

Dear Mr Conway -

## **Response to public consultation on company law amendments to implement June 2013 EU Accounting Directive on small and micro companies**

CARA, as a very small charitable company that among other things provides administrative support and free help and advice on public accountability and regulatory compliance to other small charities, broadly welcomes the proposed UK implementation of the EU Directive affecting small and very small companies with its deregulatory implications for *charitable* micro-entities in particular. We note that the DBIS estimate is that 40k charities out of the 193k on the Charity Commission's Register are companies. However, 28k of these are "linked" charities accounted for as branches within the entity accounts of their respective "main" or publicly accountable charities. We think 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. Only 10.3k registered charities exceed £500k gross income and our estimate is that ca. 75% of these are companies, which by the way account for some 90% of the aggregate gross income of all registered charities (£64bn a year). That leaves some 32k micro-companies on the Register of Charities which are currently excluded from the micro-entities regime by company law and thus unable to opt out of the technical detail of compliance with accounting standards that were never really designed with them in mind.

Our response as set out here concentrates on the implications for the charity sector, for which there are a number of key issues arising. This consultation helpfully reopens the question of the existing Companies Act 2006 exclusion of *charities* from the micro-entities regime, noting that the Charities SORP already imposes extra disclosures over and above the FRS102 or FRSSE requirements and those of the Companies Act's "small companies" regime and so could do likewise for micro-entities in their new regime. There are certain Companies Act provisions for financial reporting within the micro-entities regime of particular relevance for the public accountability of charities. These will obviously feature in the FRC's proposed FRSME and therefore need special consideration with that in mind. We therefore also plan to respond to the current FRC consultation about that.

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, would put those accounts on a par, more or less, with the Charities Act's *Receipts & Payments* accounting option available for small *non-company* charities.

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, OSCAR 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 requirements of the accounting standards, 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 rather than being seen as additional items in the primary accounting statements themselves.

Without having to amend the Charities Act’s accounting provisions, the *status quo* for such non-company charities could be preserved, thus avoiding the risk of confusing the public with yet a third accounting option for them, by the joint SORP-issuing bodies amending the new Charities SORP to prohibit *non-company* micro-charities from adopting the FRC’s proposed FRSME. We propose to suggest that solution in response to the FRC consultation but have included it here in view of its relevance to the need for removal of the current company law exclusion of micro-charities from the micro-entities regime.

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 consultation document makes clear are not 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 specified by an applicable version of the Charities SORP to make the statutory accounts of a charitable company if prepared under the Companies Act’s micro-entity regulations suitable for effective regulation by the Charity Commission or OSCR.

## **Module**

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

- Endowment Funds and their movements in the year must be accounted for separately.
- Restricted Income Funds and their movements in the year must be accounted for separately.
- If summarised by fund-class, details are required of the movements on major individual funds.

### **4: SoFA**

- 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).
- Similarly, the SORP’s required sub-analysis of SoFA line-headings could also be contained in accounts notes, with cross-referencing.
- The SoFA line for funds brought forward and carried forward would be additional requirements.
- 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**

- 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).
- Disclosure of any ex gratia costs is similarly essential for effective charity regulation.

### **10: Balance Sheet**

- The only two items here for which the SORP needs to specify charity-specific disclosure are "fixed assets" and "capital and reserves"
- 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
- 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.
- 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.

For completeness, we have also answered the numbered questions in the consultation document that seem to us particularly relevant to the public accountability of charities, as set out below.

#### **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?**

Not if they are charities, except for those allowed to follow the micro-entities regulations subject to complying with the Charities SORP disclosure requirements, as the latter are essential to effective charity regulation.

#### **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?**

Yes, for the reasons stated above, that this clarification in the company law regulations would then facilitate the work that the FRC and the joint SORP-issuing bodies could undertake to cut red tape for micro-companies that are charities, consistent with effective regulation of their compliance with the public accountability obligations of charities. The discretion given by the EU Directive for very small not-for-profit companies' accounts to be able to include additional disclosures that in the case of charities are essential for their effective regulation needs to be without such regulatory disclosures impacting on their compliance with the "true and fair view" requirement of company law as now interpreted in the micro companies accounting regulations.

These extra disclosures will be those needed by the Charity Commission and OSCR and so will need to be specified in some amended version of the FRS102-based Charities SORP that will import the FRSSE reliefs in due course, as well as in a new version of the Charities SORP that will be needed for very small charities, based on the FRC's proposed FRSME. That would then avoid uncertainty for directors of small and very small charitable companies when considering what extra disclosures they can and should make in their accounts for compliance with the Charities SORP.

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 very smallest charitable companies, commensurate with the public interest in them, this approach must be much simpler and easier than amending charity law as well as company law in order to create a special regime for them.

**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?**

Yes: This flexibility is needed so that charitable companies can continue to prepare (instead of a profit and loss account) a statement of financial activities either incorporating an income and expenditure account or else in addition to it. For regulatory purposes, charities need to be able to report on their funding sources, trust capital as well as trust and corporate income, especially grants, donations and legacies, as well as investment income and trading income, and to report appropriately on their expenditure of resources in furtherance of their charitable purposes and also for fundraising purposes.

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

Yes: Trading turnover is not the only significant source of income for charitable companies, and in fact "gross income from all sources" is a more reliable size-indicator for them - as with non-company charities, as well.

Yours faithfully,

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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