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Your Ref:

Our Ref: nkd/SORP 2015

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Dear Jenny,

Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – small entities and other minor amendments Standards for Small Entities

The Charity Commission for England and Wales and the Office of the Scottish Charity Regulator are established by law as the regulators and registrars of charities in England and Wales and Scotland respectively. UK charities represent the larger part of the not-for-profit sector in the UK. The Charity Commission and the Office of the Scottish Charity Regulator also act together as the joint SORP-making body for UK charities and our response to the discussion paper is made in that capacity.

The Charities SORP is an interpretation of UK Generally Accepted Accounting Practice for charities and in developing the SORP framework for 2015, a charities SORP was expressly created to provide application guidance for those charities reporting under the Financial Reporting Statement for Smaller Entities (FRSSE). Research undertaken for the Charities SORP Committee found that approximately a third of charities eligible to use the FRSSE do so.

The Charity Commission for England and Wales and the Office of the Scottish Charity Regulator are pleased to submit a joint response to the consultation document: FRED 59 – Draft amendments to FRS 102 - The Financial Reporting Standard applicable in the UK and Republic of Ireland – small entities and other minor amendments (FRED 59). Our detailed responses to the questions posed in the consultation are set out in an annex to this letter. In the UK, charities must prepare their accounts on an accruals basis to give a 'true and fair' view or, if eligible, they may opt to prepare their accounts on a cash basis. UK charities are therefore not permitted to follow the framework for micro-entities.

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We support the proposal to harmonise the measurement and recognition principles for smaller entities with those of the new Generally Accepted Accounting Practice (new GAAP) as set out in the Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS 102). We also share the Financial Reporting Council's objective of high quality reporting. However we anticipate that users of the existing Financial Reporting Standard for Smaller Entities will find the new approach to small entity reporting much more demanding and may struggle to prepare accounts without seeking additional help from their professional advisors.

With over 55,000 charities in the UK required to prepare accruals accounts we anticipate that the smallest charities and volunteer independent examiners will struggle to interpret the small entity framework when taken together with FRS 102. The SORP-making body, advised by the Charities SORP Committee and CIPFA Secretariat, is developing a replacement SORP to support the small entities framework. In our view, the requirement to prepare the accounts on a 'true and fair' basis in the context of FRS 102 means that there seems to be little practical advantage for charities choosing to report as a smaller entity and so we intend to consult on whether to dis-apply the small entity option for charities.

Stewardship is an important feature of charity reporting as compared to private for-profit companies. Research conducted in 2014 for the Charity Commission found that knowing that a reasonable amount of donations make it to the end cause is the main determinant of public trust and confidence in charities. The public place great importance on the reporting of how a charity spends their money and that demonstrate how they benefit the public and report on what they have actually achieved.

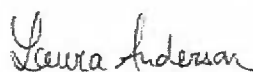
The FRSSE has historically been a cut down standard with fewer disclosure requirements than full UK GAAP and only for those matters not dealt with by the FRSSE reporting is supplemented by the requirements of the applicable GAAP. We would encourage the FRC to consider if there are any disclosures required by FRS 102 which might be simply dis-applied for small entities in addition to listing the mandatory disclosures required for compliance with the EU Accounting Directive.

Should you have any enquiries concerning this response please contact Nigel Davies.

Yours sincerely,



Nigel Davies
Joint Chair of Charities SORP Committee
Head of Accountancy Services, CCEW



Laura Anderson
Joint Chair of Charities SORP Committee
Head of Enforcement, OSCR

**Annex to the Charities SORP-making body's response to the consultation document:
FRED 59 Draft amendments to FRS 102 – small entities and other minor amendments**

Question 1. *Do you agree with the proposed Section 1A Small Entities adequately reflects the new small companies regime set out in company law and that the disclosure requirements for small entities are clear? If not, why not, and what alternative approach would you propose?*

Whilst we agree that section 1A small entities has been designed to implement the new small companies regime, the fact that the disclosures set out in paragraph 1A.14 are not deemed wholly sufficient for the preparation of 'true and fair' accounts is a source of significant complexity for the small entity framework.

Although the legal prohibition on mandating further disclosures limits the FRC's ability to specify the way in which a small entity can fulfil the obligation to prepare 'true and fair' accounts, the result is a framework that requires the preparer to evaluate the potential simplifications listed in paragraph 1A.2 together with the FRC's cautionary advice given in paragraphs 1A.4, 1A.6, 1A.10 and 1A.15 and by inference all applicable sections of FRS 102 and disclosures except where a disclosure, otherwise required by FRS 102, is substituted by a mandatory disclosure specified in paragraph 1A.14.

We would encourage the FRC (see covering letter) to indicate throughout FRS 102 those disclosures, if any, which are normally not required to reported by small entities preparing their accounts on a 'true and fair' basis.

Question 2. *In developing these proposals the FRC has applied the principle that there should not be differences between the recognition and measurement requirements applicable to small entities and those applicable to larger entities. This principle has been determined after taking account of the generally positive response to a similar proposal in the Consultation Document.*

Do you agree with this principle? If not, why not and what alternative principle or specific exceptions to this principle would you propose?

We agree that measurement and recognition principles should apply to the item and therefore different measurement and recognition principles would not apply simply due to the size of the reporting entity.

Question 3. *Do you agree with that the transitional provisions in FRS 102 are sufficient for smaller entities, or have you identified any further areas where transitional provisions should be considered? If so, please provide details.*

We agree that it is logical that measurement and recognition principles apply equally to a charity reporting under either FRS 102 or the small entity regime. The transitional arrangements offered by section 35 of FRS 102 also similarly apply in both cases.

Question 4. *Do you agree with the other amendments proposed to FRS 102 for compliance with company law? If not, why not?*

There are two public benefit entity specific proposals upon which we comment.

1) It is proposed to amend paragraph 13.4A of FRS 102 to require inventories (stock) held for distribution at no or nominal consideration shall be measured at the lower of cost adjusted, when applicable, for any loss of service potential and replacement cost.

The Charities SORP (FRS 102) provides for an alternative approach to measurement on initial recognition where measuring donated services using fair value would not be practical because those services cannot be resold and so the use of fair value may result in an overstatement of the value of the donation to the charity. Donated facilities and services are therefore measured and included in the accounts on the basis of the value of the gift to the charity. Value to the charity is the amount that the charity would pay in the open market for an alternative item that would provide a benefit to the charity equivalent to that of the donated item. Value to the charity may be lower than, but cannot exceed, the price the charity would pay in the open market for the item.

The purpose of initial recognition is to identify the economic value of the donated goods for distribution at no or nominal cost. We therefore support the amendment made and would encourage the FRC to require it on both initial recognition and subsequent re-measurement.

2) It is proposed to amend paragraph PBE34.80 so that, unless it is not permitted by the statutory framework under which a public benefit entity reports, an entity combination that is a merger shall apply merger accounting. We understand that the expectation of making this change is that charitable companies will be prohibited from practising merger accounting whereas non-company charities, howsoever formed, can use merger accounting.

The Accounting Directive specifically recognises that its provisions do not extend to not-for-profit entities and this in line with point (g) of Article 50(2) of the Treaty on the Functioning of the European Union (TFEU). In our view changes intended to place limitations on the use of merger accounting for companies which originate from the implementation of the Accounting Directive should not therefore apply to charitable companies. Indeed, substance over form means that the characteristics of the transaction rather than a particular legal form should influence the accounting treatment adopted.

We encourage the FRC to confirm with the Department of Business Innovation and Skills whether it is in fact their policy intention or application of company law to disbar charitable companies from applying merger accounting and whether the proposed change is therefore in accordance with the lawful application of the Accounting Directive.

In our view, in the absence of classes of voting equity, the simple application of acquisition accounting does not give a 'true and fair' view when the trusts are continuing and it is simply a matter of a change in legal form.

Question 5. *The FRED 50 is accompanied by a Consultation Stage Impact Assessment. Do you have any comments on the costs or benefits discussed in that assessment?*

On initial implementation, preparers of small entity accounts unfamiliar with FRS 102 may need additional help to prepare accounts on a 'true and fair' basis as currently construed by FRED 59. This may give rise to additional costs until they are sufficiently familiar with the requirements of FRS 102 for applicable items. However this will be true to some extent for any change to small entity reporting which is based on FRS 102.