Cash held as investment

Increased stock market volatility and higher interest rates mean that many charities are choosing to hold cash as an investment strategy. However, there continues to be confusion about what can and should be shown as cash on the balance sheet and what can and should be shown as an investment. This can impact on fundraising as some donors see large amounts of cash and think that the charity does not need financial support. There is also the question is whether the investment should be shown as a current or fixed asset.

Cash or investments

FRS102 section 7 deals with the Statement of Cash Flows and explains that *"Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Bank overdrafts are normally considered financing activities similar to borrowings. However, if they are repayable on demand and form an integral part of an entity's cash management, bank overdrafts are a component of cash."*

It is important to recognise that this is a definition for the statement of cash flows and not the statement of financial position (balance sheet). Although it might sound odd FRS102 recognises that these may be different and explains "*7.20 An entity shall present the components of cash and cash equivalents and shall present a reconciliation of the amounts presented in the statement of cash flows to the equivalent items presented in the statement of financial position. However, an entity is not required to present this reconciliation if the amount of cash and cash equivalents presented in the statement of cash flows is identical to the amount similarly described in the statement of financial position."*

FRS 102 does not provide any further guidance on the definition of cash and cash equivalents but IAS 7 which is generally consistent with Section 7 of FRS102 does clarify that cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes.

When drafting the FRS102 Charity SORP we considered this point and concluded that in order to determine whether a particular investment qualifies for classification as a cash equivalent, it is necessary to look at the purpose for which it is held. Therefore, it is important to recognise that even though the investment may meet the definition set out in FRS 102.7.2, unless it is held for the purpose of meeting short-term cash commitments, it will not be classified as a cash equivalent. Cash equivalents are short-term, highly liquid investments held to meet short-term cash commitments rather than for investment or other purposes.

The Charity SORP clarifies that cash balances which are not held to meet short term cash commitments should be classified as an investment. It states:

"10.70. Current asset investments are investments which a charity holds for resale or pending their sale and cash or cash equivalents with a maturity date of less than one year. ***This heading includes cash on deposit and cash equivalents with a maturity of less than one year held for investment purposes rather than to meet short-term cash commitments as they fall due****."* (my emphasis).

This is in line with the definition of cash in the SORP which states:

"10.74. ***Cash at bank and in hand is held to meet short-term cash commitments as they fall due rather than for investment purposes*** *(my emphasis) and includes all cash equivalents held in the form of short-term highly liquid investments. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value. A cash equivalent will normally have a short maturity of, say, three months or less from the date of acquisition."*

The fact that cash or cash equivalents are expected to be included as an investment if they are not held to meet short term cash commitments is emphasised again in the SORP which includes "cash and cash equivalents" as the first item in the list of classes of investment which need to be disclosed in line with paragraph 10.54.

"10.54. The classes of investments disclosed in the note will vary from charity to charity reflecting the differing nature of the investments held. This SORP requires that the analysis must as a minimum identify material amounts held in the following classes of investment:

- *cash or cash equivalents;*
- *listed investments;*
- *investment properties;*
- *loans to group undertakings;*
- *equity investment in group undertakings;*
- *social investments; and*
- *other investments.*

Fixed Asset or Current Asset

Once it has been confirmed that the cash balance is not held to meet short term cash commitments the next point to consider is whether the amounts should be disclosed as a fixed asset investment or a current asset investment. Once again it is the intended use that is paramount rather than the notice period or term associated with the deposit.

The Charity SORP explains:

10.71. To be classified as a current asset, the charity should ***not intend*** *(my emphasis) to hold the cash or cash equivalents as part of its on-going investment activities for more than one year from the reporting date. However, cash and cash equivalents that are held from time to time as part of a fixed asset investment portfolio should be presented as part of fixed asset investments. Current asset investments must be valued at their fair value except where they qualify as 'basic' financial instruments."*

and

"10.42. Fixed asset investments exclude those investments held specifically for sale or those investments which the charity expects to realise within 12 months of the reporting date."

In conclusion

Many charities are concerned that they could be holding large amounts of cash for investment purposes and not to meet their short term cash commitments. The concern was that under the statement of cash flow rules in FRS102 they would have to show these funds as cash if these funds may have been in accounts with short term maturity. The concern was that some funders accept that charities hold investments but are less comfortable with large cash balances . As shown by the minutes of the SORP committee that prepared the 2015 SORP, which is unchanged in this regard, this matter was discussed extensively and agreed by the Financial Reporting Council representatives.

It is the intention for holding funds rather than the vehicle that is used that decides whether this is cash or an investment for the balance sheet disclosure. Some preparers of accounts and auditors do not seem to have fully appreciated the SORP's requirements to consider why the funds are held and focus instead on how they are held.

- If a cash on deposit and cash equivalents with a maturity of less than one year are held for investment purposes rather than to meet short-term cash commitments as they fall due they should be treated as current asset investments (SORP 10.70)

- If the charity intends that the funds are to be held for more than one year then they should be treated as a fixed asset (SORP 10.71)

- If cash is held to meet short-term cash commitments as they fall due rather than for investment purposes then it should be treated as cash. (SORP para 10.74)

So in summary a two stage approach is needed to arriving at the correct balance sheet presentation:

1. Establish the intended purpose of holding the funds – if they are being held for investment purposes or other purposes rather than to meet short term cash commitments they should be classified as investments. This would be the case even if there is one bank account that is used for both short term and longer term requirements.

2. Establish the intended period of holding the investment funds – if they are intended to be held on a continuing basis (taken to be over one year) then they should be classified as fixed asset investments if not they should be classified as current asset investments.

This two stage process is important as otherwise if one was simply following the liquidity test then funds held in a 90 day money market account would need to be classified as cash or cash equivalents. Auditors should look for evidence to support the position taken on the intended use and the intended period and this usually comes from areas such as the reserves policy, the cash forecasts and the investment policy. It may also be helpful if this can be supported by minutes of decisions and working capital needs. However, it is important to look beyond the obvious. For example, if the cash flow forecasts show that income and expenditure forecasts show that there is an amount of cash that is not being held to meet short term cash commitments as they fall due then it should be clear that these amounts should be treated as an investment.

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Pesh is Special Advisor to the Charity Finance Group. Having been a member of the Committee that produced the 1995, 2000, 2005 and 2015 Charity SORPs he has a wealth of knowledge and expertise on reporting by charities. He is also a member of the Practitioner Advisory Group that provides advisory input and feedback in the development of the world's first Internationally applicable Financial Reporting guidance for non-profit organisations. He was a member of the Accounting Standard Board's Committee on Accounting for Public Benefit Entities and was also a member of the Charity Tax Commission.

Pesh was the partner leading teams working with social purpose and non profit organisations at Crowe, Deloitte, Arthur Andersen and BDO Binder Hamlyn. During this time these firms have been listed as the lead provider of audit services to charities for the 30 consecutive years. He now provides wide ranging consultancy services to social purpose and non profit organisations.

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