ICAEW REPRESENTATION 121/17

FRED 68 Draft amendments to FRS 102 - Payments by subsidiaries to their charitable parents that qualify for gift aid

ICAEW welcomes the opportunity to comment on the *FRED 68 Draft amendments to FRS 102 - Payments by subsidiaries to their charitable parents that qualify for gift aid* published by the Financial Reporting Council (FRC) in September 2017, a copy of which is available from this link.

This response of 27 October 2017 has been prepared on behalf of ICAEW by the Financial Reporting Faculty and reflects consultation with the Faculty's Financial Reporting Committee and with ICAEW's Charity Technical sub-Committee and Social Housing Committee.

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MAJOR POINTS

Support for the proposals

1. We commend the FRC for taking the issues addressed by the exposure draft seriously and for recognising its importance for public benefit entity reporting. Currently there is widespread diversity in practice with regards to the accounting treatment of gift aid payments made by trading subsidiaries to charitable parents. This is undesirable. There are valid arguments for a different approach to that the FRC has proposed; however, for the purpose of dealing with this diversity, on balance we support the FRC's proposals. In our view they put forward an approach which will result in a consistent accounting treatment across the sector, improving the understandability of the financial statements.

Timing

2. While we understand why the FRC is keen to take action on this matter as soon as possible, we would point out that the one-month consultation period was too short to allow ICAEW to undertake a detailed consultation with our members affected by these changes.

3. We also note that the FRC is keen to finalise the proposed amendments at the same time as the amendments to FRS 102 arising from the recent triennial review. We support this objective in principle, but think that the FRC should take the time necessary to reflect on the various responses to the consultation and on the adequacy of stakeholder participation, given the short consultation process. In our view this is more important than ensuring that the final amendments coincide with the new version of FRS 102.

Guidance

4. Given the existing diversity in practice in this area and the range of organisations affected, it will be important for the FRC to consider carefully how to communicate the amendments to those affected by the changes and to ensure that they are well understood. The FRC should also consider the scope for providing some clear and timely guidance on the new accounting treatment.

RESPONSES TO SPECIFIC QUESTIONS

Question 1: Do you agree with the proposed amendments to FRS 102 and that this will improve the relevance of information provided to users of the financial statements? If not, why not?

5. Yes, we agree that the proposed amendments to FRS 102 will improve the relevance of information provided to users of the financial statements. While we tend not to favour the development of narrow sector-specific changes to standards, we believe that on this occasion there are sound arguments for the FRC to take action to clarify the treatment of payments by subsidiaries to their charitable parents that qualify for gift aid and the related tax effect. The widespread diversity in practice in this area is not helpful.

6. We recognise that there are strongly held and diverse views on this matter, including within ICAEW's own committees, and we anticipate that a number of committee members and ICAEW member firms will make their own representations to the FRC. In particular, we are aware of arguments that the gift aid payment should be treated as expense in the profit and loss account for the year, with a constructive obligation recognised as a liability at the year end. We have considered these arguments carefully and have some sympathy with them. However, we accept the view in the exposure draft that the gift aid payment is a distribution to owners that should be recognised in equity and that a liability should not be recognised at the reporting date if the payment becomes an obligation after the reporting date; this is the most important principle underlying the accounting, which should not be lost because of the particular tax circumstances relating to the payment.

7. In our view, the FRC's proposals offer an approach which will result in a consistent treatment across the sector and improve the understandability of the financial statements. In particular, we note that under the proposals, the payment can be accrued at the year end, provided a legal obligation to make the payment has been created, for example by entering into a deed of covenant. Indeed, charities may find this route helpful to create certainty over income for the parent in any particular accounting period.

8. We have noted several points where further clarity would be helpful. These are as follows:

- Paragraph 14 of the Corporate Reporting Council's Advice to the FRC notes that in accordance with paragraph 32.8 of FRS 102, the expected gift aid payment:

  '…shall not be recognised as a liability at the reporting date if the payment becomes an obligation after the reporting date. In practice this is likely to mean that unless a legal obligation for the subsidiary to make a payment to the parent has been created by, for example entering into a deed of covenant, no liability for expected gift aid payments can be recognised at the reporting date.'

  However, we note that the proposed amendments to FRS 102 refers only to a deed of covenant (rather than a legal obligation) when outlining when the gift aid payment may be accrued at the reporting date. Further clarity on this point would be helpful.

- The proposed amendments appear to relate only to wholly-owned subsidiaries. It is not clear to us why the amendments have been restricted in this way. We are advised that there are other group situations in which distributions from a trading subsidiary would qualify for the tax treatment of gift aid and should therefore be subject to the same rules as a wholly-owned subsidiary making gift aid payments to its charitable parent. We suggest that the FRC considers whether it is justified in narrowing the proposals in this way; it is important to ensure that all relevant transactions are captured. We would be happy to provide further information on this point if needed.

- The FRC proposals state that if a deed of covenant is in place, the payment should be accrued at the year end. For the avoidance of doubt, it would be helpful for the FRC to be very clear that the gift aid payment in this situation is still a transaction with the owners and should always be recognised in equity.

- While we agree that early adoption of the proposed amendments should be permitted, we do not believe it is necessary for this to be dependent on adoption of all the proposals arising from FRED 67 at the same time. In our view, this is a standalone matter and, given the urgent need for clarity and consistency, it should be possible for the proposals to be early adopted independent of any other proposals arising from FRED 67.

- It would be helpful for users of the financial statements to be made aware of the amount of anticipated payment which has been taken into account when determining the tax expense for the period. This may help alleviate concerns that have been expressed by some that a company's assets could be regarded as overstated if they take into account the anticipated tax benefit without providing for the payment which will result in that tax relief. This could perhaps be addressed through a disclosure requirement in FRS 102.

Question 2: In relation to the Consultation stage impact assessment do you have any comments on the costs and benefits identified? Please provide evidence to support your views of the quantifiable costs and benefits of these proposals.

9. Overall, while some consequential cost and effort is inevitable, we do not anticipate that implementing the proposed amendments will lead to significant costs for companies or other parties affected by the changes. We have no other comments at this stage on the costs and benefits of the proposals as identified by the FRC.