Coronavirus: financial reporting issues for charities

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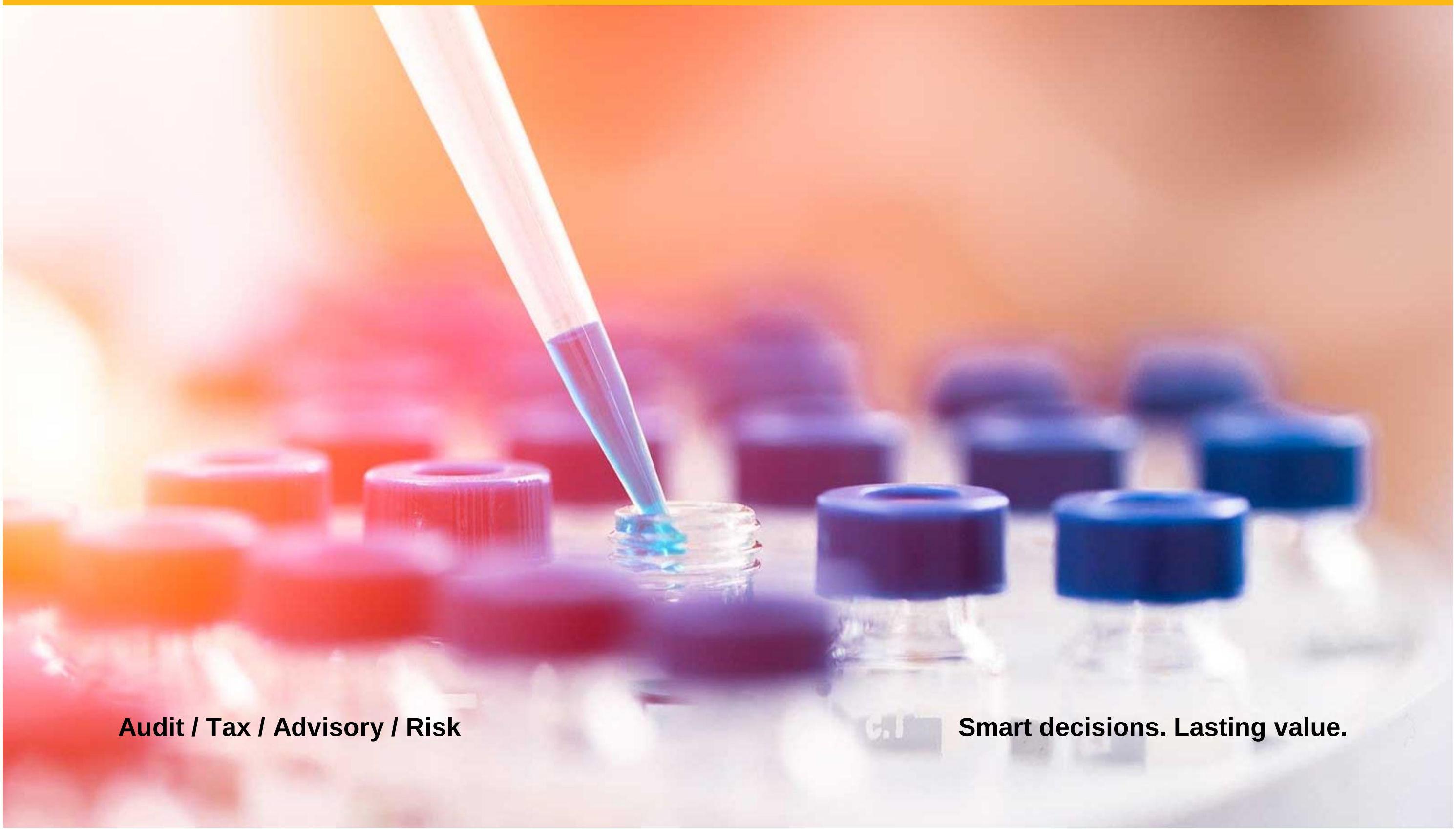

This update considers the potential impact of the new COVID-19 (coronavirus) on the yet to be published annual reports and financial statements of charities.

The measures put in place by the Government to limit the spread of the virus have been changing on a daily basis. It is expected, at least in the shorter term, the limiting of the movement of people by restricting flights and other travel, cancelling events, and closing venues, various business activities and schools will continue and may even increase.

All of these developments and measures may have a broad range of implications for charities. How the impact on individual charities will depend on a number of factors including the charity's key sources of income, areas of charitable activity, staffing models, contractual relationships, the nature of the charity's assets and liabilities and the charity's underlying funds structure.

Charity Trustees will already be facing unexpected challenges to their charities and it will be important that these are reflected into the necessary decisions that have to be made when reporting on the charity's activities and financial position.

Areas of focus

The key areas of focus of this update are as follows:

Being mindful that charities are diverse in their activities and their income generation and therefore, there may be some areas of focus not specifically addressed.

Updates to this document

The following updates have been included in this document:

❖ 2 June 2020 – Asset values, additional comment added following the RICS Valuation Practice Alert guidance to their members on reporting material uncertainty in a valuation.

Key messages

The key message is that management and Trustees will need to carefully consider the impact of coronavirus on the charity's report and financial statements to ensure that these continue to reflect the financial activities and position of the charity in accordance with the Charities SORP.

- Funding agreements, contracts etc need to be reviewed to understand the obligations and rights of the relevant parties. For example, there will need to be a consideration of any specified time to perform and termination or break clauses. There needs to be an analysis of whether parties will be able to perform to deliver and if delivery is not possible or is delayed an assessment of the impact including whether the agreement is frustrated or rescinded. Force majeure clauses will need to be considered carefully.
- While the general rules relating to entitlement, probability of receipt and measurement for income recognition remain unchanged, the impact of coronavirus may require Trustees to reconsider these criteria for their different sources of income.
- Assets where the value has suffered an impairment will need to be reviewed and the impairment reflected in the financial statements.
- Charities will have to review debtors to determine if the third parties remain in a position where they will be able to settle the amounts due or whether there will be a need to write down the carrying amounts.
- Borrowings need to be considered by the charity to ensure that it is not in breach of any related terms and covenants.
- Most organisations, including charities, are necessarily having to change their working structures in the short term. If these prompt a longer-term change in use of resources, then onerous contracts in respect of leasehold properties will need to be assessed.
- A key message to be considered within the Trustees' Annual Report will be the impact of the coronavirus on the charity and how the charity will need to adapt and change its plans going forward. Trustees will need to assess how they can best explain the impact of coronavirus on the charity's financial results and financial position, and what are their plans for the charity to manage the financial impact going forward, including a discussion of the impact on the charity's reserves and reserves policy and the level of reserves held.
- The Trustees' assessment on each charity's ability to continue as a going concern is already a key area of emphasis and importance and Trustees will need to take particular account of the impacts from the coronavirus outbreak and ensure they have the appropriate disclosures. This may also lead to a modified audit report.
- The government has already implemented a number of business support schemes, some of which will be available to charities and / or their trading subsidiaries depending on their circumstances. This is constantly changing and the details of entitlement and how any claims will be settled are still being developed. However, if a charity believes that it can benefit from any of these support schemes Trustees will need to determine when and how any such benefit should be reported in the financial statements.

Income recognition

Income recognition can be a key area of focus for the financial statements of a charity in any normal year. We have previously provided detailed guidance on income recognition which you can access on the Crowe UK website. The overlay of the current coronavirus implications will not only increase the focus on the normal income recognition decisions but may also add risks which the Trustees will need to consider.

The general rules for income recognition remain unchanged with the requirement to meet the three criteria of Entitlement, Probability of receipt of the economic benefit and the reliable Measurement of the amount of the income. The impact of coronavirus may require Trustees to reconsider these criteria for their different sources of income.

For most key categories of income it is unlikely that entitlement principle will change although cancelled or delayed activities may lead to the charity not being entitled to income. The probability of receipt will need to be carefully considered as debtors and receivables may be less certain. Measurement will also be more challenging as asset values, profitability, the time taken to complete a contract etc will be uncertain.

Paragraph 5.3 in the Charity SORP recognises that "*There are two broad categories of income:*

- *income from exchange transactions (where the charity provides assets or services and receives appropriate value (primarily in the form of cash, goods, services, or use of assets) from another party in exchange.), and*
- *income from non-exchange transactions (gifts).*

It is important for charities to distinguish between the two as they are recognised differently in a charity's accounts."

This distinction will be particularly important in the current environment to determine how coronavirus will impact on the recognition of income in the charity's financial statements.

Future fundraising events

Fundraising events often involve both exchange and non-exchange transactions with income being generated from both ticket sales and from donations. They often also involve income being received in advance of the event from ticket sales and donations as well as costs being incurred in advance.
Some charities recognise income before the fundraising event happens on the basis that they have received entitlement to income that will not be returned.

Charities with future fundraising events will need to consider the probability of the event taking place. For events that have to be cancelled it may be necessary to review the nature of any amounts already received to determine whether these are refundable or can be retained as donations.

At the same time charities will have to separately review any incurred or committed expenditure on future fundraising events to determine whether costs incurred can be recovered and commitments cancelled and, if not, the extent to which these costs should be written off in the reporting period.

Legacy income

The SORP explains that "*For accounting purposes, evidence of entitlement to a legacy exists when the charity has sufficient evidence that a gift has been left to them and the executor is satisfied that the property in question will not be required to satisfy claims in the estate.*

"Of itself, establishing entitlement is insufficient to recognise legacy income. The recognition of the gift is also affected by the probability of receipt and the ability to estimate with sufficient accuracy the amount receivable".

Once again the first test is does the charity have entitlement. At present there are different approaches being adopted by charities on the recognition of income. With regard to entitlement there are essentially two policies being operated by charities;

i. entitlement is when probate is filed

ii. entitlement is when estate accounts are settled / there is notification of a distribution.

We have explained more about these two options and their impact in the FAQs on income recognition on the Crowe UK website

Legacies will be received, but there is likely to be some disruption, at least in the shorter term, in the processing of wills and estates which may increase the time needed for charities to receive adequate assurance of the probability of receipt. Additionally, the disruption that is already evident in the investment markets and the likely disruption in other markets such as housing may make it difficult for executors to establish a sufficiently accurate value for the estate assets. In addition, difficult financial circumstances might mean that more will are contested by next of kin and others that feel that they have “lost out” by bequests to charities. There is some evidence to show this happened after the last economic downturn in 2009.

Trustees need to ensure that their accounting policy for recognising legacy income appropriately reflects the likely uncertainties going forward. In addition, they may also need to review any legacy amounts recognised as income but not yet received to ensure that the measurement of the amount receivable remains reasonable and realistic in the new environment. This will also impact on the disclosures regarding the legacy pipeline.

Grant income

The rules for recognising grant income are set out in paras 5.10 to 5.28 of the SORP and will continue to apply. However, although in principle the coronavirus outbreak should not change the nature of the grants already agreed by charities, there are likely to be a number of potential issues that charity Trustees will need to review and consider in relation to the recognition and reporting of grant income.

The key requirements for recognising grant income are set out in SORP para 5.10 “*Income from donations or grants is recognised when there is evidence of entitlement to the gift, receipt is probable and its amount can be measured reliably.*” For certain grants the changed circumstances may potentially impact on any of these three recognition requirements. The list below highlights some of the issues Trustees may need to consider and review.

- Performance related grants. Trustees may need to review the charity’s ability to meet any terms or performance conditions that must be met before there is unconditional entitlement to the gifted resources. This may be particularly the case where the terms require matched funding or where the charity’s activities have necessarily been refocused as a result of the coronavirus restrictions. For example, a grant may be in the form of a service level agreement where the conditions for payment are linked to the achievement of a particular level of service or the units of output delivered where the output is no longer practical or providing the best outcome by the charity.
- Donor imposed conditions. Donors may have specified the time period over which the expenditure of resources on a service can take place. Specification of a time period may amount to a pre-condition for use that limits the charity’s ability to spend a grant or donation until it has performed the activity related to the specified time period. What may previously have been a practical condition may no longer be realistic for the charity and this may impact on the probability of receipt. Whilst some funders have allowed no cost extensions it is important to recognise that charities will continue to have costs in the extended period.
- Restricted grants. A term or condition that simply restricts the use of a grant or donation does not affect a charity’s entitlement and recognition of income. In the absence of any other donor-imposed conditions or performance requirements, restricted grants are likely to continue to be recognised as before. Except where it appears that the restriction cannot be met. However, for grants not yet in place the changed funding needs for charities as a result of coronavirus may result in extended periods of discussions with potential donors to ensure that grants meet the current funding needs and this may impact on the income recognition timing.

There is evidence that funders are relaxing their requirements and charities should contact funders to discuss matters such as increasing the element that can be used to cover core costs, extending reporting timetables, changing deliverables, prefinancing etc. It is important to recognise that in cases such as no cost extensions to complete work the costs of the extended period will need to be financed.

Income from contracted supplies of goods or services

The basic rules for recognising income from contracted supplies of goods or services remain as set out in the SORP paras 5.39 to 5.47. However, the disruption to normal activity from the coronavirus may impact on this income in a number of ways.

- For the sale of goods entitlement is usually at the point of supply of goods to the buyer. But the timing of sales is likely to be affected through the closure of charity shops and other restrictions. Where income has not been received the recoverability of the debt needs to be considered carefully.
- Income from the supply of services is recognised in line with the delivery of the service. Any restrictions on the ability of the charity to deliver the services or changes to the level of services that are necessary may impact on the value and timing of the related income.
- Charities which have outstanding debtors will have to review these to ensure that the customers remain in a position to settle the amounts due and whether any additional provisions against the debtor balances are necessary.

Income from donated goods, facilities and services

The basis for recognising, accounting for and reporting donated goods, facilities and services, including volunteers, are set out in the SORP Section 6. For charities which are already receiving donated goods, facilities or services the requirements for the related income recognition will not change. However, one impact from the coronavirus may be some changes to the patterns of donations with charities receiving either new or changed donations.

For a charity which benefits from donated goods, facilities and services, it will be important that the Trustees understand the implications for the charity and the value of the benefit that is received. The valuation criteria may need to be reassessed in light of the current situation. They should also ensure that the charity has an appropriate accounting policy to capture the fair values and benefit of material donations in the financial statements and in the Trustees' annual report.

Where charities benefit from an increase in unpaid volunteers, the SORP recognises that placing a monetary value on their contribution presents significant difficulties and concludes for various reasons that the contribution of general volunteers must not be included as income in charity accounts.

Trustees may therefore need to review any volunteer services provided to decide on whether these should or should not be valued in the financial statements. They will also need to consider any disclosure requirements including from SORP para 6.19 which requires that "*Charities must include a description of the role played by general volunteers and provide an indication of the nature of their contribution in a note to the accounts*."

Commitments and liabilities

The general rule for recognising liabilities is set out in SORP para 7.5 and requires that "*a liability and the related expenditure must be recognised when all of the following criteria are met:*

- *Obligation – a present legal or constructive obligation exists at the reporting date as a result of a past event.*
- *Probable – it is more likely than not that a transfer of economic benefits, often cash, will be required in settlement.*
- *Measurement – the amount of the obligation can be measured or estimated reliably."*

A legal obligation arises when a charity enters into a binding contract or there is a statutory requirement to make a payment and the expenditure is normally recognised once the supplier of the goods or services has performed their part of the contract. A constructive obligation arises as a result of a charity's actions when it indicates to other parties that it accepts particular responsibilities and thereby creates a valid expectation on their part that the charity will meet them.

Financial instruments

The accounting for financial instruments can be complex even in normal times, but the impact of coronavirus is likely to add an additional level of complexity for Trustees in reviewing the financial position and impact on the charity from both basic and non-basic financial instruments.

For most smaller charities, as well as some larger ones, their financial instruments are likely to fall within the common basic financial instruments as set out in the SORP Section 11 Table 7:

Financial instrument	Measurement on initial recognition
Cash	Cash held
Debtors – including trade debtors and loans receivable (trade accounts and notes receivable)	Settlement amount after any trade discounts (provided normal credit terms apply) or amount advanced by the charity
Creditors – including trade creditors and loans payable (trade accounts and notes payable)	Settlement amount after any trade discounts (provided normal credit terms apply) or amount advanced by the charity
Overdraft (loan payable on demand)	Amount of the overdraft facility drawn down
Qualifying long-term loans (that meet the debt instrument criteria in FRS 102)	Amount on principal advanced less material arrangement or similar fees
Bank deposit	Cash amount of deposit
Investment in non-puttable (i.e. without an option to sell the shares at a later date at an agreed price) ordinary and preference shares or non-convertible preference shares	Transaction price (cost)
Loans advanced by the charity on market terms (that meet the debt instrument criteria in FRS 102)	Amount of principal advanced

The valuation of these basic financial instruments is not generally complex, but Trustees may need to review the values in reporting the financial position of the charity.

- Debtors and loans advanced by the charity. As noted above for debtors, Trustees will have to review debtor / loan amounts to ensure that the third parties remain in a position where they will be able to settle the amounts due. Based on this, Trustees will need to conclude on whether any impairment provisions are necessary to reduce the carrying amount the debtor / loan balances to their realisable amounts at the balance sheet date.
- Bank overdrafts and loans. As well as reviewing any borrowing by the charity to ensure that it is not in breach of any related terms and covenants, charities which are able and plan to take advantage of any of the planned government support schemes will need to review the impact of this on the balances reported and related disclosures

Charities with other financial instruments, including hedging arrangements through forward foreign currency contracts, will need to carry out a more detailed review to understand and identify the implications to them and their reporting from the movements in foreign currency exchange rates, the reduction in base interest rates and any other relevant factors which may potentially impact on the fair values of these financial instruments.

Leases and onerous contracts

One impact of the coronavirus is that most organisations, including charities, are necessarily having to change their working structures in the short term. Whilst this may be temporary, for some charities this may prompt a longer-term change which may in turn change the resources needed by the charity.

In reviewing the current and ongoing plans for their charity, Trustees may identify that certain leasehold properties or other contracted facilities or services will not be needed by the charity to meet its future plans. In this event, to the extent that the charity is not able to extract itself from the relevant leases or other contracts by cancellation or other means, it may be necessary to consider if provisions are required in the financial statements on the basis that these have become onerous contracts.

Grant funding commitments and provisions

Charities which award grants are likely to have an increased demand on their resources, and potentially following the fall in investment values a reduced available resource.

Charities that currently make grants should already have in place an accounting policy for their grant expenditure and liabilities, in particular to meet the principles for recognising liabilities where they have created constructive obligations as set out in the SORP paras 7.12 to 7.16.

However, any such policy, and in particular the criteria used to provide the supporting evidence that constructive obligations exists, may need to be reviewed. Evidence for a constructive obligation requires a specific commitment which has been communicated directly to the beneficiaries or recipients and an established pattern of practice of meeting these commitments.

Whilst many charities will continue to meet their commitments, with potentially reduced resources some charities may need to review these to ensure that their grant activity is focussed to maximise the benefits that can be achieved. It may also be necessary for charities to reassess the financial position of the planned recipients.

Should any changes be needed to the previous grants committed, Trustees will need to consider how this is presented, both on the financial; statements and in the grant making comments in their annual report.

Pension liabilities

The financial statements requirements for DB scheme accounting and disclosures by charities which continue to have defined benefit liabilities remain unchanged and are set out in Section 28 of FRS 102. These require the charity to report the net defined benefit liability (being the present value of the scheme obligations less the fair value at the reporting date of the scheme assets) and the change in this liability during the period.

There are many areas to consider and the estimates and judgements made in the assumptions used can have a large impact on the final result. Care will be taken to consider matters such as whether current bond rates and yields properly reflect the nature of the scheme. For example, liabilities are often assumed to be of the same term as the maturity of the bond index. The reality is that most pension schemes are normally of a much longer term nature.

There is already much comment on the impact of coronavirus on pension schemes, and in particular for employers who continue to be the sponsors of defined benefit (DB) schemes. The key short-term issue is likely to be the increase in the net liability, mainly due to a fall in the investment values, and how this is presented and explained in the Trustees' report and the financial statements. In the longer-term actuaries may need to reassess other assumptions in their actuarial valuations including overall life expectancy and these assumptions are likely to become an area that will need increased focus for the Trustees both in the valuations for financial reporting and in assessing the required future contribution rates.

Also, a pension scheme deficit calculated on the basis of FRS102 may lead to a negative balance sheet but will not, of itself, impact on the cash flows of the sponsoring charity into a defined benefit pension scheme. The cash contributions required by the employer are arrived at through negotiations with trustees and / or through statutory requirements, either of which may involve measuring surpluses or deficits on a different basis to that required by FRS102.

In this regards the Charity Commission published guidance some time ago and said, "Where, under FRS102, a charity discloses a significant pension fund deficit, this does not mean that an immediate liability for this amount crystallises. Similarly, where a pension surplus is disclosed this does not create an immediately realisable asset that can be released straight away and expended on the purposes of the charity. In particular, the disclosure of a pension liability does not mean that the equivalent amount is already committed and is no longer available to the trustees to further the charity's objectives".

For any charities for which cash flows are an immediate issue, initial guidance has already been published by the Pensions Regulator including Guidance for DB scheme Trustees whose sponsoring employers are in corporate distress. The guidance is currently brief but includes short comments on areas such as the deferral of deficit repair contribution (DRC) payments.

Asset values/impairment

Perhaps one of the initial most obvious financial impacts of coronavirus has been the fall in value of the financial markets. However, there may also be other assets where the value has suffered an impairment and it will therefore be important that Trustees review the assets of their charity to identify if any such impairment has occurred and ensure that this is reflected in the financial statements.

Tangible fixed assets in use

The SORP recognises that charities often hold tangible fixed assets primarily to provide services to their beneficiaries rather than for generating cash flows and that it would therefore be inappropriate to measure value in use by reference to the charity's cash flow. In such circumstances, it is often more appropriate to regard value in use as the present value of the asset's service potential.

SORP para 12.16 then specifically recognises that "*The demand or need for the services provided by a charity using an asset may fluctuate over time and a temporary reduction in demand is not necessarily an indication of its impairment. Similarly, an asset's service potential may not always be fully utilised and surplus capacity at certain periods will not always indicate impairment*."

As noted, many charities will currently be going through a period of disruption with changes to their operating methods and practices and as part of this charities may be holding assets which become less used.

Trustees are required to consider at least annually when preparing the charity's financial statements whether there is an indication that the carrying value of any of the charity's assets have been impaired. They will therefore need to consider whether any reduction in use of the charity's assets is temporary or longer-term and, if longer-term, whether an impairment provision should be made to reduce the carrying value of the relevant assets in the charity's financial statements.

Investment assets

Following the various actions by governments around the world there has been a significant decline in the value of the financial investment markets which will in turn impact on the net assets and reserves of charities with significant financial investment assets.

Possibly more subjective, other investment assets including property investments and unlisted financial investments have also fallen in value, potentially by more than the financial assets. In preparing their financial statements Trustees are required to determine and agree the values of the investment assets; for assets such as property which are not actively traded at least in the short-term there may be challenges in agreeing what values can now be attributed.

The RICS has in May 2020 published a Valuation Practice Alert giving specific guidance for their members on the impact of COVID-19. This includes guidance where RICS regulated members conclude there is material uncertainty in a valuation and provides a suggested 'material valuation uncertainty' wording which can be used by their members when reporting.

Initial experience has shown that property valuers following the RICS guidelines are including this material uncertainty paragraph in their valuations and it will therefore be necessary for trustees to decide how this uncertainty impacts on their reporting and how this should be disclosed in the charity's financial statements.

Stock held for trading

Charity's which operate shops or other trading outlets which have been closed, albeit hopefully temporarily, will need to assess the carrying value of any purchased stock to determine whether any impairment provision should be made.

Any such review will need to consider the nature of the stock and whether it is impacted by shelf-life or other issues that may make it unsaleable before shop trading can resume. Charities that also trade on the internet may be able to redirect stock through this alternative outlet, but again this will be an area that the Trustees will need to review.

Insurance/contingent assets

Charities that hold insurance policies may be able to claim for certain costs or losses and may have either a contingent asset for these claims if not agreed with the insurer or an actual asset which may be recognised if agreed by the insurer.

For accounting purposes FRS 102 para 2.38 requires that "*An entity shall not recognise a contingent asset as an asset. However, when the flow of future economic benefits to the entity is virtually certain, then the related asset is not a contingent asset, and its recognition is appropriate*."

Going concern

The Trustees' assessment on the charity's ability to continue as a going concern is already a key area of emphasis and importance and will necessarily in Trustees' reports and financial statements published going forward need to take account of the impacts from the coronavirus outbreak. The Financial Reporting Council thinks it is likely that more companies will disclose 'material uncertainties' to going concern in current circumstances.

SORP para 1.23 has a specific requirement for the Trustees' Annual Report that "*If, at the date of approving the report and accounts, there are uncertainties about the charity's ability to continue as a going concern, the nature of these uncertainties should be explained.*"

Additionally, SORP para 3.38 requires that *"All charities must explain if there are **material uncertainties** related to events or conditions that cast significant doubt on the charity's ability to continue as a going concern. In making their explanation, charities should provide:*

- *a brief explanation as to those factors that support the conclusion that the charity is a going concern; and*
- *a balanced, proportionate and clear disclosure of any uncertainties that makes the going concern assumption doubtful; or*
- *if the accounts are not prepared on a going concern basis, this fact must be disclosed, together with the basis on which the Trustees prepared the accounts and the reason why the charity is not regarded as a going concern."*

The impact of the coronavirus outbreak will require all entities, including charities to reassess their financial position and their ability to continue to operate as a going concern. This may require considering a number of factors but probably key will be to update the charity's budgets and forecasts and also to consider whether the charity might fail to comply with any external covenants.

Put simply, where boards identify possible events or scenarios, other than those with a remote probability of occurring, that could lead to failure, then these should be disclosed. Boards may take account of realistically possible mitigating responses open to them, considering both the uncertainty and the likely success of any realistically possible response to mitigate this uncertainty.

Budgets and forecasts

For financial reporting purposes FRS 102 para 3.8 requires that Trustees, when preparing financial statements, make an assessment of the entity's ability to continue as a going concern. An entity is a going concern unless the Trustees intend that the charity will cease its activities, or has no realistic alternative but to do so.

In assessing whether the going concern assumption is appropriate, the Trustees are required to take into account all available information about the future, *which is at least, but is not limited to*, twelve months from the date when the financial statements are authorised for issue.

For most charities budgets and forecasts will, at least initially, have been prepared based on the previous normal and will not reflect the most recent developments. Clearly charities will need to update their forecasts in light of the changed circumstances, but this may be difficult given the current level of uncertainties in relation to what actions and restrictions will be necessary going forward and the possible impact of these on the charity's future income and operations. Careful consideration should be given to extending the preparation of budgets or forecasts to a period exceeding one year from the sign off of the financial statements, to properly reflect the on-going challenges arising from addressing the pandemic challenges.

Hopefully some clarity will emerge as time progresses, but it will be important that Trustees continue to review and update their financial forecasts as developments occur and the impacts on the charity become clearer.

Covenants

The going concern review may be particularly important for Trustees of charities with borrowings for which specific covenants are in place because changes in activities and in asset values may result in charities being unable to meet the covenant requirements. For any charities in this position it will be imperative that this is identified as early as possible and that the lender is involved to seek a solution to allow the charity to continue.

Use of restricted funds

The Charity Commission has published some initial guidance on whether charities can use restricted funds to help them through the crisis. The guidance currently reiterates the legal position – "*If they are restricted funds, meaning they cannot be spent at your (Trustees) discretion, then they may only be used for a particular and defined purpose*."

The guidance does go on to say "*If there are restrictions, in some instances there may be ways to amend these restrictions, but accessing or releasing restricted funds should only be considered if other options such as reserves are not possible. The Commission encourages you to also carefully consider the wider and longer-term impacts of making such a decision on your financial resilience and donor relationships*."

It will be important that Trustees consider their overall funds structure in any overall going concern review, but from the current Charity Commission guidance they do not consider that the use of restricted funds to support the financial position of the charity is a default option.

Having said that, we have seen cases where funders have reacted positively to request by the charity relating to restrictions and other conditions.

Other financial statements disclosures

Post balance sheet events

The recent coronavirus developments are likely to impact on the reporting by charities which have reporting dates in both 2019 and 2020. One key area for possible judgement will be the effective dates of any events which will determine whether or not adjustments should be recorded in the financial statements.

For year-ends up to 31 December 2019 the general guidance is that the financial impacts resulting from coronavirus will be from events post the year-end date and that these will therefore be non-adjusting events. However, a charity may still need to reflect other adjusting events after the end of the reporting period as adjustments to the financial statements. As examples:

- If a debtor which was previously considered as "good" as at 31 December 2019 is subsequently determined to be irrecoverable after the year-end because of the impact of coronavirus, then this will in most cases be a non-adjusting event with no adjustment to the carrying value being made. For any material amounts the change in recoverability post the year-end should be reported in the notes to the financial statements. It will also be important that the changes in recoverability are fully reflected in any going concern review by the charity.
- Alternatively, if other information becomes available after the year-end which indicates that a debtor previously considered as "good" as at 31 December 2019 was not actually recoverable as at this date, then the debtor will probably need to be adjusted. This should be in line with the normal debtor provisioning reviews carried out by charities at previous year-ends.

SORP para 13.7 recognises the above and identifies as examples of non-adjusting events:

- *"a material loss of assets or diminution in the value (impairment) of assets subsequent to the reporting date; and*
- *a material decline in the market value of investments."*

SORP para 13.8 also recognises the requirement for specific disclosure in the financial statements for non-adjusting events after the end of the reporting period "*For each category of non-adjusting event, the notes to the accounts must provide details of the nature of the event and an estimate of its financial effect or a statement that such an estimate cannot be made*."

The Financial Reporting Council in their 'Company Guidance Update March 2020 (COVID-19), explain: *"There is a general consensus that the outbreak of COVID-19 in 2020 was a non-adjusting event for the vast majority of UK companies preparing financial statements for periods ended 31 December 2019. Companies will need to judge how much of the impact of COVID-19 should be considered to arise from non-adjusting events for subsequent reporting dates. This will be highly dependent on the reporting date, the specific circumstances of the company's operations and the particular events under consideration.*

In reaching this judgement, companies will need to focus on the importance of the conditions at the balance sheet date – does the event shine a brighter light on those conditions or did conditions change after the reporting date? If the judgement had a significant effect on the amounts in the financial statements, then this judgement should be disclosed and explained.

If an event is considered to be non-adjusting, then the nature of the event should be disclosed. Where an estimate of the financial effect on the company can be made, then this should be disclosed. Otherwise the fact that the financial effect cannot be estimated should be disclosed. The estimate does not need to be exact – a range of estimated effects is better than no quantitative information at all. In the absence of any quantitative estimate, a qualitative description should be provided."

Trustees are therefore likely to need to focus on the disclosure, including the financial impact on the position of the charity and its results for the period, of the impact of the coronavirus outbreak.

Accounting policies

To comply with the requirements of FRS 102 the SORP para 3.37 requires that Trustees set out in the charity's financial statements the accounting policies used that are relevant to an understanding of the financial statements and the measurement bases used in preparing them.

Trustees are required to reassess their accounting policies each year as part of the financial reporting. While most accounting policies are likely to remain appropriate, to take account to the coronavirus outbreak certain specific areas have been identified for potential review above.

The Trustees should also review the other policies used by the charity to confirm that these continue to remain appropriate.

Key judgements and estimates

SORP para 3.40 requires that charities must also state in their financial statements

- *"the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the accounts;*
- *the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next reporting period; and*
- *in respect of those assets and liabilities where there is a significant risk of material adjustment within the next reporting period, the notes must include details of their nature and their carrying amount as at the end of the reporting period."*

In the current environment of uncertainty, it will be necessary for Trustees to make a number of specific judgements, assumptions and estimates concerning the future in relation to various issues including potentially asset values, liabilities and income receivable. Trustees will need to consider the extent that disclosure of these is necessary to comply with the above SORP requirement. The Financial Reporting Council is encouraging *"companies to provide as much context as possible for the assumptions and predictions underlying the amounts recognised in the financial statements, irrespective of any narrow interpretation of the requirements. Such information will help users to understand the amounts presented."* In their guidance issued recently they explain:

"Relevant judgements and assumptions might include the:

- *availability and extent of support through government support measures that have been announced;*
- *availability, extent and timing of sources of cash, including compliance with banking covenants or reliance on those covenants being waived;*
- *duration of social distancing measures and their potential impacts.*

In the absence of any consensus view of the future path of the COVID-19 pandemic and its impact on the economy, users cannot expect all companies to apply consistent assumptions when there is such uncertainty. This lack of consistency makes the need for full disclosure of judgements, assumptions and sensitive estimates significantly more important than usual."

Trustees' Annual Report

The primary purpose of the Trustees' annual report (the report) is to ensure that the charity is publicly accountable to its stakeholders for the stewardship and management of the funds it holds on trust. Good reporting explains what the charity is set up to do, how it is going about it, and what is achieved as a result of its work.

The report should assist the user to make economic decisions in relation to the charity and to assess the charity's progress against its objectives and to understand its plans in relation to its purposes. A key message within this will what is the impact of the coronavirus on the charity and how the charity will need to adapt and change its plans going forward.

As well as explaining the general impact on the charity there will also be some specific areas within the report which will need a specific additional focus by the Trustees.

Financial review and risks

SORP para 1.46 requires Trustees to "*comment on the significant events that have affected the financial performance and financial position of the charity during the reporting period*" and this should include:

- a description of the principal risks and uncertainties facing the charity and its subsidiary undertakings, as identified by the charity Trustees, together with a summary of their plans and strategies for managing those risks; and
- any factors that are likely to affect the financial performance or position going forward

Trustees will therefore need to assess how they can best explain the impact of coronavirus on the charity's financial results and financial position, what are their plans for the charity to manage the financial impact going forward.

For charities with material DB pension liabilities and/or investment assets, Trustees will need to report on the implications for the charity from fall in investment values and the likely turbulence in the investments market.

Reserves policy

Trustees must explain any policy the charity has for holding reserves and state the amounts of those reserves and why they are held.

Charity reserves are likely to be impacted in various ways, including changing sources of income, changes to the charity's liabilities and the impact on the value of charity assets. The Charity Commission guidance in CC19 recommends that "*The level of reserves should be monitored throughout the year as part of the normal monitoring and budgetary reporting processes*." The guidance further states that Trustees should

- ensure that the reserves policy continues to be relevant as the charity develops or changes its strategy and activities
- review the statement on reserves in the Trustees' annual report where there have been significant changes in the reserves policy or level of reserves held.

In preparing their next Trustees' Annual Report, Trustees will need to consider any impact of the coronavirus on the charity's reserves policy and the level of reserves held. They may also need to consider any changes to designated funds set aside for future commitments

Future plans and activities

SORP para 1.49 requires the Trustees to "*provide a summary of the charity's plans for the future, including its aims and objectives and details of any activities planned to achieve them*". The Trustees will therefore need to consider the likely impact on the charity of the virus control measures and report on this. They will also need to form a judgement on the potential duration of the control measures and how this might impact on the future aims and activities of the charity.

Government support

The government has already implemented a number of business support schemes, some of which will be available to charities and/or their trading subsidiaries depending on their circumstances. The current support announced includes:

- Coronavirus Job Retention Scheme
- Deferring VAT and Income Tax payments
- A Statutory Sick Pay relief package for small and medium sized businesses (SMEs)
- A 12-month business rates holiday for all retail, hospitality, leisure and nursery businesses in England
- Small business grant funding of £10,000 for all business in receipt of small business rate relief or rural rate relief
- Grant funding of £25,000 for retail, hospitality and leisure businesses with property with a rateable value between £15,000 and £51,000
- The Coronavirus Business Interruption Loan Scheme offering loans of up to £5 million for SMEs through the British Business Bank
- A new lending facility from the Bank of England to help support liquidity among larger firms, helping them bridge coronavirus disruption to their cash flows through loans
- The HMRC Time To Pay Scheme
- Arts Council England has announced a coronavirus crisis plan to compensate out-of-pocket artists and institutions

The Crowe Covid 19 hub has information on a number of these initiatives.

All of this is very new and is constantly changing and the details of entitlement and how any claims will be settled are still being developed. However, if a charity believes that it can benefit from any of these support schemes Trustees will need to determine when and how any such benefit should be reported in the financial statements.

Gift Aid payments from trading subsidiaries

It is now well recognised that the Companies Act requires that a payment from a company to its member(s) can only be made if there are sufficient distributable profits. Whether or not a distribution may be made within the terms of the Companies Act is determined by reference to a company's 'relevant accounts'. For most charity subsidiaries these would be the last audited accounts.

However, as well as the statutory rules about distributions in the Companies Act, directors need to bear in mind that certain aspects of the common law apply to distributions. The most important rule here is that a company cannot lawfully make a distribution out of capital and must consider this both at the time of proposing the distribution and at the time it is made.

Directors should consider whether distributable profits have been eroded by subsequent losses after the date at which the relevant accounts were prepared. This means that directors must also consider whether the company will still be solvent following the proposed distribution. They should consider both the immediate cash flow implications of the distribution and the continuing ability of the company to pay its debts as they fall due. So if they know that asset values have eroded – for example because a debt has to be written off - they would need to consider this.

Start the conversation

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About us

Crowe UK is a national audit, tax, advisory and risk firm with global reach and local expertise. We are an independent member of Crowe Global, the eighth largest accounting network in the world. With exceptional knowledge of the business environment, our professionals share one commitment, to deliver excellence

We have been listed as the lead provider of audit services to charities for 11 consecutive years and working with non profits, social enterprises, NGOs and their funders is a key focus of our business worldwide. We provide a range of services including governance, risk management, structures, performance measurement, counter fraud and global mobility

We are trusted by thousands of clients for our specialist advice, our ability to make smart decisions and our readiness to provide lasting value. Our broad technical expertise and deep market knowledge means we are well placed to offer insight and pragmatic advice to all the organisations and individuals with whom we work. Close working relationships are at the heart of our effective service delivery.

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