

Activity Basis of Reporting and the Charities SORP - Discussion Briefing

Prepared by: CIPFA and Reviewed by the Charities SORP-making body, October 2021

Purpose of the briefing paper

To assist the engagement strands and Charities SORP Committee in their reflections on the current approach to the activity basis of reporting as required by the SORP and to undertake a problem-solving exercise to identify:

- Whether there is a general lack of understanding by preparers of accounts as to what is required.
- The link between the cost of the activity and the income is not always clear in reporting terms. Can the SORP provide any recommendations to make this clearer?
- Is there any cross over from the previous work on the presentation of the Statement of Financial Activities (SoFA), and the links of costs to income, which can be of use to the activity basis of reporting? *[Note that there is also cross over to the support costs Briefing]*

A preferred option is required with a recommendation as to what changes there should be to the SORP, or other guidance required, if any.

Reflection - what are the SORP requirements for activity reporting?

Support costs had to be analysed and disclosed by way of a note (SORP 2000 paragraph 60) to the accounts with management and administration shown separately (SORP 2000 paragraph 152). Activity reporting came in with SORP 2005 and with it the replacement of management and administration with a specific definition of governance costs; governance costs to be shown separately on the face of the SOFA even if immaterial (SORP 2005 paragraph 86 and table 3). Very influential in the change to activity reporting was the research by New Philanthropy Capital and ACEVO that criticised the charity sector for its approach to costing its activities: 'Funding our future II: Understand and allocate costs' (ACEVO 2002).

Module 8 of the SORP specifies the reporting requirements for the SoFA for charities reporting on an activity basis. Costs incurred in direct charitable activities must be clearly distinguished from those incurred in the raising of funds. The analysis must be a on a full cost basis, meaning direct costs plus the allocated proportion of shared costs and overheads across all headings including raising funds.

Module 8 sets out the requirements for the;

- general principles for reporting activities;
- identification of support costs;
- methods of allocating costs to activities;
- accounting for costs shared between fundraising and charitable activities; and
- disclosures required in the notes to the accounts.

Para 8.5 to 8.14 of the SORP contains the following requirements for activity reporting.

General principles for reporting activities

- 8.4. A charity's SoFA or related notes should provide an analysis of a charity's significant activities in a way that is relevant to both the charity and the users of its accounts.
- 8.5 Significant activities are those which, due to their scale or importance, are key to the charity in meeting its aims and objectives. The analysis of activities should provide an understanding of how a charity raises its funds and uses them to further its purposes. For example, charitable activities may be analysed according to services provided, projects or programmes undertaken, or by the particular aims or objectives taken forward.
- 8.6. The activities reported should also be consistent with the significant activities noted in the trustees' annual report. The narrative provided by the trustees' annual report should help the user of the accounts to understand the nature of those significant activities and what has been achieved as a result of the expenditure incurred on them.

Identification of support costs

- 8.7. While some costs relate directly to a single activity, the cost of certain central or regional support functions may be shared across more than one activity undertaken by the charity. For example, governance costs, payroll administration, purchasing, budgeting and accounting, information technology, personnel (human resources), building management services and finance are functions that are likely to support more than one area of activity. These costs must be apportioned across the activities that the function supports in order to arrive at the full cost for each reported activity including relevant restricted funds unless prohibited by the terms of a gift.

Methods of allocating costs to activities

- 8.8. To ensure that the accounts present the costs of activities fairly, charities should ensure that the method(s) of cost allocation adopted are reasonable and consistently applied. In attributing costs to activities, the following principles must be applied:
- Direct costs attributable to a single activity must be allocated directly to that activity (for example the salary cost of someone solely employed on a particular activity or the cost of running a vehicle used wholly for a particular activity).
 - Shared costs which contribute directly to more than one activity must be apportioned between those activities (for example the cost of a staff member whose time is divided between a fundraising activity and working on a charitable project).
 - Support costs which are not attributable to a single activity must also be apportioned between the activities being supported.
- 8.9. The method(s) of apportionment adopted by a charity should be reasonable and be consistent between reporting periods unless circumstances change. Charities should also balance the benefits of greater accuracy with the costs involved when selecting methods of apportioning costs. Examples of bases for apportionment that may be applied include:
- usage of a resource or activity in terms of time taken, capacity used, requests made or other measure;
 - per capita, based on the number of people employed within an activity;
 - floor area occupied by an activity; or
 - time, where staff duties span more than one activity.

Accounting for costs shared between fundraising and charitable activities

- 8.10. Information about the aims, objectives and projects of a charity is frequently provided in the context of mail shots, websites, public fundraising collections and telephone fundraising. In determining whether costs are shared, a distinction should be drawn between:
- publicity or information costs involved in raising the profile of the charity which is associated with fundraising; and
 - educational publicity or information to further the charity's aims and objectives.
- 8.11. For publicity or information to be regarded as charitable expenditure, it must be provided for an educational purpose. In the context of a fundraising activity, in order to achieve an educational purpose the information supplied must fulfil the following educational criteria:

- be targeted at beneficiaries or others who can use the information to further the charity's purposes;
 - be information on which the recipient can act in an informed manner to further the charity's purposes; and
 - be related to other educational activities or objectives undertaken by the charity.
- 8.12. For example, a health education charity might target high-risk beneficiary groups or medical professionals when distributing its fundraising material and, as part of the same mailing, also supply information on health risks and symptom recognition. The health information supplied would be charitable expenditure because it is targeted at beneficiaries or others who could act on the information and has been distributed by the charity as part of its health education activity. The shared cost of producing and distributing the information should therefore be fairly apportioned between the fundraising and charitable activities. If the educational criteria had not been met then all relevant costs would be attributed to fundraising activities.

Disclosures required in the notes to the accounts

- 8.13. This SORP requires that charities reporting on an activity basis must disclose:
- details of the accounting policy adopted for the apportionment of costs between activities and any estimation technique(s) used to calculate their apportionment;
 - the total amount of support costs incurred in the reporting period;
 - an analysis of material items or categories of expenditure included within support costs, with the total amount of governance costs incurred separately identified (refer to Appendix 1, '[Glossary of terms](#)', for the definition of governance costs); and
 - the amount of support costs apportioned to each of the charity's significant activities as disclosed in the SoFA or in the notes to the accounts.
- 8.14. The information required for support costs and their apportionment may be provided in a tabular format

The SORP contains a table illustrating the tabular format of reporting of support costs and their apportionment. This table is illustrated in Appendix 1 to this paper.

FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* does not cover activity reporting in charity accounts. The SORP extract therefore provides the explicit provisions on reporting on an activity basis for charities.

Additional guidance

No additional guidance relating to activity reporting is contained in the accounting regulations in the UK jurisdictions.

What is the reporting difference between ‘all’ and ‘larger’ charities?

The SORP requires that larger charities must report on an activity basis. Other smaller charities have the option of adopting an ‘alternate approach’ (See SORP paragraph 4.22).

Engagement strand feedback during the exploration stage

Activity reporting

Engagement strand feedback reported to the Charities SORP Committee 16 and 23 February 2021

Four strands highlighted a need for better links between the narrative and financial information in the accounts in their feedback in February 2021:

Analysis of expenditure was raised by three engagement strands. One suggested it should be simplified and transparency increased. Two others raised the issue of natural classifications. One engagement stand suggested the option [for the use of natural classifications] be made more prominent, another strand suggest removal of the requirement to be made available to more charities.

Smaller charities and independent examiners

- The construction of the Statement of Financial Activities, and the volume and ordering of the notes to the accounts often makes it difficult to relate the accounts to the trustees’ annual report, this might be mitigated by greater use of natural classifications.
- The ability to use natural classifications should be made more prominent and this should be available to more charities. Most charities accounts preparers are not aware of the availability to use natural classification.

Trustees

- Create a clearer link between the narrative and financial aspects of a charity’s performance (supported by trustee survey).
- There are occasions where the notes do not reflect the main body of the report, or accounts or where the notes are omitted or wrong because the narrative and numerical parts of the document are not joined up well.

- Encourage the reporting of a charity's performance to be more rounded, linking it with the charity's approach to and management of risk.

Academics and regulators and proxies of public interest

- All relevant information (financial and non-financial) is grouped under a theme (income, expenditure, reserves/resilience, public benefit). Requiring charities to bring financial and non-financial information to bear on addressing each theme would greatly enhance clarity and readability of annual reports.

Professional and technical strand A

It was suggested that there was a general lack of understanding by preparers of accounts and the link between the cost of an activity and the income was not always obvious.

- *"Some charities do not do activity reporting very well and it is not always easy to compare the cost of an activity to the income generated from the activity. Could the SoFA be presented to clearly link costs to related income, where appropriate? For example, in relation to grant funding, it could be shown how the grant was used to fund a particular activity."*

Professional and technical strand B

- There should be a greater focus on the report and accounts as a package which together tell the story of the charity and its finances. For example, risk management information should be more meaningful and closely linked to the accounting information.
- Remove the requirement to allocate support costs with natural classifications used instead. The strand considered the use of a threshold or taking more radical approach of abandoning the [reporting of] support costs altogether. Their view was that the current method [of support cost allocation] is time consuming and is not done objectively as a result, the accounts of two different charities are not comparable.

Observations from the SORP Committee:

At the meeting on 23 February 2021 the Committee noting the comments of the engagement strands considered that the activity-basis of reporting should be included as a topic for consideration.

Relevant SORP research findings

The survey results from the OSCR and CCEW public research, presented on 13 November to the Charities SORP Committee, contained the following findings.

- OSCR's survey found that the key factors to increase trust were around accountability and transparency, were the users (including the public) being presented with the work that has been achieved with money donated how much is spent on administration and being open about what the charity is doing.
- CCEW's survey identified similar issues that are important for public trust in charities. The Committee's reflections at that time in terms of the impact for the SORP were summed up as *"there should be no numbers without a story and no story without numbers"*.
- The 2016 research exercise included the following comment:
'Restate the SORP 2005 exemption for smaller charities for certain note disclosures which relate to the constituent costs of an activity or where relevant information is provided on the face of the SoFA'

What needs to be done now?

Step 1- Making the case for change - a 'basis for conclusions'

At this stage, there is a need to decide:

- i) whether any changes are required to the reporting requirements in the Charities SORP
- ii) what those changes might be to improve the understanding of the users of the accounts or to assist accounts preparers with the decisions and judgements required to report on charity expenditure
- iii) the reasons to support the changes.

Step 2 - Advising the change required to the SORP

Having made the case for change, the detailed changes required to the SORP need to be specified. Consideration should be given in as much detail as possible for activity-based reporting. If no detail is given, the conclusion drawn is that the detail is left wholly to the discretion of the SORP Committee and SORP-making body.

Undertaking an assessment of the impact (savings or costs on the preparer and benefits or disadvantages to the reader)

The FRC will require an impact assessment but until the implications of change are worked through the SORP framework, the impact is unlikely to be clear and so this will be considered at the drafting stage of the process.

Step 3 - Recommendation

The case made by each engagement strand or combination of strands will inform the deliberations of the SORP Committee and so there needs to be a clear recommendation from the engagement strands and the SORP Committee.

Following evidence provided by the engagement strands the SORP Committee will have its own discussion about what needs to be done and taking the evidence and views from the process, the Committee will settle on a recommended approach for drafting the SORP based on the evidence presented.

Appendix 1

Analysis of support costs

Support cost (examples)	Raising funds	Activity 1	Activity 2	Activity 3	Grand Total	Basis of allocation
	£	£	£	£		
Governance	x	x	x	x	x	Text describing
Finance	x	x	x	x	x	Text describing
Information Technology	x	x	x	x	x	Text describing method
Human Resources	x	x	x	x	x	Text describing
Function/ Activity Total	x	x	x	x	x	