

PAPER 4.1 Annex 1 Engagement Strands and Working Groups on Activity Based Reporting in the Statement of Financial Activities (SoFA)

Editorial note- in reviewing the feedback an attempt is made to identify conclusions, supporting evidence and recommendations from the submissions which are in very different formats. SORP Committee members can have sight of any original submission on request.

Views of the SORP Committee working groups

The overlap with previous topics relating to the presentation of the SoFA were noted, in particular the discussions of support costs and expenditure classification.

- Apportionment methods appear to be the key topic not yet discussed.
- Some feedback that guidance on the most appropriate way to identify different activities may be beneficial. This may avoid situations in which charities overcomplicate reporting by subdividing activities, or do not disclose sufficiently disaggregated information. This guidance could be by way of worked examples. Table 2 presents Charitable Activities on a single row. This could lead to a single activity being seen as the default position. It was suggested that this Table could instead have indicative rows for Charitable Activity A, Charitable Activity B etc. to encourage charities to report more than one activity if relevant. (This is already in the wording. Updating Table 2 as above will mean it matches the wording).
- There was not a consensus in support of including such guidance in the SORP. It was questioned whether it was the job of the SORP to provide such guidance as it is up to the charity itself to decide what the main activity is. Some members of the working group argued that it is not the job of the SORP to train people/emulate a management accounting textbook.
- Software is fairly supportive of activity-based reporting. SORP paragraphs 8.4 – 8.6 were referred to as already being clear, and already containing examples.
- It was suggested that the issue of identifying activities may be problematic because the person who writes the TAR is different than the person who prepares the accounts. Something could be added to the SORP highlighting the importance of consistently describing activities throughout the annual report and accounts. Noted that people don't spend long enough on the TAR and can see it as a compliance exercise.
- SORP language could reflect the different audiences – module on the TAR written for non-specialists, accounting modules written in more technical language. Hyperlinks between the TAR module and relevant accounting modules could be used where relevant.
- Need for an education piece on the importance of the TAR and the need for connections between the TAR and the accounts.

Feedback from the engagement strands

Trustees

In discussing the options detailed above the strand was mindful of reflecting the experiences of trustees as both preparers and readers of annual reports and accounts. These perspectives are presented below to help the SORP Committee in its deliberations. The strand made the following observations when discussing activity basis reporting:

- Because of the diversity of the sector and the large number of charities that would be considered small or medium-sized in terms of income, it was noted that changes to the SORP should take in to account the difference in resources available to charities and trustees to apply the SORP;

- The connection between costs and activity within the current SORP is not very clear and can lead to confusion about why management accounts and statutory financial reporting is different. For example, the annual report and accounts appears to awkwardly combine an annual review, management accounting and financial reporting which can promote a box-ticking approach to preparation rather than delivering a meaningful and rounded overview;

- The SORP is trying to cover too many issues within one document making the final reports by charities unduly burdensome and not overly helpful for most readers of the annual report and accounts. It might be helpful for the purpose of the SORP to be re-established and changes to be focused on delivering those primary aims;

- Any changes should be 'light touch' as trustees are already struggling to understand what is expected of them and the production of annual reports is inconsistent;

- Natural classifications was viewed as a sensible approach, although it was noted that the terminology is unhelpful as it is not used in any other sectors. Along with making it the default setting for small charities (noting the variation in the definition of 'small'), the term 'natural classification' should be changed to something more recognisable and/or understandable by a larger group of people. Perhaps there are examples in other accounting treatments that would be more relevant to those without a financial or accounting background (the tax self-assessment regime for example);

- There can be an inconsistency within the SORP as to how different types of expenditure should be reported, for instance, the cost of IT could be identified as an activity or support cost or both;

- There's an overload of information within different aspects of the annual report and accounts and there needs to be a critical evaluation of what is necessary and what could be removed;

- In general, there needs to be a better way for annual reports and accounts to 'marry' the figures with the narrative reporting to provide a more rounded account of the charity's performance. It is noted that trustees could provide additional information in their annual reports and accounts to provide a more holistic review,

but the current structure of the SORP and the risk averse nature of some trustees may combine to limit further thinking on how to combine the 'facts and figures';

- There is too much duplicated information in the annual report and accounts which is burdensome for preparers and unhelpful for readers;

- There are opportunities to revamp the TAR and SoFA to deliver more meaningful information to those readers who are not financial experts; the TAR could be enhanced to provide more meaningful non-financial data and the financial notes could be reduced in length and complexity;

- It was noted that under FRS105 commercial entities do not need to publish 'profit and loss' accounts and that the reporting requirements of charities is disproportionate when compared to other sectors with bigger incomes and turnovers. We recognise that readers will want to understand how a charity has raised and expended funds, but also the impact a charity has made on its intended communities, such disclosures should be proportionate to the size, risk and complexity of the sector and individual charities.

- It is further noted that the SORP Committee, in its first submission to the FRC, has requested that FRS102 1A concessions should be made available to smaller corporate charities; • The changes to the SORP could be an opportunity to draw more attention to the impact a charity has made, aligned to a published theory of change for the organisation. This would need to be kept within the TAR, as the type of scrutiny offered by audit or independent examination is quantitative rather than qualitative;

- The use of better cross-referencing within the annual report and accounts would be helpful and the SORP should be reviewed to highlight areas where cross-referencing would be better than simply repeating information in different formats in different sections; and a more permissive approach in the revised SORP could help promote to trustees to provide additional information rather than just the minimum expectations of the current SORP. Promoting those permissions might embolden charity trustees to deliver more useful annual reports and accounts.

In general, the strand was agreed as to the options it would recommend to the SORP committee, although there were some additions and amendments to the proposals discussed:

Recommendation: As a general approach to developing the next SORP, the strand is committed to its option 1 To re-commit to the recommendations made by the strand at the end of phase one. Specific recommendations included: • The use of plain English accompanied by an additional 'think non-financial expert first' approach; • Greater use of hyper-linking; • Inclusion of a comprehensive glossary (reflecting terms and definitions used by the regulators) and full indexation to assist cross-referencing; • Equal consideration to the importance of reporting both non-financial and financial performance in the annual report and accounts; • Make it easier to identify within the SORP what is a legal or regulatory requirement and what is recommended practice, citing sources where relevant; and • Reduce the length and complexity of the financial notes by better use of referencing, signposting, cross-referencing and hyperlinking. In previous reports from the Trustee Engagement Strand, it has been proposed that there need to be better definitions and more consistent uses of terms, especially around subjective matters as judgement and

materiality. Having clearer definitions, used consistently within the SORP, would be of benefit to the issue of activity basis reporting, especially given its reliance on a consistent use of judgement when apportioning costs

Recommendation: Option 2 Permit the use of ‘natural classifications for smaller charities (though we appreciate that the definition of a larger charity is different across the jurisdictions covered by the work of the SORP Committee). Increased awareness and understanding of natural classifications is likely to result in more charities adopting this approach (unless the size, complexity, risk and liquidity of the charity would mean this option was not appropriate should be the default position for small charities and also noting the variations in the definition of ‘small’ across the jurisdictions), however the term ‘natural classification’ was not deemed helpful and should be changed to better reflect the terminology used in other settings and more understandable to non-accountants (perhaps draw on the vocabulary of the tax regime).

Recommendation: A think small first approach (option 3) should be the premise for all changes to the next SORP, alongside this should be a ‘building block’ strategy whereby the bare essentials of financial and performance reporting for all charities is the starting point, with additional requirements placed upon larger, more complex organisations.

Recommendation: Annual reports and accounts should incorporate a degree of information about a charity’s impact (linked to an agreed and published theory of change). This could be done by expanding the scope of the TAR (but we would urge that this is mirrored by a reduction in data required elsewhere, such as the financial notes).

Recommendation: In developing the next SORP there needs to be a return to establishing what the primary principles of the SORP are and focus on extracting the information that supports the achievement of those primary principles or aims. Recommendation: Write the next SORP in a more permissive tone to encourage trustees to include additional information over and above the bare minimum to ensure the annual reports and accounts are more meaningful to a wider group of readers. This would still need to differentiate the “musts” from the, “coulds”, “shoulds” and “mays”.

Smaller charities and independent examiners

We suspect that many preparers may be taking the SORP SOFA template at face value – ie being the only level of detail that is required for compliance or it may have been provided to them by an umbrella body as a standard template without further guidance. We also believe it is likely that accounts production software used by commercial accountants is defaulting to activity basis accounts in the name of compliance but again taking the SORP template as all that is required and therefore collapsing all of the charitable income into one heading even when there are significantly different activities being undertaken. The trustees, then not having the depth of knowledge are just accepting these accounts without question.

Therefore it may be problematic to assume that the large number of charities apparently using activity based classification is really a true endorsement of that method since it may not have been chosen from a position of good knowledge. In many cases the accounts are not being prepared in the true spirit of the SORP so whilst appearing to be compliant they are not actually providing the information that the proponents of activity basis accounts really want to see.

We are instead seeing poor quality activity basis accounts with no subdivision of activity even if these are reported in the TAR and often no identification of support costs. The reasons for this are not entirely clear since there is already a great deal of well written guidance in existence within the SORP and in the various accounts packs CC16 and CC17 / CC17a which, if used, should enable preparers to put together good quality accounts in various formats.

Our central concern is that this lack of understanding is preventing charity staff and trustees from making informed decisions about which format of accounts to adopt and partly explains the low take up of Receipts and payments and also natural classification accounts, both of which may be more achievable and affordable to prepare to a higher standard.

Conclusions

- Clear information early on in the SORP about the three options available for accounts format – R&P, natural classification, activity based classification with a shift from the notion that activity basis is the preferred option with an alternative. Instead the options should be set out with equal standing but list the pros and cons of each. This could be a table in the choice of accounts section so that it stands out. Trustees may then be in a position to make much better informed choices.
- Example accounts should be available for one fictional charity, prepared in the three basic ways – eg with income of say £200k so big enough to have more than one significant activity but not so large as to have complex issues and notes – just containing the most common items. This would give trustees and preparers a visual sense of what they should be expecting from each method and again be able to make an informed choice.

- More references in the SORP to the accruals accounts pack(s) since these give a much clearer visualisation of how activities should be analysed in the notes. They are lengthy but the preparer can scan through and figure out what is not required as opposed to perhaps not being aware that something is required. It would at least prompt them to check the SORP. Again, this can build in the mind of the preparer a sense of what is expected. There is also a secondary value to these packs in that it may be possible for a preparer with good excel skills to take elements of the template to build their own tailored accounts template. The packs are a really valuable resource and it's a shame they are not referred to in the SORP.
- A natural classification example SOFA in the SORP may also be helpful, again just to give a visual cue that there is another option.
- Provide more clarity the support costs - what should be included or excluded. Specifically guidance is needed in relation to treatment of management salaries, admin salaries and other overheads such as premises costs. This may make it more achievable to prepare the note confidently and could improve consistency between charities. Also on support costs – it should be made clearer – either by referencing the accruals pack or in a table referred to above, or within section 4 (it is already stated in section 8. . .) that all charities reporting on an activity basis must show the total support costs and an analysis of material items even if they only have one activity. That said, we did indicate in our earlier paper that we would like to see smaller charities exempted from having to identify and analyse support costs given the problems with it and the lack of consistency.
- Clarity could also be provided on the provision of further analysis of charitable activity spending. At the moment it appears that this can be just down to the total cost of each charitable activity split into activities undertaken directly, grant making and support costs (4.57 & 4.58). Further analysis only being needed for support costs and then the total salaries being shown in another note. We do see a natural classification breakdown of charitable activities from time to time and so it could be helpful if clarity was provided as to whether analysis into material items is needed or whether it can be omitted.
- Provide clarity on categorisation of non-performance related restricted grants. These will be the main source of financing for charitable activities for many if not most charities under £1m income. They should probably go in with Donations and legacies as they will be recognised along similar lines but currently this section only refers to restricted donations, and grants of a general nature. It needs to be unquestionably clear to the preparer where these should go. Some preparers may be treating them as charitable income since they may be such a fundamental part of funding their activities, however such grants may be awarded to cover costs of fundraising activities as well just to add another complication.

Our focus is really on the promotion of natural classification. However, if the final view is that links are to be promoted then there need to more examples which deal with activities financed from a combination of types of income, and how linking should be established where there are restricted grants specifically for charitable activities which are not performance related. If it is not made clear what to do in more complicated but common circumstances then the guidance will be ignored anyway.

Even if every charity prepared perfect activity basis accounts, would public trust and confidence increase? We should also be aware that it is unlikely that the day to day transactions in many charities will be recorded in such a way as to separate out the activities. It is more likely, in our experience at least, that income and expenditure will be naturally classified in the accounting records for ease of budgeting and recording and the additional dimension of categorisation will be used for accounting for different funds as this is a strict requirement and reports will have to be produced frequently for funders.

The trustees' annual report (TAR) should be telling the story of what the charity did or is trying to achieve. The numbers are part of that story but cannot tell the story on their own regardless of what basis they are prepared under and whether or not elements are linked.

The maxim 'no numbers without a story and no story without numbers' is no less true for natural classification accounts or for activity basis accounts where income is not linked to expenditure. The numbers in the accounts can still be a means of logic checking the TAR and vice versa.

As readers of the accounts, we should be concentrating on how the charity's funds were spent on advancing its objects as a whole and then be looking at the funds and reserves to establish where they are in the balance of expending funds within a reasonable time and retaining a justifiable amount with a view to going concern and risk

Professional and technical (Group A)

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

It was generally accepted by the group, that activity reporting should remain in place for larger charities and that it would be a backward step to move away from this. The option to use natural categories for smaller charities should also be retained.

Activity reporting was considered necessary to link the front-end with the back end of the accounts. There was some thought that 'activity' reporting was more of an art than a science and that it gave scope to 'fudge' the results. It was generally agreed that activity reporting was not a perfect method but the general consensus was that it should be retained.

As per our paper giving feedback on support costs, members of the strand generally accepted that change was necessary in this area. In particular, there was a view that the use of the term “support costs” implied that these costs were non-charitable and led to negative connotations about such costs. One idea was that the term “support costs” be abandoned on the basis that it was unhelpful to refer to any activity as non-charitable so if there needs to be a distinction, the terms ‘direct’ and ‘indirect’ charitable costs were thought to be more helpful. (There was not consensus on this).

On a practical level, it was previously pointed out that trustees spent a huge amount of time deciding how to allocate support costs and the benefit of doing this in terms of more accurate, consistent accounting information was questionable. It would be more helpful to users of accounts of the SORP put more emphasis on the narrative detail, explaining why such costs are incurred.

In terms of the feedback on expenditure, there was a view that the expenditure notes required under the current SORP were too complex especially after taking comparative figures into account. This made it difficult to preparers of accounts and was not necessarily helpful to users of accounts. So although the strand did not see a case for change from activity reporting altogether some changes were needed in the SORP in relation to support costs and expenditure disclosures.

Recommendations:

No change was advised in relation to the requirement to prepare activity based accounts for larger charities. Equally, preparation of accounts using natural categories should be kept in place for smaller charities. Activity reporting was considered necessary to link the front-end with the back end of the accounts. It was also agreed that fundraising should be considered as a separate activity.

In terms, of support costs our feedback was that there was very little value in splitting them out and that they formed part of the activities. In our previous feedback, it was proposed that the term “support costs” be abandoned. One comment was that it was unhelpful to refer to any activity as non-charitable so if there needs to be a distinction, the terms ‘direct’ and ‘indirect’ charitable costs were thought to be more helpful. (There was not consensus on this). The disclosures required by the current SORP concentrate in the methods used to allocate support costs. More emphasis on the narrative detail, explaining why such costs are incurred, would be more helpful to users and preparers of accounts. Paragraph 8.6 could provide more detail in this respect.

The guidance in Module 8 could still be provided but it should be clear that this is guidance only and that charities should use methods of allocating appropriate to their particular charity. The guidance could be more ‘gentle’ guidance rather than mandatory. It was thought that many charities would already be allocating support costs to provide information to funders and grant makers. It should be possible to use these figures for the accounts.

In terms of other changes to the SORP, it was generally agreed that Table 4 should not be required but that Table 3/13 could be expanded to show the different type of costs across the top. Specifically, the support costs column would be removed and replaced by a number of columns of specific material costs e.g. wages and salaries, fundraising costs, IT costs etc. The costs would be allocated out as the charity sees fit. The detailed disclosures on methods of allocating support costs could be replaced by a general explanation of why such costs were incurred. In relation to comparatives, it was agreed that methods of allocating support costs should only be required for the current year; not the previous year as well.

Professional and technical (Group B)

Key points discussed

Understanding what is meant by ‘activities’/ ‘activity reporting’ is really key to making a success of activity reporting. It is something that charities find it difficult to do well. The Charities SORP does provide requirements and guidance but there is no overall summary which gives charities a feel for what activity reporting is all about. For example, paragraph 8.5 suggests how charitable activities could be analysed and paragraph 4.29 gives some easy to understand examples of activity reporting. It may therefore be useful to introduce commentary on what activity reporting is and what it is seeking to achieve, along with examples, up front in the Charities SORP. Some additional examples would be welcome.

The Strand considered two scenarios beyond the status quo:

- Radical change
- Non-radical change

Radical change

If starting again (which could include restructuring existing material), consideration should be given to providing requirements and guidance based on how charities currently report within their organisation and to their trustees about their finances. Under this approach the expenditure classifications/ activities in the charity’s financial statements would align with a charity’s management reporting practices, for example, with its management accounts.

Under such an approach comparability between charities would effectively be de-prioritised in favour of the financial statements being more tailored to the way the charity is managed and governed. The Strand felt that comparability between charities at a detailed level in relation to expenditure is not necessarily meaningful anyway. This approach could also strengthen the link between the trustees’ annual report and financial statements in telling the charity’s story.

The SORP would still need to set out minimum disclosure requirements for some expenditure items (potentially to meet the requirements of FRS 102 and accounting regulations), for example, salaries and wages and audit fees.

Another suggested new approach was to report total expenditure on the face of the SoFA as the mandatory disclosure. If funders want more detail in the SoFA then they won't support the charity, until it provides more detail. This is a 'market-based' approach.

There was not unanimous support for either of the above options, however, the former option linking financial reporting to management reporting was viewed as preferable by more Strand members compared to the minimal reporting of expenditure.

After the discussions at the meeting, one member of the Strand questioned whether the former option would represent a radical change. The current requirements and guidance within the Charities SORP allow charities to report on what they see as being the significant activities they undertake to fulfil their objectives. This gives charities the freedom to name their activities. However, an emphasis on linking activities to the way the charity is managed and governed (and therefore to the trustees' annual report) could mean broadening the concept of what could constitute an activity. This point relates to the comments we made in our report on expenditure classification about the use of the term 'expenditure on charitable activities', when a charity should not routinely incur 'non-charitable expenditure' anyway.

Non-radical change

The Strand supports, as a minimum, changing the word 'should' to a 'must' in the following paragraphs of the Charities SORP:

- Paragraph 4.5. "Charities reporting on an activity basis must ensure that those activities reviewed in the trustees' annual report are also reported on the face of the SoFA or in the notes to the accounts".
- Paragraph 8.6. "The activities reported must also be consistent with the significant activities noted in the trustees' annual report. The narrative provided by the trustees' annual report should help the user of the accounts to understand the nature of those significant activities and what has been achieved as a result of the expenditure incurred on them."

The Strand envisages that these changes will contribute to the overall objective of the trustees' annual report and financial statements working together to tell the story of the charity. It is the experience of Strand members that there is a disconnect between the trustees' annual report and financial statements. This is true both when the trustees' annual report and the financial statements are prepared by the same person (for example, the director of finance), or, in the case of some smaller charities, where their financial statements are prepared by a third party but the trustees' annual report is prepared by the charity. Therefore, there is a need for a change of mindset whereby greater regard to the financial statements is needed when the trustees' annual report is prepared. The small wording changes we have identified will help achieve that change.

The Strand believes that the principle of a more holistic approach to trustees' annual report and financial statements should still apply to charities applying natural classifications but we recognise that this may be more difficult for them to achieve.

Conclusions and recommendations

- We recommend that consideration is given to the way requirements and guidance on activity reporting are structured in the Charities SORP. For example, the preparation of an upfront summary explaining what activity reporting is, why it matters and providing some additional examples. Perhaps a new chapter/ or module which focuses on how the SORP intends to create a more holistic approach would be helpful. It could cover other issues such as going concern, reserves policy, impact and sustainability as well as activity reporting.
- We recommend that consideration is given to introducing either requirements or guidance to the effect that activity reporting involves corraling activities in a manner which reflects the way the charity is managed and governed. Under this approach, most members of the Strand would favour fundraising activities being reported on in the SoFA separately from (other) charitable activities.
- As a minimum, the wording within the Charities SORP should be revised in paragraphs 4.5 and 8.6 to replace 'should' with 'must'.

We believe that these recommendations will improve the quality of activity reporting in the financial statements and support a more holistic approach to reporting on activities within the trustees' annual report and financial statements.

Larger charities

It was noted that this topic has a close overlap with other topics such as expenditure classification, support costs and the format of the SOFA and therefore we may already have covered some of this ground previously.

Points in discussion

A strand member said that as this engagement group was for larger charities, they did not see a need for change to activity reporting and that they felt that full costs recovery works and focusing on activities for the charity is the way to do it. They said that they didn't feel this presented issues for larger charities, but that perhaps for **smaller charities** it might.

Another strand member agreed with the previous comment, adding that they feel that there seems to be a desire to link income and expenditure which is not helpful and that it would be more helpful to link expenditure to impact. They explained that they believed that this is where there is a mismatch, and that when you have the income and expenditure argument it links to the argument that you have spent X on expenditure with only y received in income. An example of this was provided in relation to legacies and the mismatch in reporting. The strand member said they didn't feel that there was a case to change the current approach to activity reporting.

Another strand member commented that the trustees annual report, figures and notes don't exist in isolation the TAR is an **important place to tell that** story.

Another strand member said that they didn't see a need for a change in the requirement but were struck by the fact that **charities don't do activity reporting very well**. They raised the point of how well activity reporting was understood in the audit profession noting that they have not experienced auditors ever raising this issue. A strand member commented that this was a point well-made and that it has to be about **education and understanding** which is not necessarily for the SORP, but as has come up several times in the SORP review, there is a gap in how the SORP is understood and applied. Another strand member agreed that the issue of education and understanding of SORP has been something that has been a common issue raised throughout the engagement discussions. It was suggested that it would be helpful to pick this up as an overarching point on education in the feedback to SORP Committee.

A strand member commented that whilst logically it seemed like the right thing to do, thought needed to be given, **highlighting the explanation** given for must, should and may in the SORP.

Recommendation

A change to paragraph 8.6 - first should be **changed to a must** for all sized charities to encourage better linking of activity reporting with TAR and numbers which should also help drive up understanding. Agreed to suggest that the first 'should' be changed to a 'must' and that the second 'should' remain as a 'should' as it is a much higher bar to achieve.

A wider feedback point on importance of **training and education** as part of implementation of new SORP – this has come up multiple times on various topics i.e. in many cases the SORP guidance is good and adequate but poorly understood or inconsistently applied.

Major funders and donors and government bodies

We refer the SORP Committee to our previous submission regarding Expenditure Classification and Support Costs. We do feel that we have already submitted our thoughts on this matter.

Conclusions:

We would comment regarding para 8.6 of the SORP: '8.6. The activities reported should also be consistent with the significant activities noted in the trustees' annual report. The narrative provided by the trustees' annual report should help the user of the accounts to understand the nature of those significant activities and what has been achieved as a result of the expenditure incurred on them'.

We would recommend that the word **'should' be changed to 'must'**.

As a general point it is not always possible to link expenditure with income, and for **smaller charities it is easier for them to report using natural classifications**. If the next iteration is being prepared on a start small basis we would support smaller (and mid tier – if 3 tiers) charities being allowed to use natural classifications, but charities falling within the highest tier should be using the activity basis. Small charities can always adopt that method of reporting on a voluntary basis.

Until there is an **education programme** that changes public perception about ‘charitable costs’ and other costs automatically being considered ‘bad’. This discussion will go round in circles. The key point is trust in the charity that ALL monies raised are being spent to achieve the charities objectives. SORP 2015 is not clear enough to advise small charities that they can adopt natural classifications, and some auditors/preparers also do not make this clear to their small charity clients

Recommendations:

1. Change the requirement to adopt **activity reporting to a higher tier level**. Smaller charities can have the option to adopt should they so wish, but it is not mandatory. We support the start small philosophy.
2. Recommend to Trustees and Auditors/professional preparers the use of the **‘natural classifications’** as the clearer way for the small charity to ‘tell it’s story’ to the general public and lay readers.
3. Increase the **categories lines of expenditure** in accordance with the above suggestion so that any explanatory notes can be more easily and simply reconciled to each expenditure line.
4. Charity Commission to engage in an **education programme** to do away with the public concept of ‘bad’ expenditure.

Academics and regulators and proxies for the public interest

Discussion points:

One strand member took the view that the lack of clarity on the allocation of costs against activities can reduce the degree to which activity reporting is useful to a reader of the accounts.

In Scotland, the Charity Register is predominantly made up of small charities – 51% have an income of less than £25k and only 9% have an income of more than £500k. The recent Scottish Charities 2021 research also provides that two thirds of Scottish charities are entirely run by volunteers. Within this context, the time and resources required to classify expenditure accurately on an activity basis may be very onerous to such charities. As such, it is likely that where the activity basis is used it is likely to be an arbitrary calculation used. Sector demographics are similar in other charity law jurisdictions.

However, another strand member re-emphasised the views previously advanced in relation to the topics of expenditure classification and support costs:

- Activity based accounting provides a more **consistent framework** and allows consistent regulatory analysis and comparison.
- Allowing smaller charities to use ‘natural’ categories is not automatically simpler for them without detailed guidance. Rather than needing a simpler option, the lack of consistency we see in accounts suggests that charities may just need **clearer and simpler guidance** on preparing their accounts rather than more options.
- The consistency and comparability of the activity-based reporting format is vital for the data that we wish to collect about charities and display on the Register of Charities.
- Drawing together the relevant information and guidance on activity-based accounting into a single SORP module would make it easier to follow.
- The accounting framework needs development so it can better enable **charities to be consistent and transparent** about reporting support costs (as a category in their own right) and explaining how they contribute to achieving the charity’s purpose (including by supporting effectiveness and good governance).
- The strand member emphasised the importance of these issues in relation to public expectations of, and trust and confidence in, charity. Charity accounts and reports need to help demonstrate:
 - how money is spent, particularly that a high proportion is used for charitable activity
 - whether the charity is making the impact that it promises to make
 - whether the way the charity operates is consistent with the spirit of charity

Conclusions:

Consistent views were on the **need to help charities** report clearly and transparently. There is a need for education and training to support this – the SORP cannot do it all. Agreement that many charities do not properly understand how they should report. In jurisdictions where the SORP is still relatively new (e.g. Northern Ireland), the need for education is even greater.