

# Report

**To:** Charities SORP Committee

**From:** Alison Bonathan, CIPFA Secretariat

**Date:** 4 May 2022

**Subject:** Tiered Reporting in the Charities SORP – Scope for Change

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## Purpose

**The purpose of this report is to facilitate decision-making on tiers for the purpose of tiered reporting in the Charities SORP and to present the scope available within the reporting requirements for charities for such change to be made.**

## 1. Introduction

- 1.1 Following its consideration of tiered reporting at its meeting on 2 March 2022, the Charities SORP Committee agreed to have a further debate on the appropriate thresholds for tiers as part of a wider discussion of what reporting requirements might be included for each tier.
- 1.2 To facilitate this discussion, Section 3 of this report provides:
  - A summary of previous Committee discussions on a topic-by-topic basis for topics for which it has been indicated by the Charities SORP Committee that tiered reporting may be suitable;
  - A brief summary of the current requirements of the SORP and/or FRS 102 Section 1A *Small Entities* (Section 1A) for each topic; and
  - Whether the Committee has the latitude to recommend changes to reporting requirements for each topic.
- 1.3 This report also summarises Charities SORP specifications that are only required by the SORP (i.e. those additional specifications not required by FRS 102, law or regulators). This content is presented to allow Committee Members to consider the scope for possible simplifications in the Charities SORP.
- 1.4 To facilitate a practical approach to the way forward this report assumes that future developments of the Charities SORP will have to be based on the current provisions of FRS 102 and the current legislative framework.

## 2. Background information

### **Opportunity for simplification**

- 2.1 The SORP is based on FRS 102. However, as with all SORPs there are additional reporting requirements to reflect the circumstances and typical transactions of charities. The phrase *'this SORP requires'* is used within the SORP to distinguish the additional, charity-specific disclosures required by the SORP which are not specifically required by FRS 102. These requirements are likely to be the area where the joint SORP-making body is able to be the most flexible and where the Committee can focus its analysis and advice to the SORP-making body on tiered reporting. Paragraph 6 of the SORP indicates what some of these charity-specific requirements cover, in particular:
- the trustees' annual report (TAR)
  - fund accounting
  - the format of the statement of financial activities, and
  - additional disclosures aimed at providing a high level of accountability and transparency to donors, funders, financial supporters and other stakeholders.

**Appendix 1** to this report summarises requirements in the current SORP denoted by *'this SORP requires'*.

### **Minimum reporting requirements**

- 2.2 In 2015 the FRC withdrew the Financial Reporting Standard for Smaller Entities (FRSSE) and replaced it with a new section for small entities (Section 1A Small Entities) within FRS 102. Following consultation, the Charities SORP (FRSSE) was withdrawn and the scope of the Charities SORP (FRS 102) was widened. Although a charity can apply the small entities regime option (Section 1A Small Entities) within FRS 102, in order to produce true and fair accounts the preparer must also follow all the applicable requirements of the SORP – in the main, these are denoted by *'must'* within the SORP.
- 2.3 Section 1A of FRS 102 sets out the minimum reporting requirements for the information that must be presented and disclosed in the financial statements of a small entity that chooses to apply the small entities regime.
- 2.4 **Appendix 2** to this report summarises key requirements of Section 1A of FRS 102 (*'Section 1A'*) to enable Charities SORP Committee Members to assess whether there might be any possibility of simplifications to the reporting requirements for smaller charities. This Appendix allows the Committee to understand the minimum starting point that might be able to be considered if looking at smaller charities.
- 2.5 It might be the case that there is some scope to simplify SORP reporting requirements for smaller charities by amending SORP requirements denoted *'this SORP requires'*. However, it should be noted that the scope to simplify requirements is constrained by the need to prepare financial statements that give a true and fair view. As Section 1A (paragraphs 1A.5 and 1A.6) states:

*The financial statements of a small entity shall give a true and fair view of the assets, liabilities, financial position and profit or loss of the small entity for the reporting period.*

*A small entity may need to provide disclosures in addition to those set out in this section in order to comply with the requirement of paragraph 1A.5.*

### **3. Topics for which the Charities SORP Committee has expressed an interest in exploring tiered reporting**

- 3.1 During the exploration, reflection and problem-solving stages of the process, Charities SORP Committee and Engagement Strand Members have been asked to assume that flexibility will be extended to allow changes to be made to the reporting framework to facilitate tiered reporting.
- 3.2 Following this approach, the SORP Committee identified several areas where tiered reporting may assist preparers and/or users of charity annual reports. These areas are summarised below, together with brief commentary on the current relevant requirements of the SORP and, where relevant, the relevant requirements of Section 1A.

#### ***Trustees' Annual Report***

- 3.3 In its previous discussions, the SORP Committee has considered the following matters where tiered reporting could allow for differentiation of requirements with respect to the Trustees Annual Report (TAR):
- Reporting on compliance with corporate governance codes.
    - At its meeting on **23 February 2021**, the SORP Committee considered whether there would be an expectation that very small charities would comply with these (corporate governance) reporting requirements, as this might be overly onerous.
  - Sustainability reporting
    - At the meeting on **23 February 2021**, the SORP Committee noted that sustainability reporting might be more difficult for smaller charities and that this would need to be considered from the perspective of tiered reporting.
    - At the meeting on **26 January 2022**, tiered reporting was considered as relevant to sustainability reporting. It was suggested that very large charities should present quantitative data on climate change, while smaller charities could include narrative reporting on sustainability.
  - Impact reporting
    - At the meeting on **22 October 2021**, it was noted that there is a need for more accessible language for the specifications of the SORP which were aimed at smaller charities. Reporting requirements should be proportionate.
  - Activity Reporting
    - At the meeting on **12 January 2022**, the Chair noted that Engagement Strand feedback had been unanimous in favour of retaining activity reporting for larger charities. Feedback also acknowledged the advantages of retaining the option for smaller charities to adopt activity reporting.
- 3.4 Per paragraph 1.14 of the Charities SORP, all charities must include content for the following headings in the TAR:
- objectives and activities;
  - achievements and performance;
  - financial review;

- structure, governance and management;
- reference and administrative details;
- exemptions from disclosure; and
- funds held as custodian trustee on behalf of others.

3.5 FRS 102 is silent on requirements for the TAR. Notwithstanding the requirements of company law for the preparation of a directors' report, the SORP Committee appears to have some latitude in what can be decided on and recommended with respect to the requirements for the content of the TAR.

### **Statement of Financial Activities – classification of expenses**

- 3.6 In its previous discussions, the SORP Committee has considered the following matters where tiered reporting could allow for differentiation of requirements with respect to the Statement of Financial Activities (SoFA):
- At the meeting on **1 December 2021**, the SORP Committee discussed tying any extension of the option to use natural classification to the decisions made on tiered reporting. The Committee did not reach consensus on this matter. Some Committee Members were against extending the use of natural classification.
- 3.7 Section 1A does not prevent the use of natural classifications. Paragraph 3.16 of FRS 102 states that "*Financial statements result from processing large numbers of transactions or other events that are aggregated into classes according to their nature or function.*" That is, there is no restriction on use of presentation of expenses by nature based on the size of the entity.
- 3.8 The Charities SORP Committee therefore has latitude to recommend an extension of the use of natural classifications if considered suitable by the Committee.

### **Statement of Financial Activities - presentation**

- 3.9 For reference, at the meeting of the Charities SORP Committee on **4 August 2021**, it was tentatively concluded that an upside-down SoFA should not be introduced.
- 3.10 Current SORP requirements are that the headings used to analyse income in the SoFA must follow those required by the SORP module 'Statement of financial activities' [5.57].
- 3.11 Section 1A allows for a simplified presentation of the balance sheet and income statement of a small entity. Annexes 1 and 2 of Appendix 2 to this paper provide illustrations of potential minimum requirements for presentation of the primary financial statements. Regulation 8 of The Charities (Accounts and Reports) Regulations 2008 does not specify the line items to be included in the financial statements of a charity, stating only that a true and fair view of the financial position and performance of an entity must be provided. Similar requirements are included in Regulation 8 and Schedule 1 of the Charities Accounts (Scotland) Regulations 2006 and in Regulation 8 of the Charities (Accounts and Reports) Regulations (Northern Ireland) 2015.
- 3.12 The Charities SORP Committee therefore has some latitude to consider whether the line items on a balance sheet or a SoFA can be simplified for small charities provided any changes still allow for 'a true and fair view' to be presented.

### **Comparative Information**

- 3.13 In its previous discussions, the SORP Committee has considered the following matters where tiered reporting could allow for differentiation of requirements with respect to comparative information:

- At the meeting on **4 August 2021**, the SORP Committee discussed using tiered reporting to allow smaller charities to reduce the amount of comparative information provided, or to present information differently.

3.14 However, there is no latitude in Section 1A to facilitate removing the requirement for small entities to present comparative information. Paragraph 1A.10 of FRS 102 requires that “*a small entity shall present comparative information in respect of the preceding period for all amounts presented in the current period’s financial statements, except when this FRS permits or requires otherwise.*”

**Disclosures – including, but not limited to, the funds note and post-employment benefits**

3.15 In its previous discussions, the SORP Committee has considered the following matters where tiered reporting could allow for differentiation of requirements with respect to the funds note:

- At the meeting on **22 October 2021**, it was noted that a multi-columnar approach to the funds note may not be suitable for all charities because of the additional work involved, although there can be benefits to the approach. A Committee Member asked if tiered reporting could be part of the solution. However, it was questioned whether a tiered approach would be serving the needs of the preparers or the users. There was no consensus on whether tiered reporting should be part of the solution. It should be noted that from a financial reporting perspective most reporting requirements should prioritise the needs of the users of the accounts.

3.16 With respect to smaller charities, at present Section 1A does not require small entities to comply with the disclosure requirements of Sections 3 and 8 – 35 of FRS 102 [1A.17]. However, a small entity is encouraged to consider and provide any of those disclosures that are relevant to material transactions as necessary to provide a true and fair view of the financial position and performance of the entity.

3.17 Appendices C and D of Section 1A set out the minimum disclosure requirements for small entities. Key extracts from these appendices are included in Appendix 2 to this paper. The Secretariat notes that paragraph 1A.17 of Section 1A could indicate the Charities SORP Committee has significant latitude to reduce disclosure requirements for small charities. However, the requirements of Appendices C and D of Section 1A do limit the scope for reduction of disclosure requirements for smaller charities.

3.18 The Charities SORP Committee may therefore have some, although not unlimited, latitude to consider whether to recommend simplifying disclosure requirements for smaller charities as permitted by Section 1A, to the extent that this is considered possible while ensuring the financial statements of smaller charities continue to give a true and fair view and the Secretariat would note the previous position of the SORP in paragraph 6.

**4. Other areas of the SORP where the Charities SORP Committee may have latitude to recommend adopting a tiered approach to reporting**

4.1 In addition to the topics already discussed by the Charities SORP Committee as referred to above, Appendix 1 to this paper sets out requirements in the SORP denoted by ‘this SORP requires’. These requirements have been separately presented in this paper as they have been specified by the joint SORP-making body are most likely to be within the scope for change, subject to them not being essential for a charity so that it can provide a true and fair view of their financial statements or any legislative requirements. The requirements denoted ‘this SORP requires’ are not based on FRS 102. The Charities SORP Committee therefore has latitude to recommend changes to requirements denoted ‘this SORP requires’ to facilitate tiered reporting if considered appropriate to do so.

- 4.2 It should be noted, however, that paragraph 33 of the SORP states that the SORP uses the term 'must' to indicate those elements that are important to the reader of the trustees' annual report that must be included within the report or to identify particular accounting treatments, disclosures or presentational requirements that are likely to affect the ability of the accounts to give a true and fair view if not applied to material transactions or items. There are over 500 'musts' in the SORP which might mean that this might limit the scope to change the SORP.
- 4.3 The Charities SORP Committee will be aware that the joint SORP-making body has submitted two letters to the FRC in response to the FRC's call for views on FRS 102. While discussions of tiers and tiered reporting at the meeting of the Charities SORP Committee on 4 May 2022 assume that the FRC will not offer flexibility in response to these submissions, relevant content of the joint SORP-making body's submissions to the FRC have been included in Appendix 3 to this report.

**The Charities SORP Committee is invited to consider:**

- **observations from previous Charities SORP Committee meetings in which tiered reporting was suggested as a possible mechanism to improve the SORP;**
- **requirements from the SORP that can be changed without changes to FRS 102 or applicable regulations, as denoted by 'this SORP requires' and summarised in Appendix 1 to this paper; and**
- **whether there are possible simplifications that can be made to reporting requirements for smaller charities through use of Section 1A of FRS 102.**

**Using this information, the Charities SORP Committee is invited to consider how reporting requirements can be differentiated between tiers with respect to:**

- 1. The Trustees' Annual Report, with a focus on:**
  - a. Reporting on compliance with corporate governance codes**
  - b. Sustainability reporting**
  - c. Impact reporting**
  - d. Activity reporting**
- 2. Statement of Financial Activities – classification of expenses**
- 3. Statement of Financial Activities – presentation**
- 4. Disclosures**

**The Charities SORP Committee is invited to consider how any differentiated reporting requirements can meet the objective of financial reporting by ensuring that the information presented to the users of a charity's financial statements is useful and supports their economic decision making and accountability.**