

The lead provider of audit and related services to the voluntary sector

## Emerging issues update for charities and other Non Profit Organisations Summer/Autumn 2005

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### 27 October Charity SORP Seminar

**We will be holding a seminar to discuss practical implementation issues, examples of good practice and lessons to be learnt.**

**Venue: Deloitte, 180 Strand, London, WC2R 1BL.**

**Time: Register:15:45 - Seminar commences: 16:00 - Seminar Concludes: 18:00**

**A light buffet will be served afterwards.**

**To register and for further information contact: [nnathani@deloitte.co.uk](mailto:nnathani@deloitte.co.uk)**

Other resources, FAQs, guidance notes and articles covering governance, financial reporting, fundraising, tax, employer solutions and information technology can be accessed from our website [www.deloitte.co.uk/nonprofit](http://www.deloitte.co.uk/nonprofit)

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## Statement of Principles: Proposed Interpretation for Public Benefit Entities'

In August 2005 the Accounting Standards Board (ASB) published an Exposure Draft (ED). 'Statement of Principles: Proposed Interpretation for Public Benefit Entities' The ED explains that public benefit entities are reporting entities whose primary objective is to provide goods or services for the general public or social benefit and where any risk capital has been provided with a view to supporting that primary objective rather than with a view to a financial return to equity shareholders. Therefore the bodies that the ED will be relevant to include:

- Charities
- Government departments
- Local authorities
- Livery companies
- Professional bodies
- Higher/Further education institutions
- Hospitals
- Non departmental public bodies
- Registered social landlords
- Schools

The project to interpret, the Statement for public benefit entities has been undertaken under the guidance of the ASB's Committee on Accounting for Public-benefit Entities (CAPE) CAPE and the ASB have taken into account the comments of respondents to the Discussion Paper published in 2003

Probably the most controversial aspect of the ED is the treatment of liabilities and commitments. The Many do not agree with the view expressed in the ED that if the promised resources are being provided in furtherance of the grant making entity's objectives then the arrangement is in substance, an exchange transaction (executory contract). This would mean that almost every grant leads to an exchange transaction as grant makers can not usually make grants outside their objectives.

The ED acknowledges that there is an alternate view which is that non performance related grants are similar to voluntary gifts and are not exchange transactions and that they should be accounted for by the grant maker once the obligation arises and by the recipient once it has become entitled to the funds.

It is hoped that the final interpretation will recognise that there are grants that are analogous to contracts – (performance related grants) and there are grants that are akin to donations and gratuitous transfers (in some cases they may be purpose restricted).

The ED suggests that the designations of funds in the accounts should be precluded and that such disclosures should be made by narrative reporting instead. Perhaps this needs to be reconsidered so that designations continue to be allowed but it should be clear that there should not be any implication that a designation somehow reduces the residual interest or the net assets.

The ED's proposed treatment of grants that are received to finance the purchase of tangible fixed asset will lead to much change in financial reporting for organisations in the higher/further education and RSL sectors. At present the SORPs for these sectors recommend the treatment adopted by SSAP4 which advocates the deferral of the recognition of the grant which is then released to income in line with the use of the asset. The ED now recognises that funds received by a public benefit body should be recognised as income and a gain when the body becomes entitled to the income. The source of the income (government or an individual) or the purpose to which it will be put (revenue or capital) should not usually impact on the timing of its recognition.

The ED also covers the treatment of Gifts in Kind and donated services. The ED explains that monetary donations or gifts of goods should be recognised on their current value to the recipient taking into account expected utility to the recipient, including any restrictions placed on its use by the donor. Therefore donated office premises or other gifts in kind should be included at the value to the recipient.

There are other issues to consider when dealing with gifts of services and the ED explains that It would be expected that services that would otherwise have been purchased should be recognised in the financial statements based on the estimated value to the recipient, provided they can be reliably measured. With donated services the ED suggests that services that would otherwise have been purchased would often be those which the provider (either an individual or an entity) would ordinarily carry out in the normal course of their usual profession or trade, and for which they would ordinarily charge a fee commensurate to the services provided.

Comments on the ED are requested by 30 November 2005

For a copy of the ED and the invitation to comment see:  
<http://frc.org.uk/asb/technical/projects/project0017.html>

An article on this subject written for the October issue of Accountancy magazine will soon be on our website: [www.deloitte.co.uk/nonprofit](http://www.deloitte.co.uk/nonprofit)

## New Reports on Government Funding

Two important reports on government funding have been published in June 2005. The first '*Shared aspirations: the role of the voluntary and community sector in improving the funding relationships with government*', was published by NCVO and more recently the NAO published an influential report on working with the Third Sector.

The NAO report explains that despite government's efforts, led by the Home Office and the Treasury, to implement the recommendations of the 2002 Treasury Review, a number of funding issues continue to cause difficulty for Third Sector Organisations (TSOs). 'Full cost recovery' – ensuring that funders contribute towards TSOs' overhead costs as well as the direct costs of projects - is not yet embedded. Annual funding is still common, creating uncertainty for the TSO and diverting staff from front line activity to the negotiating table. Funding commitments of more than a year allow TSOs to do more forward planning and improve their service delivery. Funders' monitoring processes are not always proportionate to the funding and nature of the services provided. Progress has been made in other areas. Payment in advance of expenditure, which can be vital to allow TSOs to make the necessary investments to deliver a service, is more common than in the past, and departments have also made efforts to improve the application processes that TSOs must go through to obtain funding

The NAO report recommends that the Home Office, working with the Treasury and all government departments, should take a number of steps to help departments improve their engagement with the Third Sector. These include:

1. identifying and promoting beacon funders at all levels of government, to act as centres of expertise and help spread good practice;
2. developing joint or shared teams across departments to deal with third sector service providers;
3. training staff to specialise in working with the sector and encouraging secondments to the sector;
4. making all relevant guidance to funders, whether produced by government or outside experts,

A key aim is to seek through training and co-operation greater trust between the government bodies and the third sector so that real partnership can be created and inform the relationships between funding and service suppliers.

The NAO held a conference on this subject on 30 June 2005 and one of the conclusions was that TSOs need to get tough and refuse bad contracts. It is hoped that the Home Office proposals for 'Compact Plus', expected to be formally launched later this year after taking account of consultation findings, may bring renewed impetus to the funding debate.

We have been closely involved with these issues and our view is that at the operational level the message is still not getting through and voluntary organisations need to constantly remind funding and commissioning officers of the government's stated objectives in this area.

For further information see:

[http://www.nao.org.uk/conferences/third\\_sector/3rd\\_Sector\\_summary.htm](http://www.nao.org.uk/conferences/third_sector/3rd_Sector_summary.htm)

<http://www.ncvo-vol.org.uk/asp/search/ncvo/main.aspx?siteID=1&subSID=95&SID=18&documentID=2592>

## Charities and Public Service delivery

In June 2005 the Charity Commission published a "Policy Statement on Charities and Public Service Delivery". This is an area that has received much interest as it appears to change previously accepted views about charities providing services that are seen as statutory services. We have discussed this with many charities in relation to strategic aims and pricing policy and they do not all see this is a positive step. In the past many charities were able to use the argument that they were not allowed to subsidise statutory services when negotiating pricing and fees. Whilst this argument is now more tenuous charities should still be aiming for full cost recovery as discussed in the previous section.

The Charity Commissions policy statement explains:

*"Charities have always undertaken activities that are commonly regarded as "public services", and charity often pre-dated and pre-empted statutory provision. For example, highway maintenance, primary education and hospitals were all originally provided by charities. Lifeboat rescue services and hospice care are still provided by charities. Public perception of what government should provide changes over time, as do relative levels of provision by the charitable and public sectors.*

*"Providing services in partnership with local, regional or national government is just one of the ways in which charities can meet the needs for which they were established, but the role of the sector is much broader than this. Delivering public services may not be appropriate for many charities trustees must make informed decisions about whether to engage in service delivery.*

*"In considering applications from Wigan Leisure and Culture Trust and Trafford Community Leisure Trust to register as charities the Commission concluded that the law does not prevent charities from using their own funds to provide services on behalf of public authorities, even if an authority has a legal duty to provide a service. The Commission recognised that in practice a number of charities were already doing this to some extent. In this policy statement the Commission will explore some of the wider issues arising from the decision, and set out its position.*

*"The Commission's decision has come at a time when government is encouraging charities and the wider voluntary sector to take a greater role in public service delivery. As independent regulator of charities, the Commission's position on whether charities engage in public service delivery is neutral; we neither encourage nor discourage it. We are concerned with ensuring that charities retain their independence, remain focussed on their objects and properly meet the needs of their beneficiaries"*

The full policy statement is available from

<http://www.charity-commission.gov.uk/supportingcharities/polstat.asp>

## SORP 2005 implementation

The 2005 Charity SORP has been early adopted by a number of charities. The key changes have been in Trustees' Reports and the need to articulate strategy, activities, outputs and outcomes and impacts has meant that some charities have had to rethink some of these issues. A number of charities have had some difficulty in doing this and we have found that it is often because there is confusion around some of the following key definitions:

**Inputs** are the resources that contribute to a programme or activity, including income, staff, volunteers and equipment. Most of these are reflected in the accounts but certain inputs such as volunteer time are not. Due to the use of out of date chart of accounts some charities have had difficulty in linking inputs to activities.

**Activities** are what an organisation does with its inputs in order to achieve its mission. In many cases these can inform the expenditure headings in the Statement of Financial Activities and inform the reporting of outputs and outcomes.

**Outputs** are countable units, and are the direct products of programmes or organisations' activities. They could be children immunised, animals relocated, classes taught, training courses delivered or people attending workshops. In themselves they are not the objectives of the organisation but some reporting appears to be confusing these with objectives. Outputs are often quantifiable and lend themselves to tables and charts.

**Outcomes** are the benefits or changes for intended beneficiaries. They tend to be less tangible and therefore less countable than outputs. Outcomes are usually planned and are therefore set out in an organisation's objectives. The Trustees' Report should highlight outcomes. It is sometimes difficult to properly define outcomes and to be able to claim them as a result of a charity's activities. However, this should not prevent the reporting of outcomes.

**Impact** is all the changes resulting from an activity, project or organisation. It includes intended as well as unintended, negative as well as positive, and long-term as well as short-term effects. Impact reporting difficult and many of the "impact report" are in fact reporting on outcomes but most make commendable efforts in identifying, recording and reporting on what matters.

The key issues in the accounts are around income recognition and performance related grants and many have been concerned that much of their income may be treated as performance related. Our experience is that careful consideration of the SORP's definition of performance related grants identifies that to be performance related a grant should meet two criteria:

1. the terms of the grant require the performance of a specified service that furthers the objectives of the grant maker and
2. where payment of the grant receivable is conditional on a specified output being provided by the grant recipient.

Paragraph 100 was added in to the SORP to clarify that *"Simply because a grant is restricted to a particular purpose of the recipient charity does not mean it should necessarily be recognised as a performance related grant. For a performance related grant entitlement to the incoming resource only arises with the performance of a specific output identified as a condition for the grant. Entitlement to the grant in such cases only arises as the performance conditions are met. This can be contrasted with a restriction that whilst limiting how a charity may expend funds to particular purposes does not require a specific and measurable output to be delivered by the recipient charity as a condition of a charity's entitlement to the funds"*.

There has also been some confusion about the disclosure of grants payable and the 2005 SORP has

simplified the disclosure requirements. The key change is that grants paid do not have to be shown on the face of the SOFA. Therefore grants payable are aggregated with other expenditure to show the total functional cost of an area of activity (e.g. welfare, child support etc). There is some confusion about disclosure and there is an erroneous belief that the SORP requires a list of the 50 largest grants to be shown in the accounts. Paragraph 205 of the SORP states: *“The trustees may give further analysis and explanation of the purposes for which grants were made as part of the Trustees’ Annual Report or by means of a separate publication. Such further analysis does not excuse the trustees from providing sufficient detail in the notes to the accounts as is needed to provide a true and fair view...”*

The notes to accounts need to disclose the total amounts paid by way of grants and the related support costs. Analysis should be provided to show the amounts paid to individuals and to institutions. In addition, there should be an analysis of the total amount of grants paid by nature or type of activity or project being supported. There is no longer a need to show the number of grants made.

Paragraph 206 focuses on materiality and explains that if a charity has made grants to particular institutions that are material in the context of grant making, the charity should disclose details of a sufficient number of institutional grants to provide a reasonable understanding of the range of institutions it has supported. This information may be provided either in the notes to the accounts, or as part of the Trustees' Annual Report or by means of a separate publication. These details of institutional grants should give the name of the institution and total value of grants made to that institution in the accounting year.

Charities have taken to heart the requirements to show the basis of cost allocation and the nature and quantum of support costs. Surprisingly cost allocation disclosure has been cited as the reason why some charities have not chosen to follow the 2005 SORP. In fact, the requirements of the SORP are not really onerous. The SORP requires that the notes to the accounts should provide details of the total support costs incurred and of material items or categories of expenditure included within support costs. In addition, where support costs are material, an explanation should be provided in the notes of how these costs have been allocated to each of the activity cost categories disclosed in the SOFA or the supporting notes to the accounts. The explanation may include percentages or amounts.

There also appears to be some confusion whether adopting the new SORP leads to a prior period restatement. Financial Reporting Standard (FRS) 3 explains that the majority of items relating to prior periods arise mainly from the corrections and adjustments which are the natural result of estimates inherent in accounting and the periodic preparation of financial statements. They are dealt with in the SOFA for the period in which they are identified and their effect is stated where material. They are not exceptional or extraordinary merely because they relate to a prior period; their nature will determine their classification. Prior period adjustments, that are prior period items which should be adjusted against the opening balance of funds, are rare and limited to items arising from changes in accounting policies or from the correction of fundamental errors. This means that although expenditure classification changes would usually also lead to a change in the comparatives there would not be any impact on opening funds. On the other hand the adoption of FRS17 would lead to a prior period adjustment.

The following are web links to some of our clients’ SORP 2005 accounts. All have examples of good practice and are worth looking at for ideas and to demonstrate how some of the new issues have been dealt with. Some have implemented FRS17 and produced impact reports.

Action for Blind People: <http://www.afbp.org/>

Age concern: [http://www.ageconcern.org.uk/AgeConcern/about\\_4878.htm](http://www.ageconcern.org.uk/AgeConcern/about_4878.htm)

Health Unlimited: <http://www.healthunlimited.org/aboutus/index.htm>

Help the Aged: [http://www.helptheaged.org.uk/\\_boilerplate/AboutUs/default.htm](http://www.helptheaged.org.uk/_boilerplate/AboutUs/default.htm)

Marie Curie Cancer Care: <http://www.mariecurie.org.uk/about/report-and-accounts.html>

RSA: <http://www.rsa.org.uk/rsa/ar2005.asp>

Save the Children Fund: <http://www.savethechildren.org.uk/scuk/jsp/aboutus/index.jsp?section=finances>

## Scottish Charity Law

The Charities and Trustee Investment (Scotland) Act 2005 received Royal assent in July 2005. Still outstanding are the steps that need to be taken before the main provisions of the Act can come into force. There are several preparatory steps to be taken. It is intended that, subject to parliamentary time, the Act will come into force in February 2006. The new Office of the Scottish Charity Regulator (OSCR) will then take most of its new powers and begin active operation in April 2006. At that time bodies seeking charity status in Scotland will have to apply to OSCR to be on the new charity register, rather than applying to HM Revenue and Customs, as currently occurs.

A non-Scottish charity operating in Scotland will be required to register with OSCR, The non registration exemption will only apply to those charities without land or premises in Scotland and the charity will have to specify where it is registered, for example in England and Wales.

If the exemption does not apply, failure to register in Scotland could be serious. OSCR will have the power to order that any non-Scottish charity which is active in Scotland but is not registered with OSCR to cease calling itself a charity. OSCR will also have power to make a range of other orders which could have a significant impact upon the activities of that charity. The effect of the requirement to register with OSCR will therefore be that charities already registered elsewhere will be subject to more than one regulatory regime.

The Act contains provisions for OSCR to co-operate with other regulators such as the Charity Commission to minimise the burden of regulation on charities already registered elsewhere. The Government's reply to the Joint Committee's Report on the Charities Bill also confirms that it will continue to collaborate closely with the Scottish Executive to ensure the definitions of charity in the two pieces of legislation are compatible and that the consequences of registration in Scotland on applicable English and Welsh charities will not include any significant increase in the burden of regulation. The Charity Commission and OSCR have also signed a memorandum of understanding to re-affirm and build on the co-operation that already exists between the Commission and OSCR, to:

- ensure appropriate consultation and co-ordination in the interpretation and application of the relevant law and policy, ·
- minimise the burden of regulation for those charities operating across the jurisdictions;
- set out the circumstances in which the Commission and OSCR will share information and collaborate operationally where a common regulatory approach is required; and
- pave the way for future co-operation between OSCR's statutory successor and the Commission, within the framework of the new legislation.

One of OSCR's key objectives is to plan and introduce a proportionate regime of monitoring and supervising Scottish charities. Monitoring will be in two parts: all charities will complete an Annual return and charities with an income of over £25,000 will also complete a supplementary Monitoring Return. The Annual Return form will be used to compile an online 'list' or index of charities. "The List" is a one-off campaign to capture a broad range of information about each Scottish charity that is not currently available. This will form the basis of all future Monitoring Returns.

For further information see

<http://www.scotland.gov.uk/Topics/People/Voluntary-Issues/15300/Timetable>

## Charity Commission guidance on Pensions and FRS17

There has been concern that with some charities the pension fund deficit could lead to negative reserves. In May 2005 the Charity Commission published guidance on FRS 17 deficits – they stated:

*“In so far as an FRS17 calculated pension deficit does not result in an immediate equivalent cash commitment, it would not generally be appropriate for trustees to regard an equivalent amount as a designation of charitable funds. To do so would indicate an intention to apply the amount designated to make good the full amount of any reported pension liability and indicate that such funds were unavailable to expend on the charity’s general purposes.*”

*“A good starting point is for a charity to exclude the FRS17 calculated asset or liability when calculating free reserves but then to give careful consideration to the cash flow implications that may arise from the accounting disclosure in terms of increased or reduced contributions.*”

*“Where a charity is confident that it can meet contributions from projected future income without significant impact on its planned levels of charitable activity then it is unlikely that trustees will need to designate any of their existing funds to meet future pension commitments.*”

*“Where contribution increases create uncertainty as to the charity’s ability to meet them from projected future income, or would result in a significant curtailment of charitable activities, then urgent consideration by the trustees is required. In such circumstances immediate actuarial and legal advice is likely to be appropriate; it would be prudent to create a designation in so far as it is anticipated that the ability to make future contributions is dependent upon the assets currently held by the charity.*”

*“Additional contributions could result in a situation where designations of currently held resources and future incoming cash flows are insufficient to fund future contributions, or the impact of funding the scheme is such that it would have an unacceptable impact on charitable activities. In such situations issues of viability arise and formal professional advice is essential.”*

The full guidance is available at:

<http://www.charity-commission.gov.uk/supportingcharities/pensions.asp>

## FATF recommendations for a code of conduct for non-profit organisations

In July 2005 the Finance Action Task Force (FATF) published for comment “Draft recommendations to member states regarding a code of conduct for non-profit organisations to promote transparency and accountability best practices – an EU design for implementation of FATF special recommendation VIII - non-profit organisations”.

This follows on from the FATF’s international standards for combating terrorist financing – the Eight Special Recommendations. The eighth recommendation states:

*“Countries should review the adequacy of laws and regulations that relate to entities that can be abused for the financing of terrorism. Non-profit organisations are particularly vulnerable, and countries should ensure that they can not be misused:*

- *by terrorist organisations posing as legitimate entities;*
- *to exploit legitimate entities as conduits for terrorist financing, including for the purpose of escaping asset freezing measures; and*
- *to conceal or obscure the clandestine diversion of funds intended for legitimate purposes to terrorist organisations.”*

In their report *The Financial War on Terrorism* – published in 2004 the FATF has said *“The misuse of non-profit organisations for the financing of terrorism is coming to be recognised as a crucial weak point in the global struggle to stop such funding at its source.”*

All this has led to new legislation and new emphasis and a number of NPOs have been concerned that new legislation and the focus on security and terrorism is having an impact on development. Their concerns are that political and media attention is being drawn away from the real operational agenda. There is also concern that “security issues” are influencing aid allocations and the nature of donor co-operation with developing countries. There is also concern that the “war on terror” is being used to justify practices that could undermine the achievement of development goals and run contrary to international commitments on human rights. Whilst these may be legitimate concerns it is important that careful consideration is given to the rules.

The discussion draft recommends that NPOs should produce and keep up to date the organisation’s “Basic Identification Form” that should be sent to the authority competent in fulfilling relevant registration functions. The “Basic Identification Form” should also be held available at the registered office. The suggestion is that the “Basic Identification Form” should as a minimum include the following elements:

- Full (formal) name of the NPO, any the commonly used acronym or other informal name, business/working name and Registration Number (if appropriate);
- Address of the registered office, telephone/fax number/web site address (if appropriate) and a record of previous addresses and changes of addresses;
- Full (formal) name (incl. acronym) and address of sub branches of the organisation;
- A statement of the General Objectives, Policies and Priorities of the NPO;
- A description of the NPO’s organisational and decision-making structure, reflecting the size of the organisation and by indicating internal financial control systems
- Description of the geographical areas where funds are transferred to and received from;
- A list of Names of all members/directors/executive committee members or trustees and their responsibilities. Where appropriate the controller/beneficial owner of NPO should also be identified.
- A list of the bank account numbers under the name of the NPO (this will not be publicly available)

There is also a list of risk indicators concerning the abuse of non-profit organisations to terrorist

financing or other criminal purposes. The main aim of listing the indicators of potential risks is to raise awareness of the non-profit sector, of public authorities and potential donors to vulnerabilities of the non-profit sector to terrorist financing.

The consultation document seems to suggest that failing to adopt the code of conduct could in the future impact on tax benefits and also EU funding. Whilst many of the recommendations are good practice there are clearly some that need to be thought through to assess their regulatory impact.

The document is available on:

[http://europa.eu.int/comm/justice\\_home/news/consulting\\_public/code\\_conduct\\_npo/draft\\_recommendations\\_en.pdf](http://europa.eu.int/comm/justice_home/news/consulting_public/code_conduct_npo/draft_recommendations_en.pdf)

## New VAT opportunities

### *Recovery of VAT on Fundraising costs*

A decision of the High Court in the case of **Church of England Children's Society** v HMRC has opened the way for charities to claim VAT on fundraising costs. The court held that VAT on charges levied by face-to-face professional fundraising organisations (PFO's) can be claimed to the extent that they are attributable to the charity's VATable business activities. Potentially this is a very significant victory for the charity sector and could allow significant retrospective reclaims as well as reducing charities' costs going forward.

This ruling would appear to negate the need for charities to undertake a business/non-business apportionment where they can demonstrate that their fundraising activities are undertaken to support their underlying business activities. Therefore more VAT would fall into the residual input tax pot. Charities may need to consider a means of apportionment which is not values-based in order to ensure a more equitable allocation of costs.

In addition, it also opens the way for UK charities to claim the appropriate percentage of VAT in respect of fundraising costs which previously may have been treated as irrecoverable on the basis that they were wholly used in non-business activities. Claims can go back for the last three years. It should also allow VAT to be partially recovered on such activities going forward. The relevant types of expenditure will differ from charity to charity but it should include many areas of fundraising expenditure

Although it is not yet known whether Customs are to appeal the decision, charities should take steps now to identify VAT incurred on fundraising costs and where appropriate submit a protective claim. Going forward, charities should also consider how much VAT can be treated as reclaimable on such costs.

### *Recovery of VAT on building expenditure*

Following the ECJ decision in P Charles and TS Charles Tijmens, Customs have now confirmed in Business Brief 15/05 that the changes to the UK law made in 2003 to counter use of "**Lennartz**" planning were ultra-vires. Customs now accept that businesses that incur VAT on, for example, buildings to be used both for business and non-business purposes can rely on the Sixth Directive and treat the VAT they incur as fully recoverable, "subject to the normal rules", accounting for output tax on the non-business use over the economic lifetime of the asset (20 years at most for land, buildings and civil engineering works and a maximum of 5 years for other assets).

Customs have invited businesses that wish to do so to make retrospective claims, subject to the 3-year cap in relation to purchases made after 9 April 2003 (the date of introduction of what is now accepted to be defective law). Customs take the view that businesses that did not make a claim before 9 April 2003 chose not to do so at a time when they could have done, and cannot revisit that decision. Organisations should immediately review the position for input tax incurred on the following, and where appropriate submit a claim to HMRC:

- acquisitions of land;
- construction of new buildings and civil engineering works; and
- major refurbishments or extensions of existing buildings.

Going forward non profit organisations should also consider the potential cash flow opportunity which this presents in respect of new projects. The VAT impact can be significant and early planning is important.

Further information on both these issues can be found on our website: [www.deloitte.co.uk/nonprofit](http://www.deloitte.co.uk/nonprofit)

## Gift Aid on entrance fees

Legislation on Gift Aid on Charity Visitor Donations, which comes into effect on the 6th April 2006, was enacted in Finance No 2 Act 2005. In order to give charities time to prepare, guidance has now been published on the HMRC Internet.

At present the normal Gift aid benefit rules are modified for certain types of charity. Charities that have as their sole or main purpose the preservation of heritage property or the conservation of wildlife can disregard a right of admission given in return for a donation in determining whether the benefits received by a donor, or connected person, exceed those allowed. There is no restriction on the level of donation that can benefit from the exemption.

The new rules have broadened the scope of who and what qualifies for the exemption so that all charities where the public pays an admission charge to view qualifying property can benefit from the exemption. This means that if the right of admission is a right granted by the charity for the purpose of viewing property preserved, maintained, kept or created by a charity in pursuance of its charitable purposes, including, in particular:

- buildings;
- grounds or other land;
- plants;
- animals;
- works of art (but not performances);
- artefacts; and
- property of a scientific nature

Although the scope of who and what the exemption applies to has widened, the new rules limit the application of the popular Gift Aid on entry type schemes. The new rules will apply where the following conditions are met:

- The visitor makes a donation that is at least 10 per cent more than the admission charge for the equivalent right of admission.

Or

- The donation secures admission to the property for a twelve-month period, for example through a season ticket or a membership scheme. Access should in general be unlimited whenever the property is open to the public during that 12 month period but charities may exclude from the right of admission up to 5 days in each 12-month period when the property is otherwise open to the public and still qualify.

The VAT position generally is unaffected and only the additional 10% on top of the admission fee is treated as a donation for VAT purposes.

HMRC's guidance has many examples and frequently asked questions and can be viewed at <http://www.hmrc.gov.uk/charities/chapter3-insert.htm>

## Construction Industry Scheme ("CIS") Reform

HM Revenue & Customs ("HMRC") have issued further guidance concerning the changes to the CIS legislation which are due to take effect from April 2006. This will mean significant changes to the way the CIS is operated.

CIS is not restricted to those businesses who operate solely in the construction sector but also applies to those 'deemed contractors' whose business is not involved in construction operations but who spend more than £1m on average on construction work over a 3 year period ending with their last accounting date. As a consequence many non profit organisations are caught by the legislation.

Perhaps the key issue for deemed contractors is that the new legislation provides an exemption from operating the CIS if certain conditions are satisfied. For businesses that meet the exemption criteria this will be exceptionally good news and cut out a significant amount of administration next year.

The exemption operates by excluding from the CIS requirements qualifying expenditure associated with property occupied by your own business or by group companies. However, the exception does not extend to property not used for your business, investment property or property which is for sale or let. However, if you are able to take advantage of it - or are able to restructure your property holding to maximise the relief within the group, you may be able to benefit from a much reduced, or even a zero compliance workload.

For those that do not meet the exemption April 2006 isn't that far away given the changes to internal processes which will be necessary as a result of the introduction of the new rules - this might involve training staff and updating any technology you currently use to capture and report the relevant data.

The key changes are:

- The gross payment certificates and registration cards currently used under the scheme to determine whether a subcontractor may be paid gross or net will be replaced by a verification process.
- There will be a stricter line taken on determining whether subcontractors are correctly treated as self employed, with the onus on the contractor to have properly considered the status position.
- The current annual CIS36 return will be replaced by a monthly return which will include a declaration on the sub-contractors' employment status.
- HMRC are replacing their IT systems with a more efficient system capable of dealing with e-services, allowing communication and submission of returns over the internet.
- A new penalty regime is to be introduced

It will be necessary to address the practical issues to ensure that you will be able to conform with your revised compliance obligations.

For further information on this and other employer solutions see the other Deloitte Resources link on our website [www.deloitte.co.uk/nonprofit](http://www.deloitte.co.uk/nonprofit)

## International Standards on Auditing

On 17 December 2004, the Auditing Practices Board (“APB”) published 30 new International Standards on Auditing (UK & Ireland) (“ISA pluses”) which will replace existing UK Auditing Standards (“SASs”) and align them with International Auditing Standards. The ISA pluses are effective for audits of accounting periods commencing on or after 15 December 2004 and planning for the impact of the changes needs to be considered sooner rather than later.

The “plus” elements do two things – to incorporate elements of previous UK SASs where these are not covered by the existing ISA, and to include local legal requirements. Whilst UK standards have historically included the requirements of existing ISAs, there have been several major changes in the last year which will mean significant new requirements for auditors and require them to overhaul their approach and methodology. The key changes are:

- ISA plus 240 - “The Auditors’ Responsibility to consider fraud in an audit of financial statements”
- ISA plus 260 - “Communication of audit matters with those charged with governance”
- ISA plus 300 - “Planning an audit of financial statements”
- ISA plus 315 - “Understanding the entity and its environment and assessing the risk of material misstatement”

The most significant changes are highlighted below. The existing audit procedures of many auditors address some of these but inevitably there are changes that are likely to require additional input from auditors and clients:

### ISA plus 240

- Makes the presumption that revenue recognition is a specific risk.
- Requires the performance of certain audit procedures to address the risk of fraud due to management override of controls.
- Management should represent it has disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

### ISA plus 260

- The auditor should consider whether the two way communication between the auditor and those charged with governance has been adequate for an effective audit.

### ISA plus 300

- Introduces the concept of the strategic audit plan.

### ISA plus 315

- Will require auditors to gain a deeper understanding of the control environment.
- Requires the auditor to evaluate the design of a control and determine whether it has been implemented.
- Understand the financial reporting process.

### ISA plus 700

- Revises the wording of the audit report.

In the longer term, the APB will update Audit Practice Note 11 (‘APN11’) which provides guidance on the application of Auditing Standards to the audit of charities in the United Kingdom. However, they recognised that in the short term there was a need for more urgent guidance on applying the new requirements to charities. Accordingly, on 17 February 2005 they published a 25 page bulletin entitled - ‘Audit Risk and Fraud - Supplementary Guidance for Auditors of Charities’.

This bulletin provides supplementary guidance for auditors of charities on these additional requirements, by replacing the relevant sections of APN 11. It focuses on the three ISA pluses that address the areas of audit risk and fraud:

- ISA (UK and Ireland) 240 - "The Auditors' Responsibility to consider fraud in an audit of financial statements"
- ISA (UK and Ireland) 315 - "Understanding the entity and its environment and assessing the risk of material misstatement"
- ISA (UK and Ireland) 330 - "The auditor's procedures in response to assessed risks"

In February 2005 the Institute of Chartered Accountants in England & Wales (the 'ICAEW') published a guide "Auditing Standards – All Change! A Short Guide to Selected International Standards on Auditing (UK and Ireland)" to provide useful guidance and examples of responses to the new standards.

The most significant changes which will lead to a review of the audit approach are the need to gain a deeper understanding of the control environment and to evaluate the design of controls and determine whether they have been implemented. Prima facie, this may not appear different to the audit approach currently required by existing SASs. However, ISA (UK and Ireland) 315 goes on to more fully explain this requirement and it demands significantly more than the existing UK requirements.

Paragraph 43 of ISA (UK and Ireland) 315 explains that an auditor must obtain an understanding, consider and document each of the following five components of internal control.

- i) Control environment (In the case of a charity there are many issues to consider from the tone at the top, the use of volunteers and the nature of activities)
- ii) Entity's risk assessment process
- iii) Information system, including the related business processes, relevant to financial reporting and communication
- iv) Control activities
- v) Monitoring of controls.

This may seem like stating the obvious but it is telling that the ICAEW guide explains that. *"For many, this will represent one of the most significant changes from current working practices."*

The ICAEW guide also clarifies that *"Much of the information used in monitoring of controls is often produced by information systems. The auditor must determine whether the entity has a reasonable basis for relying on such systems."* This increases the need to use IT specialist auditors and this may become a norm.

The changes required by these standards have not yet received much publicity and, although the degree of change will vary from one audit to another, change is inevitable. It is important that clients and auditors understand this as it is likely that both will have to consider the new requirements as the bar has been raised and it is likely that there will be cost implications. The ICAEW guidance states:

*"Audit engagement partners are encouraged to communicate the extent and nature of changes in their audit processes and procedures with those charged with governance and any increase in resources required to perform the audit in accordance with the new standards."*

The ICAEW Audit and Assurance Faculty (AAF) publication *Auditing Standards – All Change!* can be downloaded by members of AAF from:

[http://www.icaew.co.uk/auditassfac/index.cfm?AUB=TB2I\\_78397|MNXI\\_78397](http://www.icaew.co.uk/auditassfac/index.cfm?AUB=TB2I_78397|MNXI_78397)