

Consultation response – Financial Reporting Standard for Public Benefit Entities: FRED 45

1 Introduction

As with our response to the consultation on FRED 43 and 44, we fully endorse the response made by OSCR and the Charity Commission for England and Wales as the joint SORP-making body. We have limited our response here to the points on which we wish to place most emphasis, as well as those most relevant to the Scottish charity sector.

2 Application of the FRSPBE

In our response to FRED 43 and 44, we highlighted the potential pitfalls in having a three tier regime where a standard that has specific application, such as the FRSPBE, does not apply on a mandatory basis across all tiers. We are aware that the ASB made some tentative decisions at their meeting of 16 June, which include the intention to remove PBE's from tier 1, meaning that PBE's will either report under tiers 2 or 3. However, such an arrangement will potentially result in inconsistency in accounting treatment amongst PBE entities in tier 3 and in comparison to those in tier 2.

The demographic of the charity sector means that the vast majority of UK charities are small. In Scotland, nearly 95% of the c.23,300 registered charities have an income of below £500,000 and (other criteria apart) would be eligible to prepare their accounts using the FRSSE.

In practical terms if the PBE standard is not mandatory for charities preparing accounts under tier 3, charities will find it more challenging to account for charity-specific transactions which are not addressed in the FRSSE. While the development of the new SORP will aim to assist small charities, it will be difficult to escape the complexity inherent in such a model if different accounting treatments apply for the same transactions or categories of income or expenditure depending on the reporting tier being used. In addition, consistent application of the PBE standard is of critical significance to the public audience to enable comparability and would aid and support charities in achieving high quality financial reporting.

Under the current framework for Scottish charities preparing accrued accounts, consistency is achieved by virtue of the fact that the Charities SORP is part of the statutory requirements for such charities. If the PBE is not mandatory for tier 3

entities, similar transactions may be accounted for differently by charities which in our view would be a retrograde step. From a regulatory point of view this will also make it harder to compare charities and monitor them effectively and in addition audit opinions on the true and fair view will include a greater degree of judgement than previously. Funders and the general public may then find it harder to understand charity accounts and this will reduce confidence in the sector.

On the assumption that the tentative decision of the ASB to remove PBE's from tier 1 remains, we strongly recommend a further amendment to allow the FRSPBE to be mandatory for entities in tier 3.

3 Incoming resources from non-exchange transactions

The changes to the accounting for donated goods will have a significant effect on the sector. Recognition of income from the date that the items are received rather than when distributed will result in different accounting treatment and also additional administration compared to current practice.

If items have not been sold within the year they will require to be included within inventory at the year end. This will result in additional administration of stock taking and valuing items. In practical terms, this will place a considerable burden on volunteers running such shops, and may ultimately have a detrimental effect on the number of individuals willing to act in this capacity. This in turn may mean that the viability of these operations is called into question with a resulting decline in resources flowing into the sector. However, the operation of charity shops is in furtherance not only of income generation for the charity concerned but also has a social support aspect for volunteers and beneficiaries of the charity and is important in raising awareness of the charity's name and brand. Consequently, the survival of charity shops is critical in many aspects for the sector.

Paragraph 2.2 of the Statement of Principles, refers to cost versus benefits. It states, "the information provided by the financial statements will need to be useful and...the benefits to be derived by providing the financial statements will need to exceed the costs of doing so." Similarly, within paragraph 1.26 (b) of FRED 43, it is stated that "the framework must be proportionate, so that preparing entities are not unduly burdened by costs that outweigh the benefit to them and to the primary users of the information in their financial statements". It is our view that the principle of the cost/benefit test is particularly relevant here and accordingly, charities should be permitted to apply a cost/benefit test when applying this section of the standard. We strongly recommend that this should be more explicit in the guidance.

We acknowledge the guidance at 7A.3 and 7A.4 reminds the user of the need to apply materiality to such transactions and that where a large number of small value items are donated, a reasonable estimate of the value may be used. In some instances, this may negate the need for a charity shop to carry out additional procedures. **However**, this guidance is not part of the Standard and in our opinion, this issue is so significant that greater emphasis on these points and explicit

references to the principles of certainty and measurement should be considered by the ASB in this part of the Standard.

4 The future of the FRSSE

We acknowledge the fact that the ASB will permit the continued use of the FRSSE by smaller entities, at least on a transitional basis. However, we do have concerns about the maintenance of the FRSSE and how it will continue to be supported. In our opinion, this issue is particularly pertinent given the ASB's tentative decision to extend the implementation timetable to 1 January 2014, as this extends the period in which the FRSSE has been unsupported.

After the new regime is implemented, UK GAAP will no longer be in existence. The FRSSE defers to UK GAAP for transactions and events which are not covered in the FRSSE. Once UK GAAP is removed users of the FRSSE would effectively have to defer to FRSME for items not covered and this may lead to inconsistent accounting treatments and anomalies.

We would encourage the ASB to formalise their intentions in respect of the FRSSE and to make these public.