knowledge and culture" are part of the charity's objectives it could be difficult to separate the assets which are operational and those which are heritage assets, and there may be a few grey areas, for example for schools and churches occupying historic property.

The standard makes no exceptions for inalienable assets, those assets which the charity cannot realise either because of the donor's wishes or because the asset is so central to the entity it could not continue without it.

The concept of inalienability is described as "not robust" by the

ASB, and has not been taken into consideration in forming the accounting standard. The ICAEW asked why a user of the accounts would care if an asset is valued at £10million or £100million if the asset cannot be realised anyway.

The fact that assets acquired prior to 2001 do not have to be recognised does address part of this issue, but any assets of this nature acquired in the future would need to be recognised, and included at valuation if received by donation.

Conclusion

FRS 30 attempts to standardise the treatment of disposals and post 2000 acquisitions, whilst taking a pragmatic approach to the need to obtain valuations of heritage assets by relaxing some of the measurement criteria of FRS15.

In doing so, whilst it does not introduce a radical change in accounting for heritage assets, FRS30 provides some useful certainty to what has been a rather confused area of balance sheet accounting.

MEMBERSHIP SUBSCRIPTIONS AND SUPPORTER INCOMES

Many charities and other voluntary organisations rely on individual supporters for a large proportion of their income. Whether the charity has a structured membership scheme or not there can be many VAT advantages in receiving regular income from individual supporters.

Here, we explain how this income can be very VAT efficient in assisting to increase a charity's overall VAT recovery position.

Membership

In order to establish the correct VAT liability of subscription income a distinction needs to be made between a 'membership' subscription and a subscription which merely affords the supporter a range of benefits.

To be a membership subscription HMRC normally require that the subscriber is afforded a voting right to appoint the management of the organisation.

Where a voting right is a benefit of membership, the subscription income is exempt from VAT (although see the further information opposite), **provided the organisation is either:**

- a) A non-profit making trade union, professional or representative body; or
- b) A non-profit making body with objects which are in the public domain and are of a political, religious, patriotic, philosophical or philanthropic nature.

The right of admission to any premises, event or performance is specifically excluded from the exemption and thus an element of the subscription income is standard-rate for VAT purposes.

Subscription

Where a voting right is NOT a benefit afforded to the subscriber, the subscription does not fall within the exemption from VAT outlined above. It is then merely a subscription for a range of benefits.

VAT liability

The VAT liability of membership or other subscription income is dependent upon the benefits supplied to the supporter. Normally an organisation must treat a subscription as what is termed a 'single supply' for VAT purposes with the VAT liability reflecting the prominent or main benefit.



Apportionment

However, where this is not beneficial a non-profit making organisation may treat the subscription as a multiple supply and thus apportion the subscription income to reflect the standard, reduced, zero rate and exempt benefits.

Where such an apportionment is necessary it is HMRC's preferred position to require this to be calculated by reference to the relative cost of each benefit.

Care should be taken as benefits may fluctuate between different categories of subscribers (e.g. individual/family etc) and with some benefits only afforded at certain times (e.g. on joining). It may therefore be necessary to have different apportionments for different categories of subscribers.

Donation

If the whole of the subscription is voluntary and does not entitle the subscriber to any benefit then the subscription income is a donation and is outside the scope of VAT in the same way that income from a regular or committed giver is treated.

Minimum subscription

If a charity promotes a minimum subscription which is the level required to be paid by a supporter to receive the benefits given, any monies paid over and above the stated minimum can be treated as a donation.

Donation element

A charity or other body which has objects that are both in the public domain and of a philanthropic nature may treat an element of its subscription income as a donation. In order to do this either:

- All of the substantive benefits provided are available to non-members at no charge or more cheaply than the subscription; or
- Some or all of the substantive benefits are exclusive to members and the organisation can demonstrate that the amount paid is higher than the amount that the subscriber would normally have to pay for similar goods or services.

Gift Aid

Treating a subscription, or part of a subscription as a consideration for VAT purposes does not jeopardise the ability of the charity to receive the income under the Gift Aid arrangement providing the value of the benefits is within the normal 25 percent test.

Overseas subscriptions

Subscriptions received from overseas usually follow the same VAT liability as subscriptions received from UK persons. However, where there are different benefits, goods exported or higher postage costs the VAT liability and apportionment may differ.

Input tax recovery

Subscription income can be very good for increasing the overall VAT recovery position of the charity.

The reason for this is that it is common for the sole, or a key, benefit of membership to be zero-rate publications e.g. magazine, newsletter, annual review etc.

Where this is the case, all or most of the subscription income can be treated as being zero-rate. The effect of this is to increase the taxable income of the organisation which in turn should increase the recovery of VAT incurred on general overheads.

Where the subscription income is wholly taxable (be it all zero-rate or a mix) then all VAT incurred on related costs such as recruitment, retention,

data inputting etc can be recovered in full.

Where the subscription income is partly taxable, VAT incurred on these costs can be treated as an overhead and partly recovered under the charity's agreed VAT recovery method.

Where the subscription income has no taxable element (e.g. wholly exempt or donational or a mix of these) VAT incurred on related costs can only be partially recovered if the donations are unrestricted or the exempt input tax incurred by the charity during the year is below the partial exemption de minimis limits.

Summary

Many charities retain the distribution of a publication as a supporter benefit to enable their subscription income to be wholly or mainly zero-rate. This enables a recovery of VAT incurred on supporter costs such as recruitment and retention and also increases the level of VAT recovered on general overheads.

THE EFFECTIVE TRUSTEE BOARD

AND PERFORMANCE APPRAISAL

Over recent years there has been much greater awareness by charity trustees of their duties and responsibilities and many Trustee Boards are steadily improving their organisation and effectiveness.

In order for a Board to be effective, consideration needs to be given to the following areas:

- That the Trustee Board is constituted in accordance with the governing document and is the right size for the charity
- That trustees understand their duties and responsibilities
- That recruitment of trustees is properly managed and a comprehensive induction process is in place
- That there is an adequate mix of skills, knowledge and experience amongst the trustees and that this is used effectively
- That there is a clear understanding of the roles of committees
- That there are systems in place to monitor the way in which delegated powers are exercised
- That trustees should ensure they take professional advice, if necessary to make good decisions

However, one area which is often overlooked by charities is a regular review of board effectiveness to ensure that it continues to be fit for purpose as the charity evolves.

The Code of Good Governance suggests that a review should be done at least every two years and should cover the performance of the Board as a whole, the performance of committees and the performance of individual trustees.

This type of exercise can often be put off by trustees as being too time consuming and is allocated to the 'too difficult' pile.

However, with the right approach, benefits will usually flow from the performance review process, enabling the Board to achieve greater efficiency and effectiveness overall.

One way of appraising individual trustees is to prepare a self evaluation questionnaire which enables trustees to comment both on their own performance and their opinion on the performance of the Board as a whole.

Questions might relate to the effectiveness of meetings, the contributions of individual trustees at meetings, the quality, quantum and timing of papers for meetings. Do trustees have adequate information on which to make informed decisions and is there an adequate spread of skills and knowledge?

Each trustee should then have a one to one meeting with the chairman of the trustees (or an external third party if appropriate) to discuss the questionnaire and any issues arising.

The results of these appraisals should be used to identify if any additional training or support is required for individual trustees in order to enable them to carry out their duties more effectively. Initial induction training for trustees is just the beginning of a process which should last as long as a trustee is in office.