



26 June 2013

Our ref: ICAEW Rep 88/13

Your ref:

Charity Commission Direct
PO Box 1227
Liverpool
L69 3UG
policydgr@charitycommission.gsi.gov.uk

Dear Sir/Madam,

Consultation on a total return approach to investment for endowed charitable trusts

ICAEW is pleased to respond to your request for comments on *the consultation on total return approach to investment for endowed charitable trusts*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

A TOTAL RETURN APPROACH TO INVESTMENT FOR ENDOWED CHARITABLE TRUSTS

Memorandum of comment submitted in June 2013 by ICAEW, in response to the Charity Commission's consultation on a total return approach to investment for endowed charitable trusts

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation on a total return approach to investment for endowed charitable trusts published by the Charity Commission (the Commission), a copy of which is available from this [link](#).

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 140,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
4. ICAEW has a charities technical sub-committee and a charities & voluntary sector special interest group with over 3,400 members. Many ICAEW members are active in charities and the voluntary sector; approximately 30,000 are charity trustees, treasurers, school governors and in other voluntary roles.

MAJOR POINTS

We welcome the proposal to allow trustees of endowed charities to adopt the total return approach to investment in respect of permanent endowment without having to apply to the Commission for an order under section 105 of the Charities Act 2011. As explained in the consultation document, this greater flexibility for trustees must be subject to safeguards to ensure that the objects of the charity now and in the future are protected and that a donor's wish to establish an enduring charity is respected. We do not have any major concerns about the draft regulations.

5. However, we recommend that some flexibility be considered around the setting of an upper limit of 10% on the release of capital. Whilst we agree that it is very important to safeguard funds that were intended to endow the charity in perpetuity, there may be circumstances when more than 10% needs to be used and if the trustees have obtained appropriate, formal advice that the future returns will be able to be used to rebuild any such capital used, they should be able to approach the charity Commission for its consent to borrow more than the limit to be set in the Regulations. We would not suggest that any caps should be set on usage of the unapplied return.
6. We recommend that the disclosure requirements in the regulations be split between the trustees' annual report and the notes to the account. Draft regulation 6(4) requires the trustees to make statements in their annual report about the adoption of the total return approach, the basis for adopting the policy, and the identity of the person on whose advice the decision to adopt the policy was made. Subject to our detailed comments in paragraph 10 below, we consider that it is right that the report should describe the policy adopted and the underlying reasoning, there also needs to be disclosure in the accounting policies and notes to the accounts of the methodology and calculations that will support the figures in the accounts. Inclusion of information in the notes to the accounts also means that the disclosure is brought within the scope of the statutory external review (audit or independent examination), whereas the auditor's review of the annual report is limited to consideration of whether or not it is consistent with the accounts, and there is no such requirement for the independent examiner.

7. We understand that the revised Charities SORP will contain a module on the total return approach including a reconciliation statement for permanent endowment. However, we recommend that the Commission provide practical guidance on implementing the total return approach, to help trustees, particularly of smaller charities, who may not have specialist knowledge and who may not have a legal or accounting background.

COMMENTS ON DRAFT REGULATIONS

There are some definitional issues that could be addressed more clearly.

8. Throughout the document it is sometimes unclear whether it is talking about endowment funds as a whole or only permanent endowment funds. Unfortunately this is not helped by s.104A of the 2011 Act (as amended) which defines an 'available endowment fund' as the whole (or part) of a 'permanent endowment fund'.

The Commission's guidance should, therefore, seek to unpack this confusion by means of some reference to expendable endowments. Even with an expendable endowment there can be issues as to whether the trustees can use income to add back to the capital of the fund (for example, to compensate for past expenditure from the fund). It would help if the document could clarify the position of expendable endowment funds rather than remaining silent.

9. In the draft regulations, regulation 2 definitions defines 'total return' by listing several transactions that could produce a positive return, but the only negative item mentioned is the possibility of capital losses. Other possible negatives include investment management costs and costs related to the maintenance and services of income generating assets (e.g. servicing and maintenance of investment properties). Net returns or net costs of hedging operations may also be relevant for some charities. We suggest that the regulation could be worded in a way that is less specific and more clearly examples of transactions that may count positively or negatively in the computation of a total return.
10. We would also query some of the detailed new requirements being added to the trustees' annual report in regulation 6(4).
 - a) The requirements in regulation 6(4)(a) represent quite a major issue to be dealt with by way of a sub-regulation – at the very least it should be a separately numbered regulation.
 - b) Whilst one can see the logic of requiring the disclosures set out in regulation 6(4)(b), full compliance could result in a great deal of rather lengthy clutter being added to the annual report for any charity adopting the total return approach. Our recommendation (paragraph 6 above) that the detailed methodology and quantification of the effect of adopting the total return approach be contained in the notes to the accounts rather than the trustees' report would address this concern. The annual report would then be subject to a rather more general requirement to disclose details of any resolution and associated procedures taken to adopt a total return approach.
 - c) It would also be clearer for regulation 6(4)(c) to be worded as an amplification of regulation 40(3)(o) of the Charities (Accounts and Reports) Regulations 2008 (and the equivalent provisions in regulations 38-41) to make clear that what is needed is some additional detail in the existing investment policies note – not a huge separate note on total return. Linking this to regulation 40(3)(o) in the 2008 Regulations would also mean that charities below the audit threshold would be exempt from the detail of such disclosures, by virtue of reg.40(7). This would fit with the Government's deregulatory approach to such matters. As a minor point, we note that regulation 6(3)(a) states that the trustees need not obtain and consider 'proper' advice if they reasonably conclude that this is not necessary in the circumstances. We therefore suggest that the words 'if any' be inserted into regulation 6(4)(c) after the words "identify the person(s)".

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