

Small Charities Research Paper

1 Purpose of this paper

1.1 This paper sets out a proposal for research to:

- Improve understanding of the challenges facing small charities in preparing the Trustees' Annual Report (TAR) and Accounts in accordance with the SORP, and to identify changes which would make this easier.
- Identify those improvements in reporting which would be of most value to readers of the accounts, including in particular, regulators and funders.
- Assess which changes in the SORP would achieve the best balance between ease of production and usefulness.
- The proposed scope of the research project has been informed by initial discussions in the Small charities/Independent Examiners engagement strand and its convenor.

2 Potential issues to cover in the research

2.1 Producing Reports and Accounts

- Are charities familiar with the provisions of the SORP?
- How many charities prepare their own TAR and/or Accounts and how many rely on independent examiners to do so?
- Where charities produce their own TAR and/or Accounts, what challenges does this create for the Independent Examiner?
- What challenges do charities and Independent Examiners face in relating the Accounts to management accounts and the TAR.
- Report to the Accounts, and to management accounts?
- Do these challenges reflect the clarity of SORP requirements, or the requirements of the SORP themselves? if the latter, are there changes to the SORP which would alleviate these issues while remaining compliant (where required) with FRS102? would inclusion of templates/model Accounts in the SORP help matters? could these challenges be reduced by wider adoption of accounting packages, provided there was engagement with the technology companies to address the specific issues relating to charity accounting?
- Would adoption of tiered reporting requirements undermine usefulness and comparability of the Accounts?
- What particular problems face those preparing accounts in applying FRS102 and SORP requirements (e.g. fund accounting, income from grants and contracts, Bounce Back loans etc)?
- What potential developments in FRS102 and other requirements (e.g. carbon accounting) need to be taken into account in considering these issues?

2.2 Telling the story

- What do charities regard as the most important elements of reporting? if priorities

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- differ, why is this?
- How many charities produce an 'annual review' or similar in addition to the TAR? what are the main reasons for producing a separate document?
- How many charities use the TAR to set out what impact/difference they have made in the period of the report?
- Would introducing a 'key facts' page in the Report remove the need for a separate document?
- Would an improved TAR be of value to readers of the statutory documents, or is a separate Review document preferred? If the latter, why is this?
- What are the pros and cons - for charities, Independent Examiners and users of the TAR and Accounts - of introducing simpler requirements for very small charities, for example based on the CIC34?
- What challenges do grant makers, commissioners and others face when using the TAR and/or Accounts to understand charities' business models and sustainability?

3 Proposed approach to the research

- 3.1 The Power to Change Trust has offered financial support for this research and is currently looking for other funding partners. The research would be carried out in accordance with the ethical guidelines published by the Social Research Association.
- 3.2 Steering Group to be established to provide guidance on the detailed work programme and feedback on emerging findings. Steering group to include the members of the SORP Committee representing smaller charities and the convenor of the small charities and independent examiners strand together with Power to Change, other funding partners and two or three other key stakeholders to be agreed.
- 3.3 Possible structure of the project
 - Development of detailed project plan for agreement with steering group
 - Desk review of charity statistics, to develop an appropriate stratification of 'small charities' for the study (which needs to consider both size and status)
 - Set a clear scope of what is meant by a smaller charity in the context of the research (i.e. it is aimed at those who are required to, or voluntarily produce SORP accounts)
 - Desk review of previous research reports, including those from the Charity Regulators
 - Development of survey to be sent to a sample of small charities (NB importance of establishing appropriate sample size for each of the strata and target response rate) and to independent examiners and users of the accounts
 - Focus group discussions with charities, independent examiners and users of the accounts
 - Development of emerging findings
 - Presentation of emerging findings to the engagement strand(s) (joint meeting of relevant strands?)
 - Reporting

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3.4 Jurisdiction

The aim of the research is to cover all the jurisdictions and the steering group will work out how to do this, as the current funding offer from Power to Change is principally for England (as that is their remit).

3.5 Timescales

Specific timescales are to be agreed, but the aim is to begin in November 2020 and to be completed by March 2021.

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4 Early focus group

- 4.1 A focus group was arranged by Neal Trup on 6th October 2020. The title question was “*How can the SORP work better for smaller charities and their stakeholders?*” and the aim was to reach stakeholders working in and with smaller charities (income below £500k)
- 4.2 In total there were 17 participants, and with a mix across stakeholder groups as shown in figure 1 below:

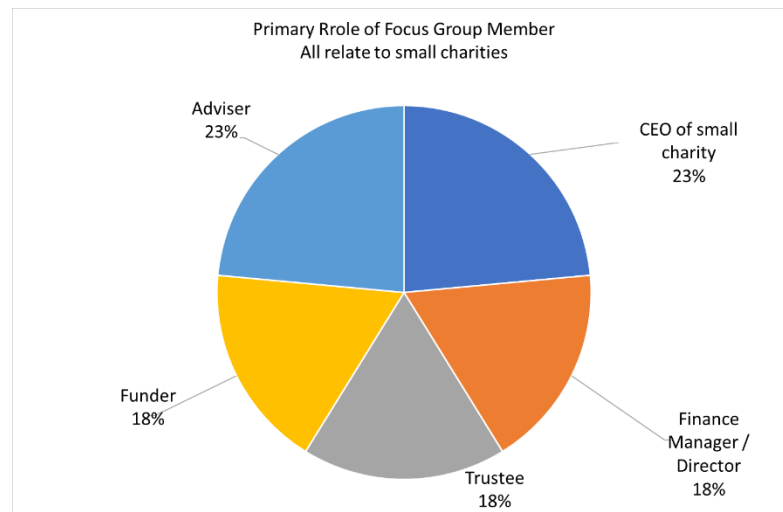


Figure 1: Members of the 6th October focus group

- 4.3 Whilst not a formal piece of research nor of sufficient statistical size, the discussions and findings are interesting and indicative of what we expect to see in the wider formal research proposed.
- 4.4 The group discussions were centred on four main questions:
- What is the best way to “tell the story” of the charity?
 - What are the specific needs of smaller charities and their stakeholders?
 - How can consistency across the sector be improved?
 - Do the complexities of specific charity accounting requirements impact understanding?

4.5 Overall feedback and points from the focus group

The headline messages and views at the focus group were:

- Whilst the trustees annual report (TAR) and accounts may not be used very much or by many stakeholders, it is still viewed as very important.
- There is seen to be a tension in the TAR between the need to be as transparent as possible but also about promoting the charity to funders, donors and stakeholders. A real difficulty is seen about balancing compliance and “telling the story”.

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- A number of participants felt that frequently there is a lack of information in the TAR and accounts about the plans for the future and the solvency of the charity.
- There is often a lack of the skillsets needed in smaller charities and with resources often stretched and focussed on delivery. There is a lot of reliance on external accountants but quality and consistency varies considerably across the profession.
- The view was that many trustees do not understand SORP accounts and are not really interested in them (seen as largely of a compliance nature). The key financial focus for trustees and CEOs is on management accounts.
- The idea of a one page summary, often referred to as “key facts”, “at a glance” or “accessibility” report has been considered previously by the SORP Committee. The focus group (87%) felt that such a one page report (see example in appendix 1) could improve understanding
- For smaller charities the role of the external accountant/ independent examiner / auditor are seen to have a key role to play in improving and maintaining the consistency across the sector alongside the SORP. It was felt that the SORP should have more examples in order to help with consistent application.
- The view of the group was overwhelmingly that many stakeholders struggle to understand SORP accounts (87%) and that clearer and simpler reports together with education and training was important.
- Reserves and viability of a charity were considered key technical areas to improve although what may work for one charity may not for another, so a principles based approach was preferred.

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4.6 Q1: What is the best way to “tell the story” of the charity?

Key points raised in the focus group were:

- Whilst the trustees annual report (TAR) and accounts may not be used very much or by many stakeholders, it is still viewed as very important
- There is seen to be a tension in the TAR between the need to be as transparent as possible but also about promoting the charity to funders, donors and stakeholders. A real difficulty is seen about balancing compliance and “telling the story”
- Some charities in the focus group prepare two documents; one to satisfy the regulator and another for stakeholders.
- Who are you telling the story to; regulators and a variety of different users with the risk of trying to be everything to all people.
- Often TARs (especially in smaller charities) are rolled over from one year to the next with just tweaking and updating of relevant figures and a feeling of “cut and paste”
- There was some surprise in the group about the average length of the TAR in the largest 250 charities as 29 pages (Charity Finance Magazine survey) and with the longest being 78 pages. Whilst the length of the TAR for smaller charities was often considerably less (we don’t have a specific figure), it was generally felt that TARs are often far too long and hence more difficult to understand.
- A number of participants, (particularly funders) felt that there is a lack of information about the plans for the future and the solvency of the charity.
- Social and charitable impact should be clear and upfront.
- Some felt that it was important to consider the cost v benefit of reporting requirements and that this would vary between different types of charities. For example, those with a fundraising or grant funding model may need to set this out in more detail than those who may have investment or rental income or where they run a social enterprise. Hence the view that some felt that the TAR should be principles based rather than template based and with clarity as to what is the minimum required.

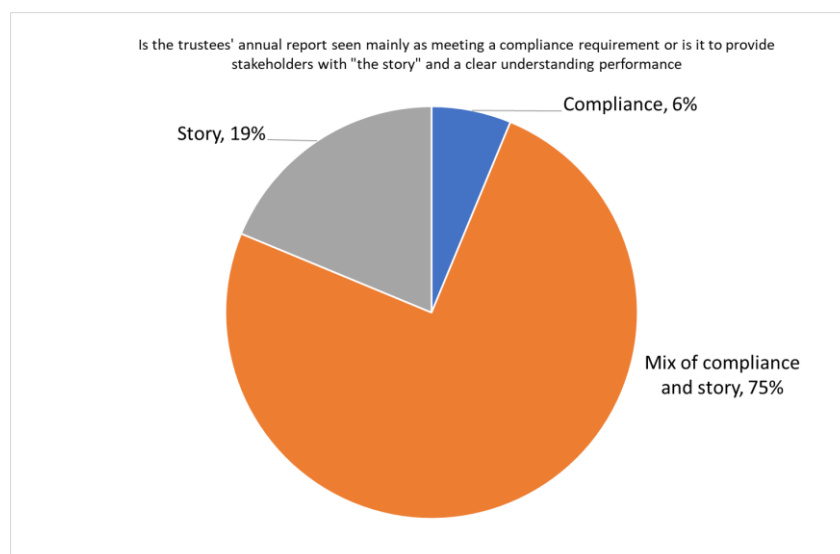


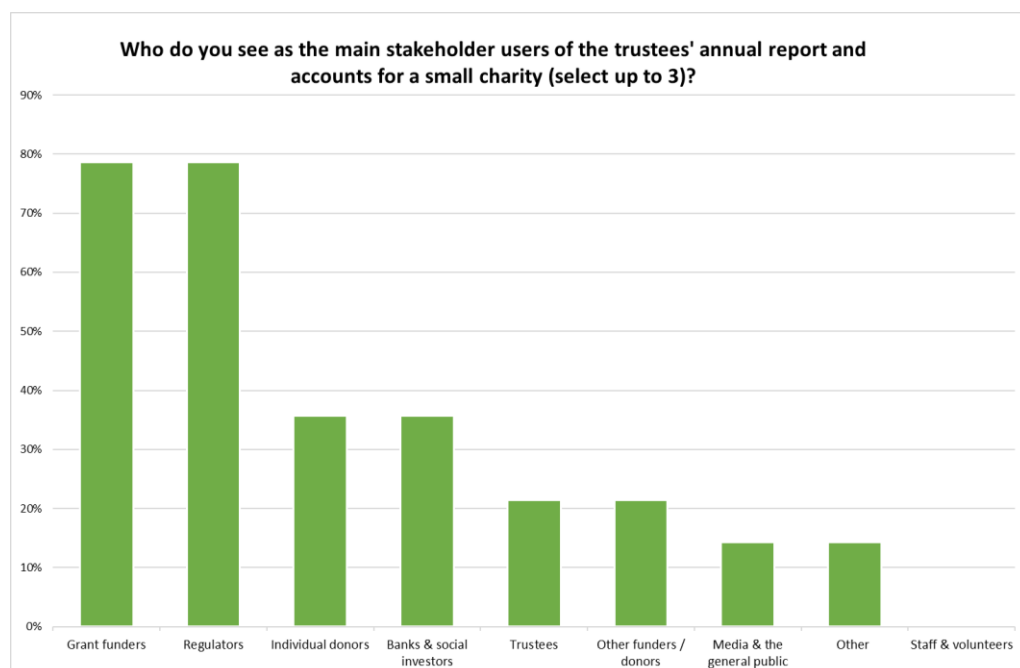
Figure 2: Purpose of the Trustees' Annual Report

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4.7 Q2: What are specific needs of smaller charities and their stakeholders?

Key points raised in the focus group were:

- It is often down to one person who is responsible for preparing the TAR and accounts, the latter generally being management accounts (rather than full SORP accounts) to pass on to the external accountant / independent examiner.
- There is often a lack of the skillsets needed in smaller charities with resources often stretched and focussed on delivery. There is a lot of reliance on external accountants but quality and consistency varies considerably across the profession
- It was expressed by some that many local accountants do not properly understand charities and charity accounts (even though they may profess to do so) and this makes it difficult for many small charities, whilst those firms that do specialise tend to be much more expensive and often not affordable.
- Smaller charities often have a real challenge in telling the story and do not have access to resources and skills to do this effectively.
- The story telling is often down to the treasurer and this can lead to too much analytical data and being less outcome / impact focussed
- The link between the words and numbers needs to be clearer. At the moment they often seem disconnected
- Many trustees do not understand SORP accounts and are not really interested in them (seen as largely of a compliance nature). The key financial focus for trustees and CEOs is on management accounts (where they have them), and indeed the differences between the numbers in the management and financial accounts contributes to the lack of confidence/interest in the latter.
- By 2024 there will be requirements for small charities to have a statement on carbon accounting. This raises further issues about how the SORP may cover this and how accountants and others will have the knowledge needed.
- The main stakeholder users of the TAR of smaller charities were seen as grant funders and regulators as well as donors and banks/social investors.



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- New accounting software (such as Xero and QuickBooks) is helping a growing number of small charities, although there is a real mismatch between the format, categorisation and analysis of financial and management accounts and this can create extra work and confusion although it is recognised that the audiences and purposes are different
- One suggestion was that smaller charities should prepared a short report like the CIC34 and be focussed on looking forward and solvency and is simple to read and understand
- Whilst there was general agreement on looking at simplifying reports there was also a view that care is needed too
- Education and training amongst trustees was considered as very important – “trustees need to know the basis”
- The idea of a one page summary, often referred to as “key facts”, “at a glance” or “accessibility” report has been considered previously by the SORP Committee. In order to gauge the view of advance of the focus group, a mocked-up example of such a report was circulated in advance of the meeting. The mocked-up example is probably a long way from what it would need to look at but was designed to put illustrate the principle (see Appendix 1 for a copy of this).

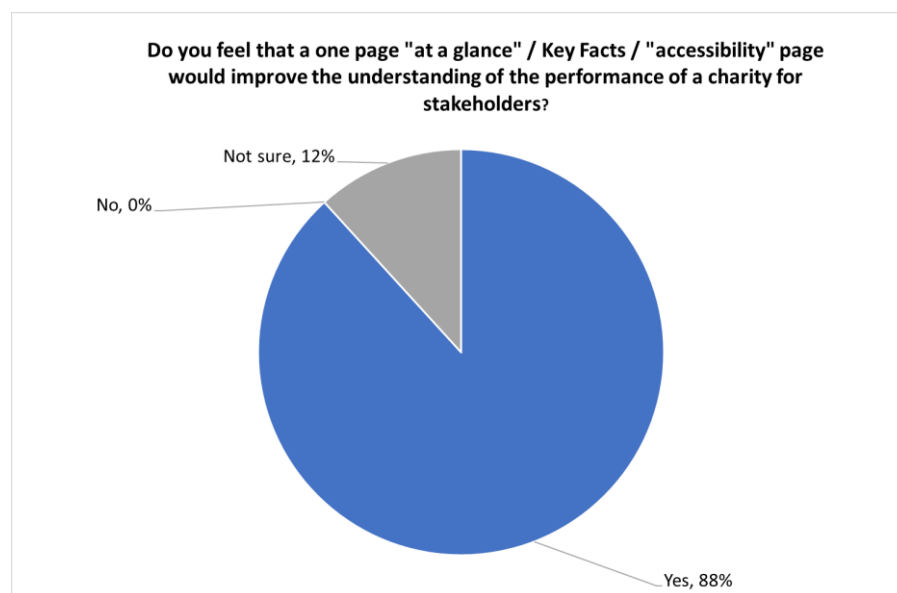


Figure 3: Value of a one page summary

4.8 Q3: What are specific needs of smaller charities and their stakeholders?

Key points raised in the focus group were:

- For smaller charities the role of the external accountant/ independent examiner / auditor are seen to have a key role to play in improving and maintaining the consistency across the sector alongside the SORP.
- It was felt that the SORP should have more examples in order to help with consistent application. It was felt that local authorities have limited understanding of charity accounts and that there is significant inconsistency in how local authority

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contracts are accounted for. Even in relation to the government support there is inconsistency of treatment such as with the CJRS (restricted v unrestricted) and Bounce Back loans (3 different approaches currently being used across the profession).

- Some examples should be specific to smaller charities
- There should be better collaboration between the SORP Committee / regulators and technology companies (similar to HMRC and MTD software) to help improve the consistency for accountants and preparers
- Improved education and training was considered important for trustees and better examples and guidance could help
- The view of the group was overwhelmingly that many stakeholders struggle to understand SORP accounts (87%).

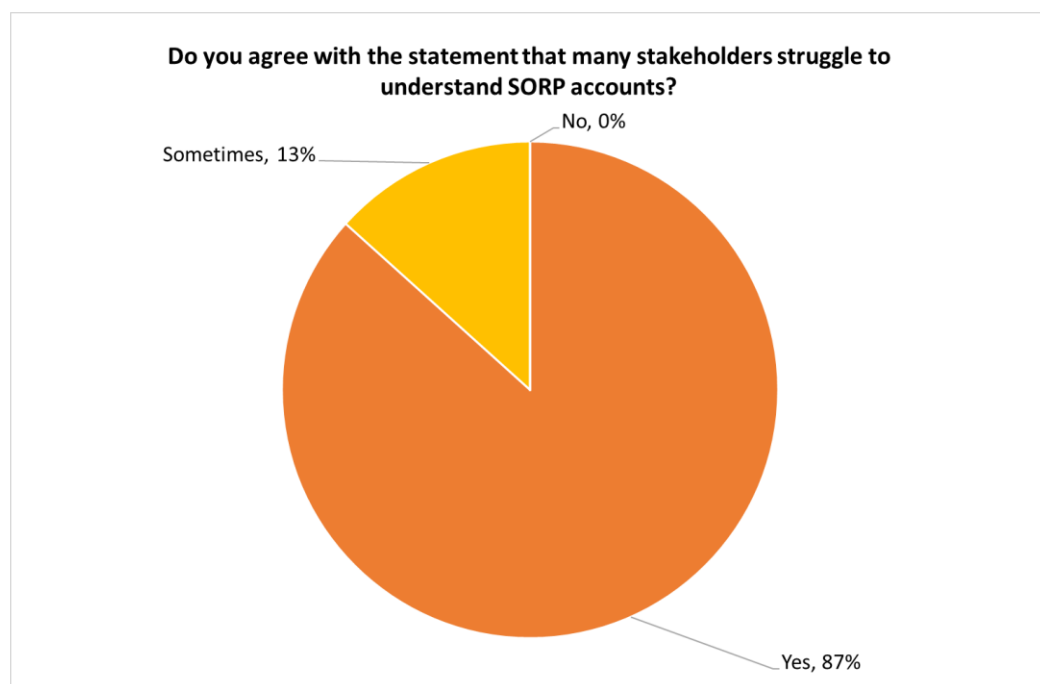


Figure 4: Understanding SORP accounts

4.9 Q4: Do the complexities of specific charity accounting requirements impact understanding?

A number of technical areas were discussed as causing difficulty, confusion and inconsistencies in charity accounts and hence clearer guidance and the way they are set out in the TAR and accounts. Those raised in the focus group were:

- **Reserves** – there was felt a need to be clear about what this actually meant and a feeling that free/liquid reserves should have a clear definition and methodology. The basis for reserves policy should be clearer and that the wide current practice of simply putting in a standard “3 to 6 months reserves” was not helpful. Understanding the viability of a charity was seen as a key priority.
- **Recognition of grants** – this is still widely misunderstood and that there should be

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- more clarity about the basis for this in clear language / presentation.
- Other areas causing confusion include local authority contracts, asset valuations, liabilities, risks & mitigation and future plans.

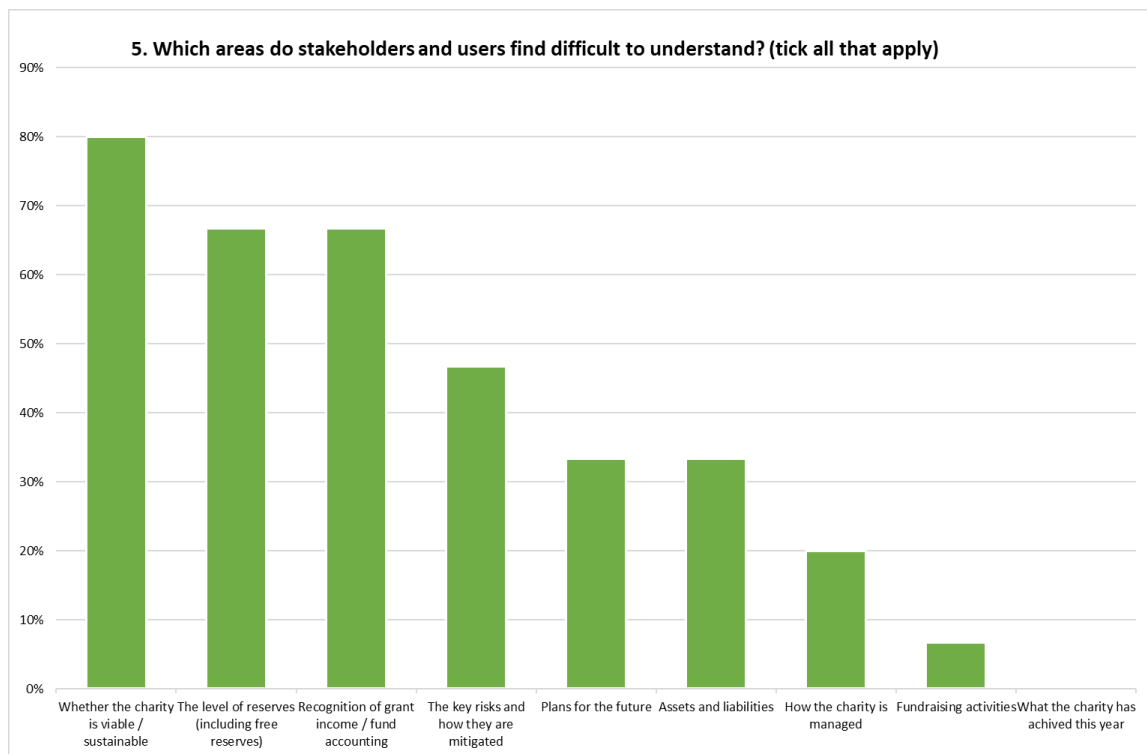


Figure 5: Understanding SORP accounts – technical areas

5 Next steps

- 5.1 To take on board views and feedback from SORP Making Body and SORP Committee members on the proposed research and approach
- 5.2 Subject to agreement to begin setting up the steering committee.

Questions:

1. Does the Committee have any comments on the proposed approach for the research?
2. Does the Committee have any comments on the feedback from the focus group?

Neal Trup
15th October 2020

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APPENDIX A

EXAMPLE SMALL CHARITY LTD Year Ended 31st March 2020 AT A GLANCE SUMMARY

Objectives and aims
The principal objectives of the charity are:

- to support people experiencing mental distress and illness
- to promote mental health and well-being
- campaign against stigma and discrimination in relation to mental ill-health.

What we achieved in the year to 31st March 2020 (see pages 2 and 3 of the trustees' annual report)

- 200 people used our drop in service
- Peer support sessions (3 per week)
- Our counselling service supported over 90 clients
- Our support service for women experiencing or at risk of postnatal depression has been well used and has helped 80 women during the year
- The allotment project has expanded and has been a welcoming and therapeutic space for people experiencing mental distress
- In March 2020, as a result of COVID-19, many of our services switched to telephone or online sessions

Impact of COVID-19 (see pages 3 and 4 of the trustees' annual report)

- From March 2020 the office and drop-in centre was closed and we had to reorganize our services and find new ways of supporting our users and beneficiaries
- Our counselling and peer groups used Zoom and telephone calls
- Mental Health training was delivered online
- We had to cancel our local fundraising events however we were successful in receiving a £30,000 grant from the National Lottery Community Fund which will help maintain services in the year to March 2021
- Trustees are monitoring ongoing risks to the organization and the increasing impact of mental health on our community and to do what we can to support people in line with our charitable objects.


Trustees and charity governance

- The organisation is a charitable company limited by guarantee
- There are 5 trustees. The chair of trustees is Karen Smith (see page 1 for a list of all trustees). All trustees are volunteers
- The Independent Examiner is IE & Co (see their report on page 5)

Staff and volunteers

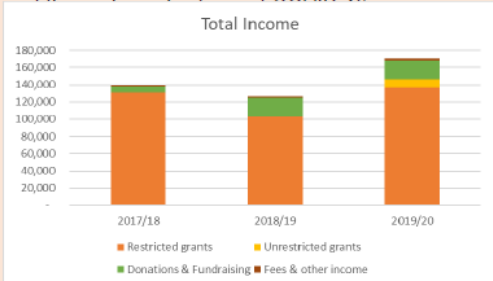
Staff: 3
Management and delivery of services

Volunteers: 21
Our volunteers lead peer groups, provide befriending support, and fundraising activities



Financial Performance for the year

- Total incoming resources (income) for the year to 31st March
- was £170,215 (see page 6). This was an increase of £44,055 from the previous year's total of £126,160. This was mainly due to increased grants including Lloyds Foundation (see note 3 on page 9)
- The charity made an overall surplus of £9,865. This breaks down to a surplus on restricted funds of £10,787 (underspend of grants to carry forward) and a deficit of £922 on unrestricted funds.
- The deficit on unrestricted funds resulted from some



Assets and reserves (as at 31st March 2020) see page 3 and note 9 on page 11

- Unrestricted free reserves of £10,504
- The charity's reserves policy is between four and six months of the unrestricted expenditure, and the level held is within this.
- Restricted Funds of £69,024. This represents grants and funding carried forward.

Future plans

- Continuing to deliver services online, but to reintroduce some in person support in line with COVID-19 safety requirements
- Develop a new service to support those in our community directly impacted by the pandemic
- To secure additional grant funding

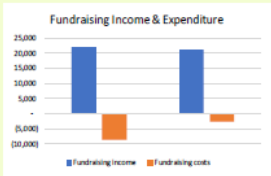
Risks and mitigation

Key Risk	Mitigation
Increased need and demand as a result of COVID-19	Early planning, support design, use of technology and funding applications
Reduced income from fundraising events	Developing alternative ways including approaching supporters directly
Lack of success in grant funding	A trustee subgroup is overseeing increased level of applications
Loss of volunteers	COVID secure risk assessments, engagement with volunteers with training and support

Fundraising (see pages 2 and 3 of trustees' report)

	2018/19	2019/20	
	£	£	
Fundraising income	22,206	21,227	
Fundraising costs	(8,915)	(2,546)	14%
	<u>13,891</u>	<u>18,681</u>	

Fundraising income was similar to the previous year. Fundraising costs were 14% of income raised



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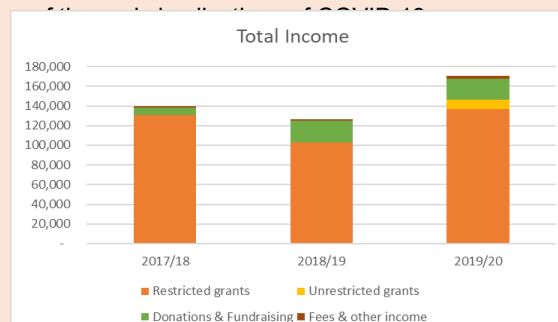
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