

From: carargd@aol.com
To: [UKERS](#)
Subject: FAO: Jenny Carter - Our response to the FRC consultation on accounting standards for small entities, especially micro-entities that are charitable companies
Date: 30 November 2014 23:49:14

CARA provides free help to small charities struggling with SORP-compliance and other regulatory matters, and so we have taken a special interest in the FRC proposal to issue a new financial reporting standard for micro-entities (FRSME), based on the recognition and measurement requirements of FRS 102 but adapted to reflect the micro-entities regime as set out in the Companies Act 2006 and simplified further where appropriate. We are aware that the Charity Commission and the SORP Committee think it is too difficult to allow micro companies that are charities to benefit from the existing micro-entity regulations with their provision for a true and fair view to be deemed without regard to any other requirement of financial reporting standards as long as the accounts and supporting notes comply with those regulations, and that furthermore it would need legislation to remove the existing exclusion of charitable companies from that regime. However, we think the DBIS proposals for changes to company law to comply with the EU's June 2013 accounting directive could easily include amending the micro-entity regulations in that respect.

The DBIS public consultation on those company law changes made it abundantly clear that the new Charities SORP(FRSSE) issued in July 2014 can continue to require additional disclosures in the statutory accounts of charitable micro-companies in the interests of charity regulation – ie, that this is not prohibited by the EU Directive, which does not limit the disclosures that can be required in the accounts of not-for-profit companies.

Whilst we must agree that it would not be in the public interest for small charities larger than micro-size to be deemed to show a true and fair view in their statutory accounts without regard to compliance with the methods and principles of FRS102 (or the FRSSE 2015), those that are *non-companies* can instead choose to prepare unregulated statutory accounts on a receipts and payments basis under the Charities Act 2011.

That option has always been denied to even the very smallest charitable companies. Their exclusion from the proposed micro-entities standard as a result of the present company law exclusion would leave them with a disproportionate regulatory burden that in our view could quite easily be removed without detriment to their effective regulation by the Charity Commission.

We understand that the micro-entities regime requires only individual Financial Statements comprising a Balance Sheet in either of two prescribed formats and a profit and loss account in a prescribed format (which, however, under company law has to be adapted by not-for-profit companies to suit their own circumstances – hence the Income & Expenditure Statement), with no cash flow statement being required and with a prescribed set of supporting disclosures as accounts notes, and with revaluing or measuring assets or liabilities at fair value prohibited for micro-entities. We think that this regime could quite easily be applied to micro-charities that are companies if permitted by the proposed FRSME and without needing any change at all to the Charities Act 2011.

We also note the statement in the FRC consultation document that company law specifies the disclosure of information in relation to guarantees and other financial commitments and advances, credit or guarantees to/on behalf of directors to be included in the financial statements of a micro-entity but that the

law and/or financial reporting standards can properly add further mandatory disclosures in the case of a charitable small/micro-company, which can quite easily include all the regulatory information needed to supplement financial statements that comply with the micro-companies regulations are which are therefore "presumed to give a true and fair view" without regard to compliance with any other requirement of a financial reporting standard.

We would agree with the FRC proposals to simplify the accounting framework for micro-entities in the new accounting standard for them, the FRSME, as long as this includes those that are charitable companies, as set out in the consultation document:

- (a) Presentation and disclosure requirements as set out in legislation and in paragraphs 2.40 to 2.42 of the FRSSE;
- (b) Recognition and measurement requirements based on FRS 102 except for:
 - (i) simplification of the requirements for financial instruments, which will be solely based on historical cost or amortised cost;
 - [neither (ii) no requirement to account for deferred taxation, nor (iii) no requirement to account for equity-settled share-based payments prior to the issue of the shares, apply to charities;]
 - (iv) a simplification to accounting for post-employment benefits, that will permit defined benefit plans to be accounted for as defined contribution plans (including recognition of a liability for contributions payable arising from an agreement to fund a deficit in relation to past service because the micro-entity will no longer be recognising the net asset or liability arising from the defined benefit plan);
 - (v) no option to capitalise borrowing costs; and
 - (vi) deletion of sections that are unlikely to be applicable to micro-entities, such as Section 19 Business Combinations and Goodwill (with a cross-reference to FRS 102 if a micro-entity has undertaken a trade and assets acquisition), Section 31 Hyperinflation and most of Section 34 Specialised Activities (apart from the sub-section on Agriculture).

We therefore hope the FRC will encourage the Charity Commission to agree that the FRSME can be made available to any charities that are micro-companies once their present exclusion from the micro-entities regime of company law can be repealed by amending those regulations.

We noted in particular the DBIS estimate that some 40k charities out of the 193k on the Charity Commission Register are companies. However, 28k of the 193k are said to be "linked" charities accounted for as branches within the entity accounts of their respective "main" or publicly accountable charity, although very few among this 28k would be companies, as the Charity Commission has always been reluctant to link them, given that they must still file statutory accounts at Companies House.

Given that only 10.3k registered charities exceed £500k gross income, and on the basis of our own estimate that some 75% of these are companies (accounting for 90% of the aggregate £64bn annual gross income of all registered charities), there must currently be some 32k micro-companies on the Register of Charities which are currently excluded from the micro-entities regime by company law and are thus unable to opt out of the technical detail of compliance with financial reporting standards that were never really designed with them in mind. This is obviously a disproportionate regulatory burden for all those charitable micro-companies compared with their non-company peers.

The stipulation (from the EU Directive) that micro-entity accounts complying with the specified format and content set out in the Regulations and therefore also in the FRSME are "deemed" to show a true and fair view without regard to any

other requirements of an accounting standard, could put those accounts on a par, more or less, with the Charities Act's Receipts & Payments accounting option which is available only to small non-company charities, including CIOs.

For that option, which is factually based (thus needing no accounting assumptions/estimates), no 'true and fair view' is required by law. As in England & Wales, in Scotland only non-company charities not exceeding £250k gross income for the financial year (and not a member of a group for which consolidated accounts are required under the relevant Charities Act) can opt for Receipts & Payments accounting as the statutory alternative to SORP-compliant accruals accounts. This has long disadvantaged charitable companies within their size-band, which continue to be burdened by a statutory requirement to comply with intricately detailed accounting standards designed to ensure a "true and fair view". The very involved technical requirements of those standards are unduly burdensome because compliance with them by such very small charities is of far less public interest than their effective regulation by the Charity Commission, OSCR or other relevant State regulator.

The micro-entity accounting regulations made under the Companies Act provide that for any item shown in the accounts that is not specified in the standard format set out in the regulations, regard must be had to relevant financial reporting standard requirements, both by the accounts preparer and the auditor (If any), meaning that a "true and fair view" will be required to be shown for all such additional items. However, for the fund-accounting and other charity-specific disclosures set out in the Charities SORP for the sake of the charity trustees' necessary compliance with charity law, the required regulatory information could just as well be given in the accounts notes (or even under the Commission's Annual Return regulations) rather than being seen as additional items in the primary accounting statements themselves.

The charity-specific disclosures needed on top of those required by the micro-entity accounts regulations (summarised from FRSSE(2015) below this response, are extra requirements which the DBIS consultation document made clear would not be prohibited by the EU Directive. These extra disclosures are readily apparent from either of the two new SORPs.

Module 1 (Trustees' Report) therein is "out of scope" here, merely setting out what is required by the SORPs' related Regulations made under the Charities Act 2011. For ease of reference, we have summarised here the charity-specific accounting disclosures that would need to be provided for as PBE sections in the proposed FRSME in order to be specified by an applicable micro-only version of the Charities SORP in order to make the statutory accounts of a charitable micro-company prepared under the Companies Act's micro-entity regulations suitable for effective regulation by the Charity Commission (for OSCR, there is no such problem, as the Scottish Charities Act accounting regulations overlay company law in any case).

Module

2: Fund-accounting distinctions for compliance with trust law:

<!--[if !supportLists]-->• <!--[endif]-->Endowment Funds and their movements in the year must be accounted for separately.
<!--[if !supportLists]-->• <!--[endif]-->Restricted Income Funds and their movements in the year must be accounted for separately.
<!--[if !supportLists]-->• <!--[endif]-->If summarised by fund-class, details are required of the movements on major individual funds.

4: SoFA

- <!--[if !supportLists]-->• <!--[endif]-->The fund-accounting information required by the SORP could all be in the accounts notes (if not required by the SORP to be in columnar form within the primary accounting statement).
- <!--[if !supportLists]-->• <!--[endif]-->Similarly, the SORP's required sub-analysis of SoFA line-headings could also be contained in accounts notes, with cross-referencing.
- <!--[if !supportLists]-->• <!--[endif]--> The SoFA line for funds brought forward and carried forward would be additional requirements.
- <!--[if !supportLists]-->• <!--[endif]-->Goods and services donated to the charity and included in "Other Income" in the SoFA along with all other voluntary incoming resources (such as gifts of land and investment securities) would need to be analysed in an accounts note (or else in the trustees' report as required in the Scottish accounting Regulations under the 2005 Act there).

9: *Trustee's and other Related Party transactions*

- <!--[if !supportLists]-->• <!--[endif]-->The SORP's requirements for disclosing trustee-benefits and trustee-expenses (including persons "closely connected" with the trustees) are seen as essential regulatory information – unlike the wider requirements of the FRS for disclosure of all material transactions with other Related Parties, which should therefore not feature in the SORP(FRSME).
- <!--[if !supportLists]-->• <!--[endif]-->Disclosure of any ex gratia costs is similarly essential for effective charity regulation.

10: *Balance Sheet*

- <!--[if !supportLists]-->• <!--[endif]-->The only two items here for which the SORP needs to specify charity-specific disclosure are "fixed assets" and "capital and reserves"
- <!--[if !supportLists]-->• <!--[endif]-->The fixed assets note needs to separate functional assets (tangible and intangible, with the latter unlikely to be of material value, and likewise for heritage assets) from investment assets
- <!--[if !supportLists]-->• <!--[endif]-->Investment assets need to distinguish social investments from commercial investments. The year-end market value of the latter will be needed, as another essential regulatory disclosure.
- <!--[if !supportLists]-->• <!--[endif]-->The "capital and reserves" line of the Balance Sheet needs to be analysed in an accounts note distinguishing the main classes of charitable funds as defined by the SORP.

In general, examples of disclosures that are essential for understanding a charitable company's activity are the purposes for which all its charitable funds are held, any trustee-benefits and the authority for them and also any financially significant grant-making to institutions. In terms of the government's overriding deregulatory objective to ease the administrative burdens of financial reporting by the smallest charities, as well as companies, such generic disclosures are relatively simple and easy to require without company law having to continue imposing the full weight of compliance with financial reporting standards on them in stark contrast to the facility enjoyed by non-company micro charities and also micro-CIOs.

We would be happy to amplify any of this if required.

Yours faithfully,

Greyham Dawes

Exec.Director, **CARA**
(Charity No.1117929)

Annex: Financial statements of a micro-entity

FRSSE 2.40 A micro-entity preparing its financial statements in accordance with s.393(1A) of the Act shall prepare a balance sheet in which only those items listed in the following formats must be shown, where applicable:

Balance Sheet - format 1

b fixed assets (this needs to distinguish investment assets and to note their market value)

c current assets

d prepayments and accrued income

e creditors: amounts falling due within one year

f net current assets (liabilities)

g total assets less current liabilities

h creditors: amounts falling due after more than one year

i provisions for liabilities

j accruals and deferred income

k capital and reserves (this will need to distinguish trust capital and revenue reserves)

Balance Sheet - format 2

Assets:

b fixed assets (this needs to distinguish investment assets and to note their market value)

c current assets

d prepayments and accrued income

Liabilities (or: & Funds, in the case of a charity):

a capital and reserves (this will need to distinguish trust capital and revenue reserves)

b provisions for liabilities

c creditors (distinguishing the total due within one year and after one year)

d accruals and deferred income

The Balance Sheet must contain, in a prominent position above the signature, a statement that the accounts are prepared in accordance with the micro-entity provisions in Part 15 of the Companies Act 2006.

FRSSE 2.41 A micro-entity preparing its financial statements in accordance with s.393(1A) of the Act shall prepare a profit and loss account in which only the following items must be shown, where applicable (amended for compliance with the Charity SoFA):

A Turnover (charitable and non-charitable: to be split here or in charity-specific notes)

B Other income (voluntary income, also GiftAid thereon, split from other income: ditto)

C Cost of raw materials & consumables (= non-staff trading costs: charity-specific split ditto)

D Staff costs

E Depreciation & other amounts written off assets

F Other charges (charity-specific analysis needed in accounts notes)

G Tax (can normally be omitted as not applicable to the charity)

H Profit or Loss (= net-specific income/expenditure for year)
(Disclosure of any endowment capital movements will be a charity-specific extra that could be required as an accounts note, as it cannot be included in the I&E Statement itself.)

FRSSE 2.42 A micro-entity [accounting under] s.393(1A) of the Act shall [disclose in] notes ... at the foot of the balance sheet:

- (a) guarantees and other financial commitments, as follows:
 - (i) particulars ... of any charge on the assets of the company to secure the liabilities of any other person, including, where practicable, the amount secured.
 - (ii) [for] any other contingent liability not provided for: (a) the amount [/estimate] of that liability; (b) its legal nature; and (c) whether any valuable security has been provided by the company in connection with that liability and if so, what.
 - (iii) ... where practicable, the aggregate amount [/estimate] of contracts for capital expenditure, so far as not provided for.
 - (iv) particulars ... of: (a) any pensions commitments included under any provision shown in the company's balance sheet; and (b) any such commitments for which no provision has been made; and where any such commitment relates wholly or partly to pensions payable to past directors of the company separate particulars must be given of that commitment as far as it relates to such pensions.
 - (v) particulars must also be given of any other financial commitments that: (a) have not been provided for; and (b) are relevant to assessing the company's state of affairs.
 - (vi) commitments within any of [the above] which are undertaken on behalf of or for the benefit of (a) any parent undertaking or fellow subsidiary undertaking, or (b) any subsidiary undertaking of the company, must be stated separately from the other commitments, [showing] (a) [and (b)] separately ...
- (b) directors' benefits: advances, credit and guarantees as follows:
 - (i) details of: (a) advances and credits granted by the company to its directors; and (b) guarantees of any kind entered into by the company on behalf of its directors.
 - (ii) the details required of an advance or credit are: (a) its amount; (b) an indication of the interest rate; (c) its main conditions; and (d) any amounts repaid.
 - (iii) the details required of a guarantee are: (a) its main terms; (b) the amount of the maximum liability that may be incurred by the company; and (c) any amount paid and any liability incurred by the company for the purpose of fulfilling the guarantee (including any loss incurred by reason of enforcement of the guarantee).
 - (iv) there must also be stated the totals: (a) of amounts stated under para.(ii)(a); (b) of amounts stated under para.(ii)(d); (c) of amounts stated under para.(iii)(b); and (d) of amounts stated under para.(iii)(c).
 - (v) references in this paragraph to the directors of a company are to the persons who were a director at any time in the financial year to which the financial statements relate.
 - (vi) the requirements of this paragraph apply in relation to every advance, credit or guarantee subsisting at any time in the financial year to which the financial statements relate: (a) whenever it was entered into; and (b) whether or not the person concerned was a director of the company in question at the time it was entered into."

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