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Your Ref:
Our Ref: nkd/SORP 2014

Date: 27 November 2014

Dear Jenny,

Accounting Standards for Small Entities - Implementation of the EU Accounting Directive

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: accounting standards for small entities. 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 and so we have not commented on this aspect of the consultation.

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 agree that harmonisation will reduce training and education costs and should help in raising standards in accounting and financial reporting. It will also enable new GAAP to more easily keep in step with developments in International Financial Reporting Standards (IFRS).

Although charitable companies and other not-for-profit companies are scoped out of the Accounting Directive in accordance with point (g) of Article 50(2) of the Treaty on the Functioning of the European Union, the proposed withdrawal of the Financial Reporting Standard for Smaller Entities (FRSSE) will affect those UK charities currently reporting under the FRSSE. As previously noted, as the SORP-making body approved by the FRC, we prepared a SORP to provide application guidance for charities choosing to report under the FRSSE and this SORP will need to be withdrawn and replaced.

The FRSSE has historically been a cut down standard with fewer disclosure requirements than full UK-Irish GAAP. For example in the area of financial instruments the only requirement is the disclosure of the accounting policy. Given that FRS 102 does not fully replicate the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs), the framework for smaller entities under UK-Irish GAAP could similarly not fully replicate FRS 102. The FRC has an opportunity to not require certain disclosures and thereby simplify reporting for smaller entities as compared with medium and large entities. Almost 99% of registered charities could be eligible to follow the FRSSE were the income threshold raised to £10.2m. The sector would therefore be significantly affected by a simplified disclosure framework for smaller entities.

Although the requirement, if an item is material, to make the full disclosures required by FRS 102 is a valuable discipline that encourages higher quality financial reporting, we recommend that the FRC consider simplifying small entity reporting in the spirit of the existing FRSSE. The FRC might do this by keeping disclosures in matters not greatly covered by the existing FRSSE to a bare minimum. For example in the area of financial instruments by only requiring the disclosure of accounting policies (FRS 102 paragraph 11.40) and those items required by the EU Accounting Directive and specify that only medium and large entities make the other disclosures currently required by FRS 102.

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: accounting standards for small entities

Question 1. Do you agree with the proposal to develop a new accounting standard, the Financial Reporting Standard for Micro-entities (FRSME), for entities taking advantage of the micro-entities regime (see paragraph 2.4)? If not, why not?

No comment

Question 2. Do you agree with the proposed recognition and measurement simplifications that are being considered for the FRSME (se paragraph 2.6(b))? If not, why not? Are there any further areas where you consider simplifications could be proposed for micro-entities?

No comment

Question 3. The accounting standard that is applicable to small entities (not just small companies) (ie currently the FRSSE) is being revised following changes to company law. Company law, which will limit the disclosures that can be made mandatory, may not apply to entities that are not companies. Do you agree that the accounting standard for small entities should continue to be applicable to all entities meeting the relevant criteria, not just companies? This will have the effect of reducing the number of mandatory disclosures for all small entities, not just small companies (see paragraph 3.11). If not, why not?

We agree that in principle common regime for all entities meeting the definition of a small entity has clarity and simplicity in its favour, if the practical effect of preparing accounts to give a 'true and fair' view (consultation paragraph 3.13(c)) is such that small entities must consider all the disclosure requirements set out in FRS 102, then there is no practical simplification, other than in not preparing a statement of cash-flows.

This approach would simplify the situation for the charities SORP as the SORP-making body could simplify withdraw the SORP providing application guidance to the FRSSE and simply insert into the SORP providing application guidance to FRS 102 a requirement that any charitable company following the FRSSE can do so provided it meets all the presentation and disclosure requirements of the SORP. This was the position previously taken in the 2005 charities SORP.

Question 4. Do you agree that the FRSSE should be withdrawn and small entities should be brought within the scope of FRS 102, so that they apply recognition and measurement requirements that are consistent with larger entities, but with fewer mandatory disclosures (see paragraph 3.15)? If not, are there any areas where you consider there should be recognition and measurement differences for small entities and why?

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) standard: Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS

102).The recognition and measurement principles applied should related to the item being considered and the character of the item is unaffected by its size. Relative size is only a factor as part of making a judgement about materiality and so we cannot see a logical basis for having different recognition and measurement criteria for smaller entities. However, we do see scope for offering simplified disclosure requirements (please refer to our covering letter).

Question 5. FRED 50 Draft FRC Abstract 1 – Residential Management Companies' Financial Statements was issued in August 2013. After considering the comments received, the FRC published its intention to roll this project into the work required to implement the new EU Accounting Directive. Do you agree, in principle, with adding a new sub-section to Section 34 Specialised Activities of FRS 102 to address the principles of accounting by residential management companies (RMCs) (see paragraph 3.27)? If not, do you consider this unnecessary, or would you address the issue in an alternative way?

No comment

Question 6. FRS 102 does not currently include all of the disclosures specified in company law. Other than in relation to the new small companies' regime within FS 102, it is not proposed that this will change. Do you agree that FRS 02 should not include all the disclosure requirements for medium and large companies from company law (see paragraph 4.6)? If not, why not?

It will also enable new GAAP to more easily keep in step with developments in International Financial Reporting Standards (IFRS) if the inclusion of UK specific company law disclosure requirements is kept to a minimum. Insofar as the company law items relate to smaller entities this is consistent with providing greater assistance to smaller entities which may have fewer specialised accounting staff and more limited access to accounting expertise. Inclusion of small company requirements would assist preparers of smaller company accounts and facilitates a higher standard of financial reporting compliant with company law. However FRS 102 is used by sectors other than for-profit companies and so it is recommended that UK company law specific items are kept to a necessary minimum.

FRS 101

Question 7. Do you agree that, if UK and Irish company law is sufficiently flexible, FRS 101 should be amended to permit the application of the presentation requirements of IAS 1 Presentation of Financial Statements, rather than the formats of the profit and loss account and balance sheet that are otherwise specified in company law (see paragraph 5.4)? Do you agree that this will increase efficiency of financial reporting within groups? If not, why not? Do you foresee any downsides to this approach?

Since charities do not report under FRS 101, no comment offered.