

## **SORP Committee 23 February 2021**

### **Paper 3: Perspective of the users of the SORP and preparers of accounts**

#### **Preparer of accounts and users of the SORP Summary**

##### **Introduction**

This document draws out the main issues that have emerged from exploration phase of the Charities SORP (the “SORP”) engagement process as they relate to the preparers of accounts and the users of the SORP.

The report sets out:

- Introduction- the approach and methodology followed and summarises the feedback from the discussion with the convenors of the engagement strands
- Section A- those issues in common with the perspective of the reader of the report and accounts; within the readers’ perspective there were 20 issues flagged with some containing a series of points for consideration.
- Section B- those issues unique to preparers of the accounts and users of the SORP
- Section C- some nuances regarding other issues raised for consideration

The numbering in section A is identical to that in the paper prepared from the reader’s perspective and so gaps in the sequence reflect an item not appearing to resonate with the preparer’s perspective.

##### *The approach to summarising the findings*

The approach we have taken to analysing the feedback from all six engagement strands is set out in the methodology below. The issues have been organised into six categories. The first four are those used to categorise the engagement strand’s interim feedback for the joint meeting of the Committee and convenors on 17 November. The last two are additional categories which have been added to capture key areas featuring in the final feedback received from the strands:

- The trustees’ annual report;
- Presentation of financial statements;
- Technical accounting points;
- The structure and presentation of the SORP;
- Tiering and reporting thresholds; and
- Education and training and accountancy qualification requirements.

The aim of this document is to enable the SORP Committee, in partnership with the SORP-making body, to determine which of those issues are to be reviewed in the reflection phase. This is the next phase of the Charities SORP engagement process. The goal of reflection phase is to review the current SORP and related materials with the view to identify the changes needed and detail any shortcomings to be addressed in the problem-solving stage that follows.

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#### *Methodology*

The submissions made by each of the seven panels (six engagement strands), were reviewed to identify which points were (or could be for) the benefit of the preparers of the accounts and the users of the SORP. There is a separate report to consider the issues from the standpoint of users of the reports and accounts but because some points are likely to benefit both groups there is expected to be duplication between these reports. This reflects the fact that preparers are seeking to tell their charity's story to the reader and so are likely to address their reporting to these needs.

Due to the number of points identified the report was discussed with the Engagement Strand Convenors to identify the key issues which they considered should be brought forward to the SORP committee.

The report therefore highlights the key points from the meeting at the start of each section and then provides more detailed summaries of the written responses.

Where some of the points reference a strand the following abbreviations have been used:

- A&R&PPI: Academics and regulators and proxies of public interest
- MFDGPB: Major Funders and donors and government and public bodies
- L: Larger charities
- S&IE: Smaller charities and Independent Examiner
- PTS(A): Professional and Technical Strand A
- PTS(B): Professional and Technical Strand B
- T: Trustees

It is worth noting that not all the points put forward by the strands will have been recommend by every member of the strand putting them forward. Not all panellists are equally familiar with the existing SORP requirements and no assessment has been made as to how the existing SORP already address the issues raised as this falls to the reflection stage.

#### *Feedback from meeting with the engagement strand convenors*

At the meeting convenors were asked to identify the key issues that they considered should be highlighted to the SORP committee for consideration from the viewpoint of the preparer of the accounts and user of the SORP. The main feedback related to technical accounting points where a number of strands identified key issues. There were also comments raised around the areas of support costs and grant accounting. The analysis below identifies which areas were specifically identified as a strand as key; however it should be noted that there was in the main a consensus over the points identified.

It was also highlighted by a number of strand that there is overlap between changes for the user of the accounts and changes for the preparers of the account. Please note that unfortunately A&R&PPI weren't able to re-join the call due to technical issues.

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#### *Trustees Annual report*

Unifying the 'front and back' to some extent by mandating the bringing forward of some key financial information in the narrative was raised as a key point by one strand. (PTS(A))

#### *Presentation of the financial statements*

Comparative requirement: Presentation of comparatives causes cutter in the accounts and difficulty for some charities, this was raised by one strand. (PTS(A))

#### *Technical accounting*

Recognition of income and funding commitments was raised as an issue for all present strands although it was not always raised for the same reasons. One strand in particular mentioned the matching principal and that if expenditure and income is not matched it can have an impact on reserves another spoke about a mixed option on the strand about legacy recognition whether there should be flexibility around income recognition or a fixed treatment (S&IE, PTS(B), L, MFDGPB PTS(A))

Tiered accounting was raised as a key issue for four strands. It was suggested the development of a tiered approach should be with a focus on 'think small first' and then add complexity as you go. (PTS(B), L, T MFDGPB)

'Think small first' this was often commented on and in particular it was raised by three strands. Often it was raised in conjunction to Tiered accounting but MFDGPB mentioned the simplification of requirements could also reduce accounting costs and funders don't like seeing large professional fees (MFDGPB PTS(B), L)

Analysis of expenditure was raised by three strands. One suggested it should be simplified and transparency increase and two others raised Natural classifications. One stand suggested the option be made more prominent, another strand suggest removal of the requirement (L, S&IE PTS(B))

Reserves were highlighted as a concern for two strands (S&IE, PTS(A))

Going Concern was raised as a key areas for one strand (MFDGPB)

#### *Presentation of the SORP*

Examples, or extracts of reports showing the accounting disclosures for certain complex areas were mentioned as key issues for two strands (S&IE, PTS(A))

Use of language, definitions and jargon makes it difficult for non-accountants to understand and apply properly. This was raised by one strand (T)

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#### *Other issues*

Education and Training: Need to provide education, training and resources to those who has no accounting or charity accounting background was raised by two strands. (MFDGPB, T)

FRS 102: It was verbally recognised that much of SORP is dictated by FRS 102 by one strand. (PTS(A))

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**Section A. Summary- Issues in common with readers of reports and accounts**

**1. Trustees' Annual Report**

**1.1 Summary Sheet/Key facts page**

Two of the strands suggested that a summary sheet of key facts at the front of the accounts might be helpful.

“A suggestion that a one-page towards front of accounts that might summarise key data to indicate the type of charity and key data might be a beneficial uniformly available page for all readers – it should not be complicated and not extend beyond one page, like an info-graphic – our strand identified suggested templates that already exist.” (L)

Although this was considered useful, there was a suggestion that this should not be mandatory with flexibility for charities to choose their key facts.

“While there is some merit in introducing a 'key facts' page, this should not be mandatory. A requirement to summarise the achievements and plans of the charity in a few bullet points at the start of the Trustees' Annual Report (TAR) might however be worth considering.” (S&IE)

**1.2 Governance Code**

Two strands mentioned on reporting on charity governance:

“The SORP should encourage trustees to report against their chosen governance standard in the annual report, including why that code was chosen and how they fare in their application of the code's principles and recommendations.” (T)

“Reporting of compliance with the charity governance codes (for each jurisdiction) should be considered.” (PTS(B))

**1.3 Presentation of the TAR- telling the charity's Story**

There is a risk of defensive reporting where a charity might be reluctant to tell its story when the news is bad. Also, many charities tend to see the report as more a compliance exercise with the reporting of the difference they make elsewhere e.g. in Annual Reviews and similar.

“A very subjective question, as no charity wishes to publish a story which is bad in case it becomes a self-fulfilling prophecy; although there are times when that might be appropriate. Recent cases regarding bad stewardship within a couple of large charities over several accounts periods ably demonstrates this.” (MFDGPB)

However, the social impact that the charity makes shouldn't be confined a glossy additional report but could be better reported in the TAR.

“The financial reporting requirements can often be seen as secondary to the charity's purpose and it is the social impact that the charity has that seems to be at the forefront of the 'glossy' additional report that some charities provide, as that is the attention grabber.” (MFDGPB)

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In telling the charity's story, the trustees annual report needs to:

- Demonstrate that it has good financial management in place. (MFDGPB);
- That the Trustees are aware of their legal duties and responsibilities, and that they have complied with those requirements, and that they have protected and not been profligate with the charity's assets. (MFDGPB);
- That the Senior Management have also complied with their duties and responsibilities to service users, the general public and the staff. (MFDGPB);

There was also a recommendation to encourage the reporting of a charity's performance to be more rounded, linking it with the charity's approach to and management of risk. (T)

#### **1.4 Public Benefit Reporting**

The current approach to reporting on the public benefit in the trustees' annual report (TAR) tends to be boiler plate text. As framed, the current public benefit statement provides little insight and was thought to be inadequate in terms of reporting how the charity has met the public benefit. It would be helpful if there was more narrative and the SORP could provide guidance in this respect.

"The current, albeit limited evidence suggests that public benefit reporting is currently sub-optimal or insufficient." (A&R&PPI)

"Alongside the production of the next SORP, consideration and resources should be dedicated to delivering supporting documents, templates and models to support compliance and better annual reports and accounts. One area that would benefit from such support would be the reporting of public benefit." (T)

"Demonstrate in a narrative how the charity provides Public Benefit rather than just a bland statement that it does." (MFDGPB)

#### **1.5 Other points- specific to governance- none noted as an issue for preparers**

## **2. Presentation of the financial statements**

### **2.1 Reserves**

Issues relating to reserves were raised by 5 of the 7 engagement panels.

#### *Defining free reserves*

The main issue raised related to the calculation of 'free reserves' and the perceived lack of consistency in how reserves are identified and the need for more definitive guidance on this in the existing SORP.

"Reserves (also known as free reserves) are often not calculated correctly.....A lack of understanding of reserves can have a knock-on impact on the quality of a charity's financial review." (PTS(B))

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It was thought that more guidance was needed on how to prepare/calculate freely available reserves (L), for example, a definition of reserves could be included in SORP (only on larger charities disclosures in the current SORP). (PTS(A)).

Review of the terminology and supporting definitions used in reference to reserves would make it simpler to understand and implement by trustees and would help trustees to develop a reserves policy which reflects the circumstances of the charity. (T)

#### *Financial sustainability and linking reserves to other disclosures*

The definition of reserves should be linked to explaining the liquidity position of the charity and to going concern disclosures. (PTS(A)). Alternatively, reserves could be more than just an assessment of going concern and could usefully be tied into existing disclosures such as future developments in the business. (L)

#### *Reserves note to the accounts*

Some strands put forward the idea of having a Reserves note to the accounts with more guidance on how these should be calculated. (Currently 'free reserves' are only included in the TAR which is not subject to audit.)

“A new note should be introduced requiring charities to report their ‘free’ reserves with appropriate guidance on how to calculate these.” (PTS(B))

It was recognised that it could be difficult to include the reserves figure from the TAR within the funds note to the accounts for a charity which has complicated figures, for example, in terms of funds and fixed assets.

“As an alternative, a calculation together with a reconciliation to the primary statements could be included in the notes to the accounts.” (PTS(A))

#### *More narrative*

The requirement that charities provide an explanation about why their actual reserves differ from their stated reserves policy could be re-instated. (PTS(A))

Consideration should be given to a requirement to report on cash balances and forecasts as well as reserves. (T)

### **2.2 Impact Reporting**

Reporting impact is currently a “may” in the SORP and only for large charities. It was suggested that this requirement should be enhanced, and the question was raised as to whether this should be a requirement for all charities? However, how would this be adapted for smaller charities who may have difficulty in reporting impact? (PTS(A)) Therefore the reporting impact in terms of the difference a charity makes may need to be very flexible in its application.

“Impact reporting requirements should be introduced to enhance reporting by charities on the difference they are making. Charities should be making more use of the annual report and should not, as is the case in some instances, seek to avoid

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including impact or similar information elsewhere so that it falls outside the scope of the external scrutiny report.” (PTS(B))

**2.3 Linking narrative and financial information- a more unified Document**

An attempt should be made to provide a link between the TAR and the financial information.

“The option of having a unified document representing the front and back-end information was discussed. Given the volume of information, this could be difficult to achieve. However, would it be possible to bring some key financial figures into the narrative and /or mandate some financial information in the front-end e.g. funds note or some key elements of the funds’ disclosure/net assets notes?” (PTS(A))

“There should be 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.” (PTS(B))

Recommendation: Give equal consideration to the importance of reporting both non-financial and financial performance in the annual report and accounts. (T)

**2.4 Support costs**

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))

A further point raised was 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.

“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)

There is a sense at the moment that charities are in desperate competition with each other to declare how much is spent on front line services and this leads to significant divergence on interpretation of support costs. (L)

The distinction between expenditure on charitable and non-charitable activity is considered to be problematic as in normal circumstance 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))

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#### **2.5 Going Concern**

The need for more narrative around the 'going concern' disclosures was raised.

“Enhanced disclosures around going concern should be considered for charities.” (PTS(B))

A link between the going concern disclosure to the 'free reserves' calculation was considered.

“Whilst Covid has shone a light on the longevity of some charities, we felt that there should be a narrative provided around the specific requirements of each charity to ensure that it is a going concern, as to how the Trustees calculate their requirement for Free Reserves based on their Going Concern requirements. There is a perception by some preparers that there is a statutory requirement to have a blanket 3 months provision. The current declarations are somewhat bland, short term and differ from charity to charity in their calculation.” (MFDGPB)

#### **2.6 Presentation of the face of the SOFA- none noted as an issue for preparers**

#### **2.7 Accounting issues noted from a reader viewpoint**

##### *Future funding*

Could details of future funding be included in the accounts, for example, a 3 or 5-year plan? (PTS(A))

##### *Remuneration*

Enhanced disclosures for senior executive pay were suggested by one of the seven panels. This recommendation was on the basis that other not-for-profit sectors have moved to providing more transparent information in this area and more disclosure would increase accountability of charities.

“Increased transparency through expanded and clearer requirements for reporting the remuneration of executive/ senior staff to reflect developments elsewhere in the not-for-profit sector designed to increase accountability.” (PTS(B))

There could also be clearer requirements in the SORP on aspects of pay such as compensation for loss of office, extra-contractual payments and redundancy pay.

“Also, clearer requirements on aspects of pay such as compensation for loss of office, extra-contractual payments and redundancy pay should be included in the SORP. We believe this is commensurate with current practice elsewhere and consistent with the needs of charities to be accountable to a wide group of stakeholders.” (PTS(B))

##### *Related Party Transactions*

Enhanced disclosures for related party were proposed. “If there are disclosures in respect of payments for services from Trustees there should be an explanation as to why those services were not sourced outside of the organisation, and whether value for money was achieved. (See also under transparency).” (MFDGPB)

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*Investments and private benefit to trustees*

Better information on investments and private benefit to trustees was suggested as another area for improvement. “It is of the strand’s opinion that there are no glaring omissions in the SORP with respect to new content or information that charities should be reporting on – the exceptions would be better information on investments and private benefit to trustees.” (A&R&PPI)

**3.1 Income recognition- treatment of certain grants**

The most commonly raised issue is the general requirement to recognise grant income when received unless specific conditions apply. This is seen to distort the Statement of Financial Activities (SOFA) and give the impression that the charity’s financial position is better than it is in the year of recognition which may have an impact on funding applications. Conversely, the recognition of related expenditure in future years, creating a deficit position, may be interpreted as the charity being in a less favourable financial position than is the case. Although this issue has been debated in the development of previous SORPs, the feedback indicates it should be considered again.

Some of the comments were as follows:

“The income recognition and grant funding commitment recognition requirements can distort the SoFA and are confusing for trustees and funders.” (PTS(B))

It was thought that the revised SORP could consider whether grant commitments could be spread more evenly, with narrative in the notes or there could be an opportunity to draw on the IFR4NPO’s initiative around the recognition of restricted income.” (PTS(B))

Could the SORP permit the accrual model to be used – an option given in FRS102? Additional narrative disclosures, for example on performance conditions, could be introduced to supplement the accounting information under the accrual model (for all sizes of charity). “The ability to use the accrual model could help those more familiar with the concept of profit and loss in a commercial entity, including charity trustees and funders, to better understand a charity’s financial performance.” (PTS(B))

One of our members from the Republic of Ireland feels this can be distortive to service provider debtors. (MFDGPB)

The conditions for income recognition per the SORP are not generally well understood particularly when deciding whether an adjusting event was necessary (paragraph 5.33, Charities SORP FRS 102). Should flexibility be maintained in SORP or would it be preferable to mandate a specific treatment? Is the current accounting treatment of grant income for capital projects appropriate? (PTS(A))

The income recognition and grant funding commitment recognition requirements can distort the SoFA and are confusing for trustees and funders. The distortion comes from recognising income and grant funding commitments relating to future years, where no conditions are attached (also see our comments on accounting for grant

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income). There could be an opportunity to draw on the IFR4NPO's initiative around the recognition of restricted income. (PTS(B))

#### **3.2 Cutting clutter- reducing requirements**

*Reducing boiler plate disclosures and requirements relating to standing information was suggested.*

For those items of standing information necessary for reporting, consideration could be given as to whether this detail could be provided elsewhere, for example in the annual return to the relevant regulator rather than included in the TAR.

“Requirements relating to standing information/ boiler plate disclosures should be reviewed. There are different views as to whether or how this information should be relegated either within the annual report or to the annual return (submitted to the relevant charity regulator).” (PTS(B))

Furthermore, SORP-only disclosure requirements should be identified and reviewed to ensure that they are necessary.

“SORP-only disclosure requirements should be identified and reviewed to ensure that they are necessary. The Strand has obtained a charity accounts disclosure checklist and we have extracted SORP-only disclosures from that checklist. We are happy to share this with any other strand solely for the purpose of supporting the SORP Development process.” (PTS(B))

#### *A more considered approach to comparatives*

The requirement for comparative information on all amounts presented in the financial statements is considered inflexible, onerous and unnecessary. Previous SORPs did not require this in all cases for charity specific items.

“The requirements for comparative information are driven by FRS 102. However, this leads to more onerous disclosures for charities and challenges in presenting these depending on the particular circumstances of the charity and the scale of comparatives required.” (PTS(B))

“This information in summary form is already included on the current year SOFA, and a separate disclosure shows the movement of funds in the previous year in its entirety.” (MFDGPB)

Some of the additional comparative information is viewed as useful but not in its entirety. (PTS(B))

If the aim of showing the comparative information was to show the path a charity has been on, expansion or diminution, there could be a requirement for a 5 year summary for the largest charities akin to data in many Stock Exchange reports. (MFDGPB)

Amendments to FRS 102 may be required to resolve this issue but the possibility of a SORP only solution should be investigated. (PTS(B))

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#### *Greater exemptions for certain charities*

The application of the Section 1A regime and having exemptions from FRS 102 disclosures would be welcomed, particularly for smaller charities.

“We would welcome some exemptions from FRS102 for charities, especially the smaller ones, being incorporated in the next version of that standard.” (MFDGPB)

Some exemptions would help declutter charity accounts.

“Adherence to FRS 102, particularly the inclusion of comparative figures for all items in the accounts, causes the accounts to be cluttered and difficulties for some charities.” (PTS(A))

For-profit entities apply section 1A in the context of a regime for smaller companies that does not require certain items and so to apply section 1A in a comparable fashion for charities in the absence of a similar legal framework would require amendment to the application of FRS 102 to remove the requirement disclosure requirements.

#### ***3.3 Reporting on the remuneration of executive/senior staff- not noted as an issue for preparers***

#### ***3.4 Cash flow statement – comments around the usefulness of this statement- not noted as an issue for preparers***

#### **3.5 Pension related disclosures**

The content of the current pensions note to the accounts was considered to be difficult to understand with many figures in the note not linking to other figures in the report or accounts. There is doubt that the information is either understood or of any genuine use to the reader and needs review.

“Similarly, highly technical declarations, often cut and pasted from an actuary’s report which again contains some data which cannot be found anywhere else in the report. This is especially relevant where pension scheme deficits are not recognised within the accounts.” (MFDGPB)

“The reporting regime for charities operating, or participating in, a defined benefit pension scheme should be reviewed and revised to more accurately reflect the potential liabilities and ensure consistency between pension scheme treatment where the charity has more than one scheme.” (T)

Where a charity has a pension deficit, narrative on the effect on the charity is helpful, but this disclosure could be tied up with the Going Concern declarations. (MFDGPB)

A particular point relating to the guidance in FRS 102 was that, in the case of multi-employer schemes, it does not assist with how to account for circumstances where it is no longer appropriate for a charity to account for a net defined benefit pension

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liability either because the information to do so is no longer available or it has triggered a cessation debt (due to ceasing to participate in the scheme).

Changes to these disclosures may require changes to FRS 102.

#### **3.6 Other points- none noted as common to preparers**

### **4 The structure and presentation of the SORP**

#### *Guidance on accounting matters*

Guidance in the present SORP was considered to be appropriate for larger charities but it was thought that more guidance was needed and more education for preparers of accounts. (L). More clarity on income recognition, especially for smaller end of large charities range, would help consistency of interpretation and application. This could be achieved by less choice of approaches. (L)

#### *SORP Structure*

It was suggested that further consideration be given to how the SORP guidance is structured and certain domains/sections are emphasised for example greater weight given to governance/public benefit reporting. (A&R&PPI)

Two strands mentioned the separation of the small and large charity requirements within the SORP. One felt the SORP should start with the requirements placed on all charities, with provisions for larger charities and for complex transactions clearly separated. (S&IE). The other stated that the separation of the additional requirements of larger charities which are set out later in module 1 shows a 'think small first approach' (PTS(B))

Reporting could be enhanced/eased by posing questions that engender relevant answers This would help address issue of boilerplate reporting, and anecdotal evidence of trustee hesitance/fear to fully engage in SORP compliant annual reporting. (A&R&PPI)

It was recommended that SORP guidance should be structured around a simplified framework covering the following major themes: income, expenditure, reserves/resilience, public benefit. (A&R&PPI). Charities should be required to bring financial and non-financial information together when addressing each theme as this would greatly enhance clarity and readability of annual reports. (A&R&PPI)

The major themes represent obvious, core aspects of charity reporting, however it is not a given that i) these themes are reported on properly or sufficiently, and ii) that all relevant information – financial and non-financial – is grouped under the same section/theme. Requiring charities to bring financial and non-financial information to bear on addressing each theme would greatly enhance clarity and readability of annual reports – this suggestion should be considered in conjunction with points 3 and 4 below. (A&R&PPI)

The role of the trustee should be borne in mind when producing the SORP and associated guidance: reporting could be enhanced/eased by posing questions that

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engender relevant answers (see suggested themes in point 2). This would help address issue of boilerplate reporting, and anecdotal evidence of trustee hesitance/fear to fully engage in SORP compliant annual reporting. (A&R&PPI)

The strand felt strongly that the main issues lay with the quality and accessibility of existing reporting: it is currently unnecessarily difficult to divine the degree to which a given charity has provided public benefit, is well governed etc. We urge the SORP committee to consider how i) SORP guidance is structured and certain domains/sections are emphasised, with greater weight given to governance/public benefit reporting; (A&R&PPI)

We felt that there is a need for more education regarding the SORP than currently available. This needs to be for Trustees and preparers alike. The current SORP contains some very explicit instructions, but it is not always easy to traverse, and because the document is quite long and technical, not always read in its entirety by users. We wonder if technology could form a role in helping make the SORP easier to interpret in future? For example, we talked about whether there is scope for an HMRC Tax Return style access page whereby a charity would enter certain fixed data regarding its size and operations and then pages would be triggered detailing what information needed to be disclosed. (MFDGPB)

#### *Use of the terms: Must, Should & May*

It was suggested that only the compulsory requirements are included in the SORP and the good practise disclosures are put in a separate document. (PTS(A))

One strand felt it would be helpful for requirements denoted by 'must' to be supplemented by guidance. In practical terms, this would mean rationalising material currently denoted by 'should' (i.e. good practice) and 'may' to create guidance with a status similar to the current 'may'. (PTS(B))

Another strand recommended making it easier to identify within the SORP what is a legal or regulatory requirement and what is recommended practice. (T)

#### *Articulating guiding philosophy or principles*

One strand recommended that the SORP Committee should consult on, develop and publish a guiding philosophy or principles for the evolution of Charities SORPs, including links to national accounting standards developments and international accountancy standard developments. This would include having an eye on future developments to 'future proof' or anticipate future reporting concerns and ensure the SORP is fit for purpose in meeting the needs of a wide range of stakeholders. (T)

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#### **5 Tiering**

Comments from the perspective regarding tiering and thinking small first and reconsidering the thresholds for additional reporting requirements were noted mainly from a preparer's perspective. The case was made that the needs of those using accounts who want to be able to easily and quickly find information that is of interest and relevance to them if steps were made to simplify reporting requirements and remove clutter.

##### *Mirroring tiering under company law regulations*

The question was asked whether some of the requirements applicable to medium and large charitable companies should be brought into charity accounts e.g. environmental reports. (PTS(A))

Also whether a further tier to cover very small charitable companies is required, and if further consideration is required of whether the tiers should be better aligned with Companies Act thresholds. (S&IE)

It was suggested that tiering could be achieved by pegging the size criteria to the size criteria for a small company and micro entity which would mean that only the largest charities would have to comply with the full FRS102. (Changes may be required to the way section 1A of FRS 102 is applied and potentially to the applicable accounting regulations.) (PTS(B))

##### *Natural classifications*

If a 'think small first' approach is taken, the ability to use natural categories in the SOFA should be made prominent in the SORP. "This will make it more likely that smaller charities will be aware of this concession and will therefore use it." (PTS(B))

##### *Tiering and/or thresholds*

This was a prevalent matter to the strands in the exploration phase and it was specifically commented on by six out of the seven panels. (MFDGPB, L, S&IE, PTS(A), PTS(B), T). Tiering is associated with easing the requirements on smaller charities in both the detail and also in some of the accounting requirements.

Differentiation of the requirements by size of charity would be a helpful simplification. We support no additional burdening of smaller charities by the SORP. We would support redefining the different sizes of charities – starting from 'small' through 'medium', 'large' and 'supersized'. We would support a start small with bolt ons as size increases policy. (MFDGPB)

##### *Using tiers to reduce the burden of disclosure*

Five of these implied or stated support for tiering (MFDGPB) (L) (S&IE) (PTS(B)) (T).

Support was shown for reducing or not increasing burden on very small/smaller charities (MFDGPB) (L) (S&IE) (PTS(B)) (T). Some suggested ways of reducing the burden were through:

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- Less disclosures, more templates, or examples and less “choice” i.e. making compliance mandatory and simple. (L)
- Income recognition was specifically mentioned as an area which could be simplified for smaller charities perhaps by also providing a decision tree to assist them. (PTS(B))
- Natural classifications were mentioned by two strands in relation to simplifying accounting requirements, either by increasing the amount of charities able to use the concession or increasing the prominence of the concession (PTS(B)) (S&IE).

It was suggested that increased transparency could be asked of medium and/or larger charities and/or supersized charities. (MFDGPB) (PTS(A)) (T)

If tiering is to be introduced a general sense is that under £€1m and over £€1m seems to be the point that makes sense (L)

To help those under £€1m it might mean less disclosures, more templates or examples and less “choice” i.e. make compliance mandatory and simple – too much choice actually makes it more complicated. (L)

Greater tiered reporting: There was general support for greater simplification of requirements for smaller charities, and for a distinction between 'medium' and 'small' charities. For example, the option of using 'natural classifications' should be available to more charities, at least up to £1m (the audit threshold in England and Wales). But there was also support for further simplification for charities with turnover below £250K, for example in the volume of notes to the accounts. Whether a further tier to cover very small charitable companies is required, and whether the tiers should be better aligned with Companies Act thresholds requires further consideration. (S&IE)

Tiering: Do we need a simple format for small charities? Should consideration be given to raising the £500k threshold for small charities under SORP to £1m? Should very large charities, say income over £10.2m, be required to provide more information/greater transparency than currently required by SORP e.g. environmental reporting, information on internal financial controls? (PTS(A))

Recommendation: The SORP should adopt a ‘small first’ approach, establishing minimum standards required of all SORP-compliant charity accounts. To recognise the size and complexity of the sector, the SORP should then provide additional accounting and reporting requirements to reflect the risks associated with larger, wealthier, more complex charities. (T)

Recommendation: Consult on the definition of a ‘large’ charity and the threshold for applying the SORP. Incorporate the results of that consultation in the next iteration of the SORP. (T)

#### *Taking a new approach to defining a small entity or less complex entity*

The question was raised whether we could learn from the IAASB’s work on the audit of less complex entities where the IAASB is wrestling with developing a definition for

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a 'less complex entity' where size is not the overriding consideration for applying requirements. (PTS(B))

**6 Education and training**

As previously noted from a funder's perspective, the funders' engagement strand noted that in respect of the quality of accounts that are produced there are concerns about accounts that appear to have been prepared with no reference to the SORP. In support of this view it was also noted that the smaller charities and independent examiners strand expressed the view that charity trustees often do not understand SORP accounts. As charity trustees are potentially both users of the SORP and users of the accounts and so their understanding of the reporting requirements and the resulting accounts is clearly important.

There is agreement that there is a big difference in knowledge and resources between "smaller" large charities and larger charities leading to a lack of internal skills, knowledge and capacity in preparing SORP compliant accounts. (L)

On one point an engagement strand reached agreement on the recognition of smaller large charities as requiring a simpler and more easily implemented SORP that will meet their needs and the needs of readers and the band that seems to differentiate between large charities with expertise and resources and those who are unlikely to have such expertise and resources is a threshold of £€1m (L)

From the feedback, the need for further resources and assistance for preparers took a number of forms:

*Example model reports and accounts*

Examples were mentioned as desirable by three strands. (S&IE) (MFDGPB) (PTS(A)) For example one stated that the use of clear worked examples to explain an accounting treatment could be more useful than a written paragraph explaining an accounting treatment. (PTS(A))

It was suggested that an appendix could be built into the SORP to include several examples for different types of organisations or an information sheet or help sheet could be produced and these could be tweaked for different jurisdictions. Another alternative/addition would be to produce extracts of accounts showing the accounting disclosures for certain complex areas. (PTS(A))

It would also be helpful to have some good, worked examples for different sized charities included within the SORP modules. (MFDGPB)

Example reports were considered to be extremely useful. Perhaps an appendix could be built into the SORP to include several examples for different types of organisations or an information sheet or help sheet could be produced? It would be helpful if these could be tweaked for different jurisdictions. Another alternative/addition would be to produce extracts of accounts showing the accounting disclosures for certain complex areas. (PTS(A))

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#### *Giving examples for particular accounting treatments or disclosures*

The use of clear worked examples to explain an accounting treatment could be more useful than a written paragraph explaining an accounting treatment. Could these be built into the SORP? (PTS(A))

#### *Hyperlinks*

Two strands discussed adding hyperlinks to the SORP. (PTS(B)) (T)

It was acknowledged that the SORP could not be a one-stop-shop but hyperlinks to other helpful and/or relevant sources such as corporate reporting requirements for charitable companies, FRS 102 and/or Code of Fundraising Practice would be helpful for accounts preparers. But it was also recognised that this approach would be resource intensive to establish and to maintain. (PTS(B)) (T)

Recommendation: Make it easier to identify within the SORP what is a legal or regulatory requirement and what is recommended practice. Where helpful and/or relevant the source should be cited close to the relevant text for ease of reference optimising the use of technology to direct interested readers to the resource and section. (T)

Recommendation: Update the SORP to reflect or signpost readers to the regulations relating to fundraising, including the Code of Fundraising Practice. Provide a fully cross-referenced index so readers can easily see which sections relate to a specific topic of interest. (T)

#### *Wording/length of the SORP*

One strand highlighted their support for the accessible drafting style of the SORP compared to accounting standards and do not necessarily consider that the SORP itself needs to be shorter in order for accounts to be simplified. (PTS(B)).

Another strand recommended the future Charities SORPs should be subject to a 'plain English' test but if this is incompatible with international standard making, explanatory digital links should be included where relevant. (T)

#### *Compliance Checklist*

It was suggested that a compliance checklist for the 'musts' could be useful. (PTS(A))

#### *Discontinued activities*

More guidance is needed on the presentation of discontinued activities. This is complex for charities where the discontinued activity relates to both restricted and unrestricted funds. (PTS(B))

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#### *Proforma Statements*

Proforma statements were thought to be helpful and it was suggested that a columnar balance sheet proforma is included in the SORP. (PTS(A))

#### *Index*

Restoring an index would help with navigating the SORP. (S&IE) (T)

#### *Glossary*

The SORP should include a comprehensive glossary (reflecting terms and definitions used by the regulators) and full indexation to assist cross referencing. (T)

#### *Supporting documents / templates / models*

Alongside the production of the next SORP, consideration and resources should be dedicated to delivering supporting documents, templates, and models to support compliance and better annual reports and accounts. One area that would benefit from such support would be the reporting of public benefit. (T)

#### *Cross referencing or incorporating more company law reporting items*

Charitable companies: Should some of the requirements applicable to medium and large charitable companies be brought into charity accounts e.g. environmental reports? (PTS(A))

#### *More SORP education*

Two of the strands specifically mentioned more education regarding the SORP .(MFDGPB, L) Some suggestions were to provide training to trustee and preparers (MFDGPB) (L) in particular relating to income recognition (L) and reserves (L).

It maybe that more strands agree with these points but it was not specifically raised by them as it does not relate directly to changes to the SORP.

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**Section B. Summary- Issues particular to preparers**

**B.1 Sustainability reporting**

In response to the question “How could charities be more transparent?” the issue of sustainability reporting was raised, particularly relating to climate change, diversity within organisations and gender pay gaps disclosures. This was thought to enable a charity to consider whether they were future proof. (MFDGPB).

**B.2 Financial Notes**

Reducing the length and complexity of the financial notes by better use of referencing, signposting, cross-referencing, and hyperlinking was recommended by one strand. (T)

**B.3 Income recognition**

Although there are finite categories of income recognition and some issues on interpretation and application of multi-annual funding and legacies, for larger charities it is felt present SORP is okay and mostly needs more guidance and more education for preparers of accounts, understanding many of these preparers are independent professionals (L)

More clarity on income recognition especially for smaller end of large charities range would help consistency of interpretation and application i.e. less choice on approaches. (L)

In particular on multi-annual funding where, depending on clarity of performance specified by the funder, the funding is recognized immediately where expenditure may take place over multiple years - needs clarity – the principle of ‘matching’ would seem to be more likely to give a ‘true and fair view’ as applies to other entities. (L)

**B.4 Legacies**

This issue was raised by 3 of the 7 engagement panels.

The general point raised by the strands was that there was a need for more clarity on the accounting treatment to be adopted. Under the current SORP, trustees need to exercise judgment when deciding when to recognise a legacy in their accounts e.g. when is the receipt probable? Should flexibility be maintained in SORP or would it be preferable to mandate a specific treatment? (PTS(A))

“We debated whether the current rules for disclosing legacies is better than the old regime – only disclosed upon receipt. Good debate but not necessarily a consensus.” (MFDGPB)

“Would it be possible to adopt one method and provide an explanation in the Notes to the accounts?” (PTS(A))

It was recognised that the guidance in the SORP is based on FRS 102 PBE34B.5 so this would need to be taken into consideration of that standard.

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**B.5 Donated goods and services**

The inclusion of a figure for donated goods and services in the SOFA was questioned although there was some concern about the opportunity for theft where there was no disclosure.

“with the exception of donated buildings – (donated goods and services) should be shown as a note rather than included on the SOFA.” (MFDGPB).

“Consideration should be given to removing the requirement to recognise donated goods and services (but not donated fixed assets). However, some concerns were raised about the opportunity for theft if donated goods are not accounted for until they are sold.” (PTS(B))

**B.6 Expenditure classification**

Changes to the classification of expenditure specifically removing the requirement for the arbitrary allocation of support costs and addressing the classification of some unavoidable costs as non-charitable. (PTS(B))

Expenditure Classification: The distinction between expenditure on charitable and non-charitable activity is problematic as in normal circumstance all expenditure should be considered charitable, for example, investment management fees. A distinction will remain necessary, for example, to report losses due to fraud. (PTS(B))

Within current constraints, we believe that there is scope to move further towards a ‘think small first’ approach, for example, by Charities SORP requirements and guidance leading on the ability of ‘smaller’ charities to use natural classifications to present their expenditure (also see, our comments on accounting for support costs and the use of natural classifications under financial reporting and accounting issues). To summarise, concessions within the SORP for smaller charities should have greater visibility than requirements for larger charities. (PTS(B))

**B.7 Funds note**

Making the funds note more prominent in the accounts was suggested and more guidance on the preparation of the note would be helpful.

“Consideration should be given to giving greater prominence to the funds note. However, we recognise that this is a note which charities can find difficult to get right so some further guidance around the preparation of this note may be helpful.” (PTS(B))

The order of the notes is determined by legislation and changes to this would require changes in the legislation.

**B.8 Activity reporting**

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.

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“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.” (PTS(A))

#### **B.9 Materiality**

A guide on materiality within the SORP would be helpful.

“Especially for very large charities and in the interests of readability, if figures are not material in the overall context a guide on materiality would be helpful, otherwise accounts end up being very long and militate against being easily read or understood.” (L)

#### **Section C. Nuances to consider**

*Make changes to FRS102 to permit the desired changes to the SORP framework*

Some disclosures in Charity accounts are not prescribed by the SORP but by FRS102. We would welcome some exemptions from FRS102 for charities, especially the smaller ones, being incorporated in the next version of that standard. We also recognise the limitations in filing infographics at Companies House for some incorporated charities, which tends to lead to them producing the separate glossy report to tell their story. (MFDGPB)

Adherence to FRS 102: Adherence to FRS 102, particularly the inclusion of comparative figures for all items in the accounts, causes the accounts to be cluttered and difficulties for some charities. As part of this process, the strand would like to feedback to the SORP Committee a list of suggested changes to FRS 102 which could help preparers of charity accounts. (PTS(A))

One strand noted that information to be disclosed by larger charities is set out separately so a ‘think small first’ approach has been taken by Module one of the SORP. (PTS(B)) Support for a tiered approach to the reporting and accounting requirements with a focus on ‘think small first’ to reduce complexity. We recognise that accounting standards and accounting regulations present barriers to the development of a fully restructured Charities SORP. (PTS(B))

To allow a similar approach to accounting disclosures would require a change to FRS102 to allow other criteria than materiality to determine what disclosures are made, for example criteria such as income, assets, or activities.

A paper is being prepared by the SORP-making body to draw together the evidence supporting having greater charity sector specific flexibility within the for-profit UK-Irish GAAP framework. The paper will note specific areas for change as illustrative of the need for review. Changes to FRS 102 are not within the gift of the SORP development process.

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#### *Changes to law- tightening up of qualifications for those who can examine or audit*

It was asked whether the Accountancy profession in general needs to review charity accounts which have no reference to the Charities SORP and tighten up on the qualifications of persons permitted to prepare charity accounts. A similar process happened several years ago in the insolvency field. (MFDGPB). It should be noted that changes to law are not within the gift of the SORP development process.

#### *Receipts and Payments*

The question was asked whether the SORP could provide more for charities preparing receipts and payments accounts. (PTS(A))

It was also suggested that it is considered if there is the possibility of introducing another accounting standard that bridges the gap between receipts and payments and SORP compliant accruals accounts. (T)

Consult on and review the possibility of introducing another accounting standard that bridges the gap between R&P and SORP compliant accruals accounts, or incorporates some element of international reporting standards currently applicable to small or micro for-profit entities. Alternatively, develop an approach where charities are permitted to adopt those aspects of the SORP that benefits their reporting needs. Such an approach could be explained in the annual report and accounts outlining the reasoning behind the decision and the perceived benefits of that approach. (T)

It should be noted that since receipts and payments accounts are not prepared on a true and fair basis, UK-Irish Generally Accepted Accounting Practice, FRS 102 and the SORP does not apply to them.

#### *Having common thresholds across all four regulatory jurisdictions*

There is not a consistent threshold for the application of accruals accounts (SORP) across the four regulatory jurisdictions – a common application of the SORP and what it means is necessary otherwise the SORP ends up being applied differently in different jurisdictions which leads to inconsistency of application and potential confusion. This threshold should be £/€1 million (L) (This is a matter of charity and company law and applicable regulations in each of the jurisdictions.)

Regulatory jurisdictions: The SORP is UK and Ireland with four Regulators some of whom have different thresholds for requiring SORP – a common application of the SORP and what it means is necessary otherwise the SORP ends up being applied differently in different jurisdictions which leads to inconsistency of application and confusion. (L)

One strand advocated a campaign by the Charities SORP-making body to revise accounting regulations across the UK to facilitate a tiered approach to the Charities SORP. One way of doing this could be to peg the size criteria to the size criteria for a small company (including the ‘two-year rule’) and for a micro-entity. This approach would give charities a buffer from complying with more onerous accounts

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requirements for a one-off event such as the receipt of a significant legacy. It would also mean that only the very largest charities would be required to comply with full FRS 102. However, such an approach would depend on changes to accounting regulations across the UK and to accounting standards. For example, Section 1A of FRS 102 and FRS 105, the micro-entity standard, don't meet the needs of charities in their current form – there is a tension here with the direction of travel with company accounting where the focus has been to minimise disclosure requirements for small companies to a greater extent than would be suitable for a charity. Also, with the small company size criteria linked to audit requirements, there could be an inherent challenge in directly linking the company size criteria to the accounts preparation criteria for charities. (PTS(B))

It should be noted that changes to law are not within the gift of the SORP development process.

*Separate SORPs for different tiers*

This was specifically mentioned by only one strand and that strand recommended against having separate SORPs but preferred revisions to a single SORP. (S&IE) SORPs are accredited according to the FRC's policy and is done at industry or sector level and so size criteria are not currently relevant to the assessment of a need for a SORP.

Smaller charities make up over 90% of registered charities. Although many of these will produce receipts and payments accounts, perhaps 100,000 charities (including all charitable companies) prepare accounts in accordance with the SORP, of which the vast majority have income below £250K. While this may suggest that a separate SORP for smaller charities should be considered, the general view of the engagement strand is that revision to a single SORP is to be preferred, provided that a requirement to comply with FRS102 does not constrain some of the other simplification options suggested. (S&IE)

The policy on SORPs is the sole prerogative of the FRC and not within the gift of the SORP development process.