Consultation response:

UK IMPLEMENTATION OF THE EU ACCOUNTING DIRECTIVE

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1. About Charity Finance Group (CFG)

1.1 Charity Finance Group (CFG) works at inspiring the development of a financially confident, dynamic and trustworthy charity sector. CFG promotes best practice and works to improve standards in financial management and reporting across the sector. We also have a role in ensuring an effective and proportionate regulatory system for charities of all sizes. CFG works with finance professionals to enable them to give the essential leadership on finance strategy and management that their charities need; promoting best practice in charity finance, driving up standards, campaigning for a better operating environment, ensuring every pound given to charity works harder and that the trust of charity donors is maintained. CFG has more than 2,200 members, all senior finance professionals working in the sector. Collectively our members are responsible for the management of over £19 billion in charitable funds.

1.2 CFG welcomes the opportunity to comment on to comment on the consultation paper *UK Implementation of the EU Accounting Directive* published by the Department for Business Innovation and Skills on 29 August 2014.

2. About our response and key issues affecting financial reporting by charitable charities

Accountability and transparency of charity reporting

2.1 Our response to this consultation primarily focuses on how the implementation of the EU Accounting Directive impacts on charities established as companies. We therefore welcome the fact that the consultation gives specific consideration to this particular area of the sector. Charities operate in a regulated environment and have accountability to a wider stakeholder group than similar sized private companies which are often owner-managed. Charities also have particular reporting requirements reflected in the 'Charities Statement of Recommended Practice (the SORP)' and in the specialist section of the 'Financial Reporting Standards (FRS 102)'. As a result of these factors, the financial reporting framework that would result from the direct application of the EU Accounting Directive to small charities established as companies, without amendment, would result in an unacceptable loss of accountability and it would not meet the information needs of donors, beneficiaries and of the public. It is therefore essential that the particular reporting needs of charities are addressed in company law and that charities are given the flexibility to report their activities in a way that is meaningful to their donors, beneficiaries and the public.

The exclusion of charities from the ambit of the EU Accounting Directive

2.2 We are pleased that the consultation points out that the Recital 5 to the EU Accounting Directive specifically excludes not-for-profit undertakings from its scope and recognises that this exclusion is in line with point (g) of Article 50(2) of the Treaty on the Functioning of the European Union (TFEU). This exclusion gives Ministers discretion as to how company law in the UK is applied to charities that are companies. It is important that this discretion is recognised in regulations and is utilised to enable charitable companies to report and present information in a way that is relevant to their stakeholders (including donors, beneficiaries and the public). Charities need to provide notes to their accounts to explain their activities, the nature of the funds they hold and provide information about private benefits. Charities also adapt the format of their accounts to present their income and expenditure relating to the activities they undertake and the charitable funds they hold. It is vital for accountability and stewardship reporting that this flexibility continues to be available in company law.

Abbreviated accounts

2.3 As explained in our response to question 15, we have very significant concerns about permitting small companies to only publish abbreviated accounts. In the context of charitable companies, or companies within a group headed up by a 'parent' charity, the consultation proposal would have a detrimental impact on financial information available to donors, beneficiaries and the general public. To have a situation where charities could choose to only prepare abbreviated accounts, would potentially deny the public information about a charity and its financial activities. It would also have an adverse impact on the information filed with charity sector regulators in the UK as charity law currently requires the filing of published accounts. If charities were allowed to only publish abbreviated accounts, the oversight role of charitable companies by sector regulators would be significantly diminished. The potential loss of accountability that would result from this proposal is clearly unacceptable.

3. Responses to section 10 – Charitable companies

Question 42

Do you agree that there would be merit in specifically stating in regulations made under company law that the information provided in the notes to the financial statements of a company charity is not limited to the information required by the Accounting Directive?

3.1 We agree. It is important that preparers of charity accounts understand that the information provided by charitable companies in the notes to their accounts is not limited to those required by the EU Accounting Directive. Without this clarity, we are concerned that the directors (trustees) of charitable companies may be uncertain as to whether additional notes can be added to the accounts, for example, when particular disclosures are recommended by a relevant SORP. Moreover, the Directive fails to address a number of important disclosures relevant to a charity's activity, for example, the purpose for which particular funds are held, remuneration of trustees or providing details of grant-making activities. Including a statement in regulations, along the lines suggested in the consultation, will remove uncertainty and provide clarity that the limitation place on note disclosures is not intended to apply to charities. This will also avoid the need for directors (trustees) to assess whether or not a recommended disclosure of a SORP is essential to ensure a 'true and fair' view.

3.2 An alternative approach might be for company law to apply the accounting and audit requirements of charity law to charitable companies generally or to small charitable companies specifically. Clearly such an approach would involve amendment to charity law where it does not currently apply to charitable companies. We appreciate that charity law is a devolved matter and that such an approach would need to be taken forward in partnership with the Scottish Government (formerly Executive) and Northern Ireland Executive. We believe there would be merit in exploring this possible approach with charity sector regulators, the Office for Civil Society, the Scottish Government and the Northern Ireland Executive.

Question 43
Do you agree that the current flexibility in presentation of financial statements of charities, in particular the requirement for an income and expenditure account and to adapt the arrangement, headings and sub-heading of financial statements to reflect the special nature of the company's activities, should be retained?

3.3 We agree. Charities do not currently prepare a profit and loss account but present a statement of financial activities which incorporates an income and expenditure account. An income and expenditure account is a more relevant presentation for charities as it enables them to present their sources of incomes, for example donations and legacies, investment income and trading income, with relevant prominence in the statement. In addition it allows expenditure to be analysed in a way that reflects their particular charitable activities and fundraising activities. The flexibility of existing company law needs to be preserved to ensure charities present their income and expenditure in a way that is meaningful to their stakeholders including donors, beneficiaries and the public.

Question 44
Do you agree that a threshold based on gross income is more appropriate than its turnover for company charities?

3.4 We agree. Charities do not report turnover as they prepare an income and expenditure account as part of their statement of financial activities. Turnover (as defined in company law) excludes major sources of income received by charities, not least donations and legacies and is therefore an inappropriate criterion to be applied to charities. A 'gross income' threshold will be more relevant to charities and consistent with the presentation of income in their accounts.

4. Responses to other consultation questions

4.1 Our response to this consultation primarily focuses on how the implementation of the EU Accounting Directive impacts on charities established as companies. However, there are a number of other questions raised by your consultation to which we wish to respond as they impact on the timing of implementation or formats or accounting policies adopted in charities' accounts.

Question 6
Should companies be able to access the new financial reporting regime (increased thresholds and revised reporting requirements) ahead of the mandatory application date of 1 January 2016?

4.2 In principle, we support the option of allowing early adoption but we have significant doubts as to whether it would be practicable for many charities to adopt the revised reporting requirements until the relevant financial reporting standard and relevant SORPs are updated. We therefore only support allowing early adoption of the new financial reporting regime if it is also supported by relevant revision to existing accounting standards and SORPs.

Question 9
Do you agree that the Government should continue to measure a company's size by reference to its balance sheet total, net turnover and average number of employees?

4.3 We agree subject to charities applying a 'gross income' criterion in place of 'net turnover'. See our response to question 44.

Question 10
Do you consider that there are circumstances where the Government should include other sources of income as net turnover for the purposes of determining company size?

4.4 As explained in our response to question 44, charities should apply a 'gross income' criterion in place of 'net turnover'.

Question 13
The Accounting Directive offers an option to reduce from 13 to 8 the number of mandatory notes required from small companies. Do you agree with the Government position to continue to require the five notes listed at paragraph 8.18?

4.5 As explained in the consultation, Recital 5 to the EU Accounting Directive specifically excludes not-for-profit undertakings from its scope and therefore regulation must be explicit that the limitation on the number of mandatory notes does not apply to charitable companies. However, in the context of companies generally, we believe that the five additional notes are likely to be necessary to meet the over-riding requirement for accounts to give a 'true and fair' view and hence should be mandated in law or accounting standards.

Question 14
Should the requirement for these notes be set out in regulations or should the need for notes be set out in accounting standards?

4.6 Our preference would be for note disclosures to be set out in accounting standards along with guidance as to the circumstances in which additional notes are required, for example, when necessary to provide a 'true and fair' view or as provided in a relevant SORP.

Question 15
Do you agree that small companies should have the choice of preparing an abbreviated balance sheet and profit and loss account if they wish?

4.7 We strongly disagree that charitable companies should have the option of only preparing abbreviated accounts. We are firmly of the view that published accounts of a charity must present a full income and expenditure account as part of its statement of financial activities, a balance sheet and accompanying note in order to provide proper accountability to its donors, beneficiaries and the public. Charities do not have owners and legitimate interest in a charity's financial activities extends beyond its members. We have doubts that this proposal is satisfactory in the context of any company but in the context of a charity, this proposal would completely undermine the concept of stewardship reporting through published accounts. Moreover, this proposal would weaken charity sector regulation in the UK as charities would be able to file abbreviated accounts, as its published accounts with sector regulators, and thereby limit unreasonably the information made available about its financial activities.

Question 25
Should the UK take advantage of this option to provide greater flexibility in the layout(s)?

4.8 We strongly support flexibility in the format of charitable company accounts where this is necessary to provide relevant financial information or is a presentation allowed by relevant financial reporting standards or SORPs. For example, charities prepare an income and expenditure account as part of its statement of financial activities. A statement of financial activities is a single statement of comprehensive income and presents income subject to particular restrictions as to its use in a columnar format. We would therefore support regulations identifying that formats should be modified where necessary to present a ‘true and fair view’. Also see our response to question 43.

Question 26
If the UK took up this option, should flexibilities be dealt with in the regulations or in accounting standards and why?

4.9 Our preference would be for the principle to be stated in regulations but with detail addressed in accounting standards and relevant SORPs.

Question 27
Do you agree that the legislation should enable participating interests to be accounted for using the equity method in individual company financial statements?

4.10 We do not support accounting for participating interests using the equity method in individual company accounts.

Question 28
Do you agree that the Government should provide for the 10 year maximum period for write-off offered in the Accounting Directive?

4.11 We believe this matter would be better addressed in accounting standards.