

Support Costs and the Charities SORP - Discussion Briefing

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

Purpose of the briefing paper

To assist the engagement strands and the Charities SORP Committee in their reflections on the current approach to support costs within the SORP and to undertake a problem-solving exercise to identify:

- how charity support costs should be accounted for, and
- a preferred option with a recommendation as to what the change to the SORP should be, if any.

While efforts have been made to keep overlap to a minimum, there is some unavoidable overlap between this briefing paper and the briefing paper on expenditure classification. Both briefing papers will be sent to working groups and engagement strands at the same time. Working groups and engagement strands should note that there is no expectation for them to duplicate effort. Where it is unclear whether a comment should be made in response to this briefing paper or in response to the briefing on expenditure classification, working groups and engagement strands are encouraged to make the comment only once in response to the briefing paper they feel is most appropriate. The Secretariat will be mindful of this issue in analysing feedback once comments have been received.

Reflection - what does the SORP say about support costs?

The SORP requires larger charities to report on an activity basis. Module 4, paragraph 4.6 sets out that smaller charities may opt to report their charity's expenditure in a different way, for example by the nature of expenditure rather than on an activity basis. Charities that do report on an activity basis must apply Module 8 (Allocating costs by activity in the statement of financial activities). Module 8 contains the relevant provisions of the current Charities SORP (FRS 102) for support costs (see also briefing paper on expenditure classification).

FRS 102 does not address the allocation of costs to activities in the SoFA.

The SORP Appendix 1: Glossary of Terms defines Support Costs as follows:

Support costs are costs incurred to facilitate an activity. Unlike direct costs, which result directly from undertaking the activity, support costs do not change directly as a result of the activity undertaken. Support costs include the central or regional office functions, such as governance, general management, payroll administration, budgeting and accounting, information technology, human resources and finance.

Module 8 (Allocating costs by activity in the statement of financial activities) contains the relevant provisions of the current Charities SORP (FRS 102) for the treatment of support costs. With specific reference to support costs, Module 8 sets out that:

8.7. *“... [Support] 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 for the allocation of costs to activities are specified in the SORP as follows:

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.*

Disclosures (within the notes to the accounts) has been the topic of a separate briefing paper and was discussed by the Charities SORP committee on 4th August 2021. At that meeting, there was tentative support for further consideration of how disclosures could be simplified and reduced on a module-by-module basis. Consideration may need to be given to the disclosure requirements with respect to support costs:

- 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 ... ; 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 (see Table 4).*

Table 4: 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 method
Finance	x	x	x	x	x	Text describing method
Information Technology	x	x	x	x	x	Text describing method
Human Resources	x	x	x	x	x	Text describing method
Function/ Activity Total	x	x	x	x	x	

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

As set out above, smaller charities may opt to report their charity's expenditure in a different way (see SORP paragraph 4.6), for example by the nature of expenditure rather than on an activity basis. If smaller charities do not report on an activity basis, the SORP requirements around support costs are not likely to be relevant.

Engagement strand feedback during the exploration stage

Initial topics and ideas under discussion by the SORP engagement strands as presented to the SORP Committee in November 2020 indicated there was a need for greater clarity on support costs to help consistency.

Engagement strand feedback: User of the accounts perspective

Three strands raised the fact that the current requirements around the calculation of support costs led to a lack of comparability in the financial statements:

- A subjective division of costs incurred, which varies from charity to charity, allows no direct comparison from one charity to another operating in the same field. By not allocating all costs to charitable support costs also gives the impression that some costs are 'bad' costs, whereas all charities necessarily incur admin costs in order to run the charity. (MFDGPB)
- The current approach to allocating support costs doesn't enhance the comparability of charity accounts and can have a knock-on effect on a charity's KPIs. (PTS(B))
- Further guidance for uniformity is required plus clarity that all costs, once appropriate to a charity, are essential i.e., avoid any sense of 'overheads are bad'. There is a sense at the moment that charities are in desperate competition with each other to declare how much in each £ is spent on front line services and this leads to significant divergence on interpretation of support costs. (L)

Engagement strand feedback: Preparer of the accounts perspective

The main issue raised in relation to support costs was the amount of choice given when allocating support costs to activities. This could lead to inconsistencies between charities.

"The requirement to allocate support costs in the SoFA to different activities is arbitrary and subjective and we believe this is a key area which should be reviewed with a view to removing the requirements. The current approach doesn't enhance the comparability of charity accounts and can have a knock-on effect on a charity's KPIs, for example, through the allocation of fixed overheads to fundraising activities." (PTS(B))

As with feedback from the user's perspective, it was raised that charities seemed to perceive that all costs should be capable of being allocated to an activity and if they were not, these 'overhead' costs were seen as 'bad' costs.

The distinction between expenditure on charitable and non-charitable activity is considered to be problematic as in normal circumstances all expenditure should be considered charitable. However, it was recognised that a distinction will remain necessary, for example, to report losses due to fraud. (PTS(B))

Observations from the SORP Committee:

At the discussion between the Charities SORP Committee and SORP engagement strand convenors held on 17 November 2020, support costs were discussed. It was noted that support costs are particularly interesting to funders. However, such costs are not reported consistently. It was noted that it would be good to provide examples, showing what is a clear presentation and good explanation of expenditure on support costs and how it is relevant to a charity. This will help charities to see and understand how this can be adopted.

At the meeting of the SORP Committee on 16th February 2021, the committee questioned the importance of comparability of support costs because the sector is so diverse it is likely that charity support costs would be very different on a charity-by-charity basis. The committee considered that it might be useful to remove this as a cost category in a similar way that governance costs had been removed previously. The committee considered that this might be usefully addressed in a key facts piece for the sector. The committee agreed to take forward this topic to the next stage.

Relevant SORP research findings

In the 2016 research exercise, the need for greater guidance and disclosures around how a charity allocates support costs was highlighted. Respondents saw the methods and bases being used by charities to allocate and apportion support costs across other categories as inconsistent given that they were subject to a large level of judgement.

“Most of our charities are required to do some sort of subjective allocation of these costs which are then given key prominence in the financial statements – but are essentially someone’s view rather than objective reality. Our view is that this decreases the quality of reporting.”

“The result [of allocation] is often arbitrary and the basis used is not well explained or evidenced. We would support the issuance of guidance on how support costs should be allocated and apportioned and how appropriate approaches can be developed.”

However, the majority of respondents did not support more specific definitions or greater guidance on support, fundraising and administration costs and called for the separate accounting of support costs to be dropped. 86 respondents included the following text in their responses:

Abolish the separate accounting of support costs - These add a burden on charities and do not add any value for the reader of the accounts. Support costs are necessary for all operations and separating out support costs feeds an incorrect impression that support costs are a ‘bad’ piece of expenditure. The SORP making-bodies need to take action.

Outside of this group of respondents, there were four other respondents who called for support costs to be dropped. Of these respondents, two specified that support costs should only be dropped for small charities.

Where greater specification of support, fundraising and administration costs was rejected, it was often rejected on the basis of it being too difficult to achieve. The following response was typical:

It is unlikely that support and fundraising costs could ever be sufficient well defined as to apply in all cases. Any attempt to provide more stringent definitions is likely to lead to increased confusion.

Further feedback was received as follows:

The devil is in the detail here. I write this when the new Fundraising Regulator has just admitted defeat in being able to define a fundraising communication. I don't see how we can expect individual charities to try and decide which of their costs are support and which fundraising if the Regulator can't.

There was resistance over changes that would create an increased focus on 'bad expenditure'. Typical responses were:

"...separate disclosures panders to the misunderstanding about "admin" costs being unnecessary and somehow "bad"."

"Support functions are an important part of charities' operations and support costs should not be seen as a negative or a sign of inefficiency. Removing the categorisation may be the only way to address this issue."

Five respondents also warned against the impact of these categories of expenditure being used as a way to compare charities. Any comparisons using these costs were considered unfair and simplistic and had the potential to confuse users given the diversity of the sector.

The charity sector is so vast, with organisations providing the same type of services being funded in different ways, so that comparisons between charities are meaningless without explanation.

Some respondents went on to make detailed recommendations as to how this should be addressed. These commonly cited an increased focus on narrative reporting, but also included recommendations for more to be done to educate the public about the role of support costs in charities and to challenge the media portrayal of charities.

Using narrative reporting to provide context to the administrative and fundraising costs incurred by the charity was advocated by the majority of respondents. It was believed more could be done to encourage charities to explain their spending within the trustees' annual report. Narrative reporting could give greater context and clarity to a charity's expenditure, linking it to the organisation's overall activities and aims.

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 measurement, allocation and reporting of support costs specified in the Charities SORP
- ii) what those changes might be to improve the understanding of the users of the accounts and/or to assist accounts preparers with the decisions and judgements required to report on charity expenditure on support services
- iii) the reasons to support the changes.

This need has been raised by engagement strands and has been agreed by the SORP Committee.

Without a case for change, no change will be considered because its rationale cannot be explained to those affected.

Step 2 - Advising the change required to the SORP

Having made the case for change, the detailed changes required to the SORP and/or FRS 102 need to be set out. Consideration should be given in as much detail as possible for the requirements regarding support costs and what else the SORP should include about support costs – for example, additional disclosure requirements. 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 working group, 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 working groups and engagement strands to the SORP Committee.

Following evidence provided by the working groups and 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.

Abbreviations - Engagement Strands

Engagement Strand	Abbreviation
Smaller charities and independent examiners	S&IE
Larger charities	L
Charity trustees	T
Academics and regulators and proxies for public interest	A&R&PPI
Professional, audit and technical strand A	PTS(A)
Professional, audit and technical strand B	PTS(B)
Major funders, donors and government and public bodies	MFDGPB