

Annex - Response to ASB's consultation on the Future of Financial Reporting in the UK

The tier system

Q1. Do you agree that a differential financial reporting framework, based on public accountability, provides a targeted approach to relevant and understandable financial information that contributes to discharging stewardship obligations?

We generally concur with this approach.

Q2. Do you have any further comments on the proposed application of the tier system?

It should be noted that tier 1 and tier 3 applies a framework and a set of standards that have not been developed for public benefit entities. The ASB's intention to apply that framework without mandatory application of the FRSPBE at tier 1 and tier 3 raises considerable concerns, not least the potential inconsistency in reporting by charities across the tiers and the basis upon which an auditor can discern a true and fair view in the context of sector specific transactions. We recognised that the FRSPBE and the relevant SORP will apply as best practice to public benefit entities in these tiers but as explained in our responses to questions 5 and 9, we believe it is important for charities reporting under all tiers to apply both the FRSPBE and relevant SORP to ensure accountability to their charity stakeholders and to meet the legal requirement for 'true and fair' financial reporting.

It would also be helpful if ASB made a clear statement as to their future plans for the FRSSE. If the preparers of financial statements of smaller entities are to make an informed decision as to whether they report under Tier 2 or Tier 3 then they need certainly as to the ASB's future intentions for the FRSSE.

If the ASB see retaining the FRSSE as a transition standard then the transition period should be stated.

If the FRSSE is a transition standard then we would favour the development of a 'FRSME - light' that would be less onerous for smaller entities. We would not envisage this as a separate standard but rather certain sections or requirements of the FRSME being disapplied for small entities in order to reduce their compliance costs.

We welcome the work being carried out by the Financial Reporting Council looking at how accounting for micro entities might be simplified.

At present the threshold for defining the applicability of the FRSSE is based on turnover. Charities derive a substantial proportion of their income from voluntary and other non-contractual sources. Donations and legacies are not directly derived from the provision of goods and services but rather are amounts received to fund such activities. Hence a significant proportion of a charity's income may not fall within a Companies Act based definition of turnover. Consideration must therefore be given to defining the FRSSE turnover threshold applicable to charities in terms of a charity's gross income.

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The financial thresholds in relation to the preparation and external scrutiny of accounts within the Charity Accounts Regulations in both England & Wales and Scotland are also defined in terms of a charity's gross income.

Q3. Appendix 1 'Note on the Legal Requirements in the United Kingdom and Republic of Ireland' to this FRED sets out a note on legal matters that are applicable to the tier system. Do you have any comments or queries on the scope or content of this Appendix?

The appendix states that 'an unamended profit and balance sheet prepared in accordance with the Companies Act would not meet all the requirements of the FRMSE; conversely, a statement of comprehensive income and statement of financial position complying with section 4 and 5 of the FRSME would not meet the requirements of the Companies Act.'

For clarity, it would be helpful if a pro-forma format for these primary statements was provided that fully complied with both requirements.

If alternative titles for analysis categories to those provided by the FRSME must be used to comply with the Companies Act then it may be more appropriate for the FRSME to use terminology compatible with the Companies Act throughout. Alternatively, it would be preferable for the ASB to explore with the Department of Business, Innovation and Skills the opportunity of aligning terminology and formats.

If FRSME accounts have to be converted into Companies Act compliant accounts as inferred by Appendix 1 then this adds significantly to complexity and cost.

Entities with public accountability (Tier1)

Q4. Should entities that have public accountability, satisfy all three of the size conditions of a small company or small group, and are prudentially regulated, be permitted to apply the FRSME?

The intention is for Tier 1 to capture entities that have equity or debt traded on a listed market and other entities that as part of a primary business activity hold assets in a fiduciary capacity as a deposit taker for a broad group of outsiders.

We concur that the mandatory application of Tier 1 to small businesses that hold assets in a fiduciary capacity as a deposit taker for a broad group of outsiders would be disproportionate and that such small entities should be allowed to apply the FRSME.

Some charities may operate small credit arrangements with its beneficiaries, for example small loans to beneficiaries in developing countries, as an incidental activity of a wider programme of development aid. It is important for

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there to be clarity that such incidental activities are not construed as a primary business of a charity entailing tier 1 reporting.

Q5. Are the definition of public accountability and the accompanying application guidance sufficiently clear to enable an entity to determine if it has public accountability? If not, why not?

We welcome the focus on 'primary business activities'. A charity may, for example, have small scale micro credit activities that are incidental to its broader charitable purposes. It would be disproportionate for such incidental activities to require Tier 1 accounting. It would be helpful if the final application standard was explicit on the point.

Charities hold assets, in a fiduciary capacity, in trust for its beneficiaries. The clarification provided that charities fall outside Tier 1 accounting because they are not 'deposit taking' entities (the first part of the definition) is particularly welcome. It is important that the final application standard is absolutely clear that charities, holding funds in the fiduciary capacity of trustee, fall outside tier 1 reporting.

However, charities may also operate pooling arrangements where charities under the same control pool their investments. Again, the definition would appear to exclude such pooling charities as deposits are not taken from a broad group of outsiders. On rare occasions older pooling schemes may allow particular classes of charities to participate in pooled investment arrangements. Our view would be that such arrangements do not constitute a broad group of outsiders.

A number of charities issue listed debt instruments. The question arises whether such charities owe their primary duty of accountability to their stakeholders in relation to their charitable activities or to capital markets in relation to their listed debt. We are concerned that Tier 1 accounting only recognises accountability to capital markets at the expense of the stewardship reporting owed to its charity stakeholders.

We are concerned that the PBE standard will not be a mandatory standard for charities reporting in Tier 1. This has the potential to significantly reduce a charity's accountability to their charity stakeholders whose primary information needs relate to the organisation's charitable transactions and activities. We are very concerned that a significant proportion of the transactions that charities undertake will not then be subject to the PBE standard. It would be helpful if the ASB explored further the legal or other constraints that prevent it applying the PBE standard to charities reporting in Tier 1.

We would welcome the opportunity to explore this unfortunate and indirect consequence of the application of EU-adopted IFRS with you. We believe it is vital for all charities preparing accounts to give a true and fair view to apply the PBE standard and the Charities SORP and that all efforts need to be made to find a way to achieve full application of this standard to all charities.

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Entities without public accountability (Tier 2)

Q6. The ASB is proposing to amend the IFRS for SMEs to comply with Company law. Do you agree with the amendments? If not, please explain your reason for disagreement and, if appropriate, suggest an alternative.

We agree that IFRS for SME should be amended to comply with company law.

The statement made in paragraph A1.40 of the appendix to the exposure draft states that 'an unamended profit and loss account and balance sheet prepared in accordance with the Companies Act would not meet all the requirements of the FRSME; conversely, a statement of comprehensive income and statement of financial position complying with sections 4 and 5 of the FRSME would not meet the requirements of the Act' raises some concerns.

We note that preparers are warned of the need for care when preparing statements that comply with both set of requirements.

As highlighted in our response to question 3, we would ask for a set of pro forma financial statements to be added to the FRSME as an appendix. Such an appendix would help preparer deal with the tensions of terminology and format between the FRSME and company law. It would also be helpful if the ASB explored with the Department of Business, Innovation and Skills the possibilities for aligning terminology and formats.

Q7. The ASB decided to evaluate possible amendments to the IFRS for SMEs using three guidelines:

(a) changes should be minimal;

(b) changes should be consistent with EU-adopted IFRS; and

(c) use should be made, where possible, of existing exemptions in Company law to avoid gold-plating.

Do you agree with these guidelines? If not, please explain why.

We also recognise a tension between simplification and maintaining consistency with the underpinning international standard. Within the charity sector there are calls for both simplification and a longer term desire, particularly amongst NGO charities, for a framework that provides for consistent reporting across state borders. Clearly, addressing these competing demands is problematic.

On balance, we agree with these guidelines but we do believe that certain options ruled out by the FRSME can be reintroduced without breaking from these general guidelines. For example, there seems to be no good reason why the FRSME should not allow the revaluation of property, plant or equipment or the capitalisation of interest on development costs.

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Similarly, it also appears to us that it would be possible to disapply particular sections or requirements of the FRSME for smaller entities, for example the cash flow statement, and still have a framework that is consistent with these principles.

Q8. The ASB has amended the IFRS for SMEs to:

- (a) replace section 29 Income Tax with IAS 12 'Income Taxes';**
- (b) provide transitional relief for dormant entities with intra-group balances;**
- (c) exempt an entity preparing consolidated financial statements from including a parent company cash flow statement; and**
- (d) revise the scope of section 9 such that an entity is required to prepare consolidated financial statements only when required to do so by Company law.**

Do you agree with the amendments? If not, please explain your reason for disagreement and, if appropriate, your proposed alternative.

In general, we agree with this approach. However, the Companies Act allows for the voluntary preparation of consolidated accounts and it may be prudent to apply section 9 of the FRSME to such cases.

Moreover, the Charities Act 1993 and the Charities Accounts (Scotland) Regulations 2006 require the preparation of consolidated financial statements where the aggregate gross income of a group headed by a charity parent exceeds £500,000. Again, it would seem potentially anomalous for section 9 of the FRSME not to be applied to their preparation

Small entities (Tier 3)

Q9. Do you agree with the proposed consequential amendments to the FRSSSE? If not, why not? Please state your reason for disagreement and, if appropriate, suggest an alternative.

At present small charities may adopt the FRSSSE when preparing their accounts but non-company charities must also apply the methods and principles of the Charities SORP as required by charity legislation in both England & Wales and Scotland.

Charities preparing their accounts under the FRSME will also apply the PBE standard. A similar rationale needs to be applied where the FRSSSE is adopted by charities. The FRSSSE alone does not meet the reporting needs of charities. We would therefore seek a further amendment to the FRSSSE so that the PBE standard is applied to relevant transactions where charities report under Tier 3. The vast majority of UK charities fall within the FRSSSE thresholds and it would be anomalous for the PBE standard to only apply to a small percentage of UK charities that must apply the FRSME.

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Reduced disclosures for subsidiaries

Q10. The ASB is proposing that subsidiary undertakings which apply the reduced disclosure framework should:

- (a) disclose the disclosure exemptions taken;**
- (b) state in the notes the name of the parent undertaking in whose consolidated financial statements the subsidiary's results and relevant disclosures are included; and**
- (c) only be permitted to take the disclosure exemptions where the consolidated financial statements of the parent are publicly available.**

Are these requirements necessary and sufficient to protect users of subsidiary financial statements?

We agree that where exemptions are taken that this fact should be stated. We agree that the exemption should be limited to circumstances where group information is available in consolidated financial statements.

Q11. The ASB proposes that disclosure exemptions should be permitted for all subsidiary undertakings: do you agree, or do you consider that there should be a minimum percentage ownership requirement?

No comment.

Q12. Do you consider that a disclosure exemption should or should not be provided for transactions between wholly-owned group undertakings? Please explain your reasoning.

Charities often undertake activities through trading subsidiaries which may either be set up to raise funds for a parent charity or to carry out particular aspects of a charity's aims. Any financial support of the subsidiary and transactions between a charitable parent and non-charitable subsidiaries is potentially relevant information for users of the group accounts given trust law restrictions on the purposes for which charitable funds may be applied. We would therefore seek the disclosure of such related party transactions.

Q13. The reduced disclosure framework was developed in response to the feedback on the ASB's policy proposal issued in August 2009. Qualifying subsidiaries applying the reduced disclosure framework look to EU-adopted IFRS and the Appendix to the draft Application FRS to prepare their financial statements. Does this proposal adequately address preparers' needs?

This approach is reasonable.

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Q14 Do you have any further suggestions for disclosure exemptions for qualifying subsidiaries? If so, please explain why you consider the disclosure is not required in the subsidiary financial statements.

None

SORPs for profit-seeking entities

Q15 Do you agree with the detail of the ASB's proposal to streamline the number of SORPs for profit-seeking entities? If not, why not?

There are a number [46] of charitable common investment funds (CIFs) and a common deposit funds (CDFs) which accept investments from other charities. The accounting regulations which provided for the form and content of their financial statements and the methods and principles adopted for their accounting rely heavily on the Investment Managers Association's SORP for Authorised Funds. If the Authorised Funds SORP is not maintained then additional accounting regulations might be needed. The Authorised Funds SORP enhances the consistency and quality of financial reporting and is used by registered charitable CIFs. We therefore strongly favour the retention of this SORP.

Draft impact assessment

Q16. Do you agree with the benefits that have been identified as arising after adoption of the proposed Financial Reporting Framework? If not, why not? Please provide examples, including quantification where possible, of any benefits you believe have not been taken into account.

We accept that in the medium to long term the FRSME provides a more manageable standard than the full suite of UK GAAP. The framework for small charities wishing to move towards an IFRS-based standard is more complex and will be more costly to apply than the current FRSSE.

As we move forward, it will be vital for the UK to have a stable reporting framework. A risk exists that future changes to the framework and hence costs will be outside the direct control of UK standard setters. The feedback we have received is that UK charities value stability in reporting requirements. We believe it will be important for the ASB to recognise the need for a period of stability in its negotiations with IASB as the new framework is implemented.

The FRSME certainly has the potential to increase comparability of entities across state borders and this will be attractive to charities working internationally particularly NGO charities. We also recognise there may be advantages to charities bidding or tendering for EU funding or contracts.

We are not convinced that the adoption of the FRSME by our sector will have any significant impact on borrowing costs. Quite simply even if there is initially a slight competitive advantage through the adoption of IFRS, this position

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cannot be preserved as entities move to IFRS-based framework unless banks reduce their lending margins in response to the framework.

We recognise the difficulty in quantifying the benefits derived from cross-state comparability. In many ways the practical drivers are the untenable position, as described by the ASB, as UK standards fail to keep pace with international developments with a new generation of accountants who are being trained in IFRS. We are pointed in the direction of change by the untenable position of doing nothing.

Q.17 In relation to the case study scenarios identifying the likely costs of transition for certain entities, do you agree with the nature and range of costs identified? If not, please provide details of any alternatives you would propose, including any comments on the assumptions underlying the calculation of the costs.

The impact assessment is limited to UK companies. Other entities, not constituted as companies, such as charitable trusts and associations are subject to legal requirements to prepare 'true and fair' accounts. The impact on approximately [33,000] UK registered charities has not been addressed at all in the estimated costs.

The scenarios presented for different sized entities and varying complexity in their transactions were helpful.

Where auditors provide assistance in the formatting of accounts, we will be pleasantly surprised if costs are contained to the levels your estimates provide. The informal feedback we have received in the past on updating the Charities SORP suggests that new frameworks are often a catalyst for increased audit costs. It is also questionable, although theoretically correct, to assume that costs will fall back to the pre-implementation base line immediately. New frameworks take time to bed-in.

We realise standard costs need to be used in such exercises but few audit partnerships, in our experience, cost as little as £520 per day and even in the charity sector it would be unusual for senior finance staff to be paid as little as £130 per day.

We agree that cost in terms of amending accounting systems is unlikely to be great. The primary cost will be in relation to accountants trained in UK GAAP becoming fully conversant with the new framework. As the assessment correctly points out CCAB members do have CPD responsibilities.

Looking at a UK charity with a gross income of £20m, it is questionable whether a senior finance team will be able to limit the total of their training time and addition time spent in first time application of the FRSME to 2.5 days.

In our view the costs are likely to have been underestimated.

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Q18. The [draft] Impact Assessment also gives an indication of the impact on the 'main affected groups'. Do you agree with this analysis? If not, why not?

The impact assessment is limited to UK companies. Other entities, not constituted as companies, such as charitable trusts and associations are subject to legal requirements to prepare 'true and fair' accounts. Otherwise we broadly concur with the analysis provided.

Q19. The benefits are hard to quantify; do you agree that they outweigh the costs of transition and any ongoing incremental costs? Do you have any comments on the estimates used?

We recognise the difficulties in attaching monetary value to the benefits identified. The option analysis is helpful and provides good evidence supporting the general direction being taken.

Q20. The ASB is proposing an effective date of July 2013, with early adoption permitted, which assumes an 18 month transition period. The ASB's rationale for this date is set out in paragraphs 11.121 to 11.126. Early adoption will permit entities to secure benefits as soon as possible, however other entities may wish to defer the effective date to permit businesses more time to prepare for transition. Do you agree with the proposed effective date and early adoption? If not, what would be your preferred date, and why?

Allowing an 18 month transition date from the publishing of the final FRSME and its application is essential in the context of the UK charities sector. At present the legal framework for charity reporting in England, Wales and Scotland is linked to existing UK GAAP and amendment to accounting regulations will require separate consultation and Parliamentary time at both Westminster and Holyrood. In addition, charities in the UK applying the FRSME will do so in conjunction with the proposed PBE standard and Charities SORP. The PBE standard is currently subject to consultation and the Charities SORP can only be finalised and consulted upon once that standard is in place. In our view, it would not be practical for UK charities to apply the FRSME standard until both the PBE standard and Charities SORP are in place and therefore voluntary early adoption is unlikely to be practical. A transition period of 18 months from the publication of the FRSME and PBE Standard will be necessary to manage the transition in an orderly fashion.

Q21. Please provide any other comments you may have on the [draft] Impact Assessment.

No further comments.

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Alternative view

Boundary between Tier 1 and Tier 2

Q22 Do you agree that all the entities that the ASB has identified as falling within Tier 1 should be in Tier 1, or do you agree with the Alternative View that some could move to other tiers? If you do think some entities could be moved– which entities and to which tier?

We accept that Tier 1 needs to be mandatory for parent entities required by Article 4 of the IAS Regulation and/or currently required by UK company law to apply EU adopted IFRS.

In the context of unlisted entities falling within Tier 1 such as deposit takers, financial sector regulators can be seen as acting as proxies for the public interest and therefore, in our view, any mandatory extension of Tier 1 in regulated sectors should be with the specific concurrence of relevant regulators.

We recognise that Tier 1 is only likely to applying where charities have traded debt on a public market. We accept that capital market may have different information needs which are better served by EU-adopted IFRS. Tier 1 accounting will provide only a limited enhancement of accountability by UK Charities to their stakeholders as donors or beneficiaries.

We are particularly concerned that the PBE standard will not be a mandatory standard for charities in Tier 1. This has the potential to significantly reduce accountability to their stakeholders whose primary information needs relate to the organisation's charitable activities.

Q23 Are you aware of any information that users of financial statements of publicly accountable entities require which would not be disclosed in financial statements prepared using the FRSME (the IFRS for SMEs adapted for use in the UK)? If so, please identify such information and explain why it is required.

In the context of the vast majority of UK charities the FRSME and the PBE standard provide a more appropriate reporting framework than Tier 1. It is untenable at a conceptual level for PBE standard to apply to medium sized charities adopting the FRSME but not to charities with listed debt reporting under Tier 1.

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Accounting requirement for entities falling into Tier 2 (FRSME)

Q24. Do you believe that the ASB's proposals for the FRSME should be changed to reduce complexity? If so, what changes would you suggest? Please explain how such changes would improve the balance between costs and benefits.

Complexity of accounting is a significant issue for preparers of financial statement within the charity sector. It is important that information provided is relevant and accessible to users of financial statements.

The complication is that what is relevant information is a factor of who are considered to be an entity's stakeholders and users of its accounts. For example, in the context of a charity segmental information about activities is vital information whereas information about financial instruments and discounting to disclose fair value will only have marginal relevance to most users of charity financial statements.

We also recognise a tension between simplification and maintaining consistency with the underpinning international standard. Within the charity sector there are calls for both simplification and a longer term desire, particularly amongst NGO charities, for a framework that provides for consistent reporting across state borders. Clearly, addressing these competing demands is problematic.

Our view is that on balance the FRSME is appropriate for larger more complex charities but is too complex for the very small. A long term replacement is possibly needed for the FRSSE. It is important for the ASB to give very careful consideration to how the reporting burden for the small can be reduced either through the development of a cut-down version of the FRSME and/or a standard for micro entities. A cut down FRSME might, simply disapply certain sections for small entities, for example the cash flow requirement, the section dealing with other financial instruments and certain requirements to discount to fair value. This could be achieved simply by adding text to the current draft of the FRSME disapplying particular sections or parts for small entities.

Q25. If the FRSME was changed in accordance with your response to Q24, would it still be suitable for use by some publicly accountable entities? If not, why not?

If the ASB can address reporting burden for the small either by disapplying particular aspects of FRSME in the context of small entities and/or by developing a standard for micro entities then the FRSME would maintain its suitability for use by some publicly accountable entities. (Also see our response to Q.24).

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Boundary between Tier 2 and Tier 3

Q26. The current cut-off point for the FRSSE is the small company threshold (Turnover £5.6m, Balance Sheet £2.8m, Employees 50). Do you think the cut-off could be raised to permit all companies defined as medium-sized (Turnover £22.8m, Balance Sheet £11.4m, Employees 250) under the Companies Act to use the FRSSE without any additions to the FRSSE? If not, can you identify an intermediate level for the cut-off, and what would it be?

Unless there is an intention to maintain the FRSSE for the foreseeable future, we see no merit in extending the threshold for its application. To assist preparers to make an informed decision between reporting under tier 1 or tier 3, it is important for the ASB to be clear as to their longer term intentions for the FRSSE.

If the FRSSE is not to be maintained for the foreseeable future then there would be merit in disapplying certain sections of the FRSSE to smaller entities to encourage its adoption (see our response to Q.24).

However in the context of the development a cut-down version of the FRSSE for the small, there would be considerable merit in allowing its application at a higher threshold.

Q27. If you consider that the upper limit of the FRSSE could not be raised without amendment, what additional topics would the FRSSE need to cover if it was extended to include medium-sized entities, and why?

Unless ASB intends to maintain the FRSSE in the long term then we little merit in increasing the application threshold of the FRSSE.