CIPFA The Chartered Institute of Public Finance & Accountancy

Report – Agenda item 7 (paper 2)

Committee	Charities SORP Committee
Venue	Directory of Social Change, Euston
Date	11 December 2014
Author	Secretariat to the Charities SORP Committee
Subject	Changes to UK-Irish GAAP for small company accounting and the options for the Charities SORP

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1. Purpose

1.1. The purpose of this paper is to:

- inform the Board of proposed changes to the FRSSE;
- discuss the implications of these changes; and
- seek approval from the Board regarding the future replacement for the Charities SORP (FRSSE).

2. Changes to FRSSE

2.1. The Charities SORP (FRSSE) provides guidance for charities on how to apply the Financial Reporting Standard for Smaller Entities (FRSSE). The Charities SORP (FRSSE) issued in July 2014 was based on FRSSE 2015.

2.2. In September 2014, the Financial Reporting Council (FRC) published a consultation document 'Accounting standards for small entities – implementation of the EU Accounting Directive'[1] setting out the FRC's proposals to amend UK accounting standards as part of the implementation of the EU Accounting Directive.

2.3. Following changes in EU law, small companies need to include less information in their accounts and fewer mandatory disclosures. As a result of this, the FRC, in its consultation, is proposing the following changes:

- developing a new accounting standard for micro-entities which are defined as companies with a turnover less than £632,000 a year. This new standard will be known as the 'Financial Reporting Standard for Micro-Entities' (FRSME). It is proposed that the FRSME will be based on the recognition and measurement requirements of FRS 102 but would be simplified. Small entities which are not micro-entities will apply FRS 102 'The Financial Reporting Standard applicable in

[1] https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Consultation-Document-Accounting-standards-for-sma-File.pdf

the UK and Republic of Ireland', with limited mandatory disclosures.

- The Department of Business Innovation and Skills (BIS) has also consulted on raising the threshold for small entities[2]. It was proposed that the turnover limit for small entities be increased from £6.5m to £10.2m.As a result of the above proposals, the FRC is proposing to withdraw the Financial Reporting Standard for Smaller Entities (FRSSE).

The Not for Profit Sector was scoped of the definition of micro-entity within the legislation reflecting the reduced accountability that would be available to micro entities compared to the accountability that applies to charities. Charity Law in England and Wales and Scotland requires charity accounts prepared on an accruals basis to present a true and fair view whereas the micro entity reporting is based upon a 'deemed true and fair basis'.

2.4. The FRC, in replacing the FRSSE with the FRSME and FRS 102 with limited mandatory disclosures for small entities ensures consistency in recognition and measurement treatments, irrespective of size of company. This consistency in accounting treatments will reduce the number of accounting changes necessary as entities grow.

2.5. These proposals are likely to take effect for accounting periods commencing on or after 1 January 2016. Further information on the revised framework and limits for micro-entity and small entities can be found in Appendix A. Both the FRC consultation on accounting standards for smaller entities and the BIS consultation on thresholds for smaller entities have now closed. Feedback on the consultations is currently being analysed.

3. Options for the SORP (FRSSE)

3.1. The following section is based upon the Secretariat's current understanding of the responses to both the FRC and BIS consultations and the likely outcome from those consultations. From the general direction of both BIS's consultation and the FRC's consultation on the future of accounting standards for small entities, it seem likely that the FRSSE will be withdrawn and a move made towards a limited disclosure adoption of FRS102. If this is the case, then the Charities SORP Committee will need to consider its options for replacing the Charities SORP (FRSSE). Amending the current Charities SORP (FRSSE) would not be a suitable option as FRSSE is based on an older version of GAAP and therefore out of line with FRS's 100 to 102 inclusive which adopt the latest accounting framework. Therefore, if a smaller charities SORP is to be kept, it will need to be reviewed and re-written to recognise the changes in the new accounting framework and standards.

3.2. If it accepted that the SORP (FRSSE) need to be replaced with a variant of the SORP (FRS102) it is suggested that the following approaches would provide options for improving alignment with FRS102 whilst limiting disclosures for smaller charities:

- ***Re-issue the existing Charities SORP (FRS102).***The existing Charities SORP (FRS 102) could be updated to include the FRC's proposals on the accounting framework for smaller entities (FRS 102 – limited mandatory disclosures).

- ***Replace the Charities SORP (FRSSE) with two new SORPS, one based on FRS 102 with limited disclosures and a new one based on the FRSME (simplified FRS 102).*** This option would be in line with FRS's current

[2] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/350864/bis-14-1025-implemention-of-eu-accounting-directive-chapters-1-to-9-consultation.pdf

accounting framework for smaller entities and micro-entities summarised in Appendix A. However this approach would require consultation on the FRSME, is contrary to the approach previously taken by the previous Charities SORP Committee and is contrary to the regulatory stance of the Charity Commission and it is also not feasible in the timescale. If adopted, this approach would potentially result in three Charities SORPs being available depending on size of organisation, Charities SORP (FRS 102), Charities SORP (FRS 102 – limited disclosures) and Charities SORP (simplified FRS 102).

- ***Replace the Charities SORP (FRSSE) with a new SORP based on FRS 102 with limited disclosures.*** The Charities SORP (FRSSE) could be replaced with a new SORP based on FRS 102 with limited mandatory disclosures i.e. following the small entities regime being proposed by the FRC. If this proposal was adopted, then micro-entities and smaller entities would both have to follow FRS 102 with limited disclosures.

3.3. The previous SORP Committee debated the new micro entity reporting requirements at its meeting in January 2014, at which time the Committee was clear that it did not think the reduced reporting requirements for micro-entities provided sufficient transparency for charitable organisations.

4. Key issues to consider

4.1. Some of the key issues that the Charities SORP Committee might like to consider when considering the above options are:

- ***Consistency in recognition and measurement.*** FRC's consultation on the accounting standards for smaller entities highlights the importance of increasing consistency in recognition and measurement treatments, irrespective of size of company. More consistency within accounting treatments will reduce the number of accounting changes necessary as entities grow.

- ***Level of accountability required for charities.*** It is unlikely that a SORP based on the requirements of a future micro entity standard would provide sufficient accountability for charities whose accounts are required to provide a 'true and fair' view.

- ***Stability of Charities SORP (FRS 102).*** The rationale for issuing two Charities SORPs by the SORP making bodies was to accommodate the requirements of both FRS 102 and FRSSE while at the same time attempting to future proof the Charities SORP (FRS 102), in the knowledge that the future of the FRSSE and its possible replacement is uncertain. FRSSE is based on an older version of GAAP and therefore out of line with FRS's 100 to 102 inclusive, which adopt the latest accounting framework.

- ***Future harmonisation of the Charities SORPs.*** The issuing of two Charities SORPs in July 2014 was necessary to accommodate FRS 102 and FRSSE and was unprecedented. Going forward, if the SORP Committee and the FRC intends to harmonise the Charities SORPs, it would be easier to do this if the SORPs were based on FRS 102 and FRS 102 with limited mandatory disclosures instead of FRS 102, FRS 102 with limited mandatory disclosures and a new FRSME SORP (simplified FRS 102).

- ***Timescales.*** Production of the limited disclosure version of FRS102, and any associated Charities SORP, may be delivered within a shorter timescale than a SORP based upon the FRSME which will be dependent on the development of a completely new standard.

- ***Burden on charities, advisers and other stakeholders.*** The burden on charities, their advisers and other stakeholders is influenced by a number of factors such as:

    - ongoing change in accounting standards resulting in limited periods of stability;
    - the level of mandatory disclosures which may be excessive given the size of entity; and
    - complexity of the accounting framework and standards, for example, having more than one SORP to follow.

5. Recommendations

5.1. The Secretariat recommends that the Charities SORP Committee issues a Charities SORP FRS 102 (limited mandatory disclosures) to replace the Charities SORP (FRSSE). This recommendation is based upon the following reasons:

- Increased consistency in recognition and measurement between the two SORPs since both would be based on FRS 102. This would have the advantage that charities, irrespective of size, would be unaffected by accounting changes as they grow.

- Charities who have already adopted the Charities SORP (FRS 102) would be unaffected by proposed changes to the Charities SORP (FRSEE);

- The Board would be seen to be honouring the previous promise of a period of stability for the Charities SORP (FRS 102);

- The FRSME was developed for private owner managed micro-businesses and is a hybrid of cash and accruals accounting. The greater stewardship requirements and the legal requirement for 'true and fair' accounts under a charity law mean that the FRSME is unsuitable for charities.

- Three SORPs (FRS 102, FRS 102- mandatory limited disclosures, and simplified FRS 102) may lead to confusion as to which SORP to apply amongst practitioners and lead to unintentional non-compliance. A possible harmonisation into one SORP would be facilitated at some point in the future.

The proposed two SORP approach would preclude micro-entities that are also charities from adopting any simplified FRSME 102 accounting standard in line with the increased accountability requirements required for charities and the need for their accounts to present a 'true and fair' view.

5.2. The Secretariat has been unable to evaluate the practical implications of denying charities the reduced reporting approach that is allowed for micro-entities in the private sector. However, it is unlikely that small charities will be significantly disadvantaged since it is rare for smaller charities to have the type of transactions giving rise to the more complex accounting arrangement under FRS102; thereby minimising the impact in practice.

5.3. The FRC's proposals for accounting standards for smaller entities indicated the micro-entities would be able to voluntarily adopt FRS 102 with limited mandatory disclosures. The suggested two SORP approach, therefore, should also be consistent with FRC policy.

6. Next Steps

6.1. Should the Committee be minded to approve the recommended approach, the Secretariat will begin drafting the limited mandatory disclosures SORP based upon their understanding of the proposals set out in the FRC consultation. Subject to the FRC's timetable for producing FRS102 with limited mandatory disclosures, this would allow the Committee to consider a draft on the new SORP at its next meeting in February 2015

6.2. The time scale is very tight as if a replacement SORP is to be ready in time for 2016, the draft replacement for the Charities SORP (FRSSE) must be submitted to the FRC's CAPE Committee for its meeting of 24 February 2015.

6.3. The Committee should also note that the Trustees' Annual Report for the revised standard will be unchanged, since this is not dependent on FRS 102 changes.

Appendix A – FRC Proposed Accounting Framework and limits for micro and small entities.

	Micro-entity	Small	Larger	Listed/group
Current framework (from 1 January 2015)				
Turnover limit	£632,000	£6.5m	N/A	N/A
Accounting Standard	FRSSE special rules	FRSSE	FRS 102	FRS 101
Based on	Old UK and Irish GAAP	Old UK and Irish GAAP		IFRS
Proposed framework (from 1 January 2016)				
Turnover limit	£632,000	£10.2m		
Accounting Standard	FRSME – simplified FRS 102	FRS 102 – limited mandatory disclosures	FRS 102	FRS 101

Micro –Entity Limits
Micro-entities are the smallest companies. The definition of a micro-entity is contained in sections 384A and 384B of the Companies Act 2006 (the Act), subsequently amended by Staturory Instrument No. 3008 2013, The Small Companies (Micro-Entities Accounts Regulations 2013.

The qualifying conditions
are met by a company in a year in which it does not exceed two or more of the following criteria15:

- Turnover £632,000
- Balance sheet total £316,000
- Number of employees 10

A micro-entity may choose to apply the micro-entities regime, or to apply another accounting standard for which it is eligible.

Charities are excluded from the definition of micro-entities under the legislation as they are required to apply the relevant Charities SORP.

Small entities (not micro-entities)

BIS consulted on changing the small company thresholds in light of the requirements from the EU Accounting Directive: financial reporting. In this consultation, it was proposed that the qualifying condition for an entity to be classified as small are that in a year it does not exceed two or more of the following criteria:

- Turnover £10.2million
- Balance sheet total £5.1million
- Number of employees 50