

Feedback from Engagement Strands and Working Groups on Materiality

Engagement Strand: Smaller charities and Independent Examiners
A. Options Considered by the Engagement Strand
<ul style="list-style-type: none"> • Option 1: Bring the general concept of materiality to the fore within the SORP within the introduction or objectives section • Option 2: The SORP could provide examples/ discuss existing methods of establishing materiality thresholds. • Option 3: Granting of specific exemptions regarding particular adjustments or notes for smaller charities i.e. effectively meaning they are not material items for smaller charities. <ul style="list-style-type: none"> ○ This could be at a much lower tier threshold of say £100,000 below which it could be possible to exclude some disclosures outright. ○ Remove the requirement to disclose pay and benefits of key management personnel in its entirety for all smaller charities where there are no individual KMPs with benefits above £60k. ○ Remove the requirement to disclose details of donations from trustees for smaller charities. ○ Remove the requirement for smaller charities to disclose lease commitments.
B. Advantages/Disadvantages of Options Considered
<ul style="list-style-type: none"> • Option 1: Bring the general concept of materiality to the fore within the SORP within the introduction or objectives section. The concept of materiality can be difficult for the lay preparer to grasp, therefore existing SORP guidelines that allow omissions on the grounds of materiality may not be fully understood/utilised. If materiality is brought to the fore, charities may better understand how to ensure only useful information is included in the accounts. However, there is a risk that this may not yield that much of a change • Option 2: The SORP could provide examples/ discuss existing methods of establishing materiality thresholds. By reading examples and/or discussions of methods of establishing materiality thresholds, SORP users could get from an understanding of the concept to a practical way of applying the principles. • Option 3: Granting of specific exemptions regarding particular adjustments or notes for smaller charities. Exemptions from adjustments or disclosures could benefit small charities, who otherwise are required to produce overly complex and lengthy accounts due to their smaller gross income. <ul style="list-style-type: none"> ○ Two suggested changes in the reporting requirements for smaller charities on the grounds of materiality could be accrual of employee benefits e.g. holiday pay and the discounting to net present value for financial instruments. ○ These two areas cause problems for smaller charities but are unlikely to make any material difference to the accounts or affect the reader's ability to understand them.

<ul style="list-style-type: none"> ○ In smaller charities, where there may be only one employee, their earnings will be disclosed regardless of their level of pay and benefits. Removal of the requirement to disclose relatively low levels of key management personnel earnings would assist these charities. ○ The number of trustees captured by the donations' disclosure could be small for smaller charities, compromising the identity of donors. In some instances this may lead to trustees being reluctant to donate or conversely for donors to become a trustee. Removal of the disclosure requirements for smaller charities would eliminate this issue. ○ Lease commitments for smaller charities tend to only be for less material items like a photocopier lease. Removal of the requirement to disclose future lease commitments for smaller charities would reduce the reporting burden for lease accounting. However, this option may require changes to FRS102 Section 1A.
<p>C. Conclusions</p>
<p>Conclusions/recommendations of the engagement strand are as above.</p>
<p>D. Other comments</p>
<p>As many charities as possible should be able to adopt natural classification on the SOFA.</p>

<p>Engagement Strand: Trustees</p>
<p>A. Options Considered by the Engagement Strand</p>
<ol style="list-style-type: none"> 1. Option 1 – to re-commit to the recommendations made by the engagement strand at the end of phase one. Specific recommendations relevant to materiality include: <ul style="list-style-type: none"> • The use of Plain English accompanied by an additional 'think non-financial expert first' approach. • Inclusion of a comprehensive glossary (reflecting terms and definitions used by the regulators) and full indexation to assist cross-referencing. 2. Option 2 – To provide an approach to reporting issues of materiality that reflects a building block method, commensurate to there being a three-tiered approach. The SORP could permit smaller charities to report material issues within an approach that requires all charities to report on the legal essentials, with larger more complex charities expected to disclose additional information.
<p>B. Advantages/Disadvantages of Options Considered</p>
<ol style="list-style-type: none"> 1. Option 1 – to re-commit to the recommendations made by the engagement strand at the end of phase one. As materiality is an area where judgement is exercised, clearer definitions, explanations and examples would support understanding of materiality.

C. Conclusions
<p>Option 1 – to re-commit to the recommendations made by the engagement strand at the end of phase one – was agreed by the engagement strand. In particular, the engagement strand emphasised the need for worked examples, case studies, flow charts and decisions trees to accompany more traditional text-based resources to support better understanding of the concept of materiality.</p> <p>References to materiality should be woven throughout the SORP. Trustees should then be encouraged to ‘show their workings’ to help readers understand how they have decided upon their charity-specific definition of materiality.</p> <p>A guiding principles approach should be adopted for materiality, which should be able to accommodate the legitimate different viewpoints of different stakeholders.</p> <p>No conclusion was offered with respect to option 2.</p>
D. Other Comments
<ul style="list-style-type: none"> • There is no agreed threshold of what is a material transaction. Some may adopt a formula where 1-2% of income is material, but this may not be relevant for charities with significant assets. • There can be different approaches to materiality. Materiality is likely to be considered differently by an independent examiner, auditor, trustee, donor or other interested party. This can lead to a lack of consistency and make it hard to compare charities and their annual accounts. • The concept of materiality can also be drawn from different sources; company law, the SORP and emerging ESG reporting frameworks. This can add to the confusion. • The ongoing evolution of ESG and sustainability reporting that should be considered (if not adopted for the next version of the SORP, at least to pave the way for likely future reporting requirements). • The SORP would benefit from accompanying resources, such as a tool kit and other resources, to help promote better understanding of materiality.

Engagement Strand: Academics and regulators and proxies for the public interest
A. Conclusions
<p>Clear conclusions were not drawn, with some engagement strand members suggesting changes with other engagement strand members of the view that changes are not required.</p>
B. Other Comments
<ul style="list-style-type: none"> • Materiality can be approached inconsistently between charities or between balances, e.g. large balances in “other” grants or contracts received. Situations can exist where there are lots of small contracts, each deemed to be immaterial but as a whole the small contracts make up the majority of income for that charity. Because each individual contract is

deemed immaterial, disclosure may be inadequate i.e. allow for judgement of materiality in the context of the accounts as a whole, not just for individual transactions.

- Regulators have noticed accountants disclosing everything regardless of whether the transaction is material, this being due to erring on the side of caution or working within the confines of accounting software. Options may include:
 - Highlighting more predominantly that information need not be included if it is not material.
 - Examples of the types of transactions that would not need disclosed may be helpful.
- Different approaches to materiality are taken depending on the circumstances e.g. in the preparation of accounts, in the examination or audit or in CCEW's regulatory concerns and processes (e.g. Reporting of Serious Incidents, CCEW's risk operating model, books and records examinations). This can raise questions about materiality.
- Some issues with materiality might be addressed through the proposed approach to tiered reporting, reducing the burden on medium and smaller charities.
- However, the definition of materiality should be the same for all charities, regardless of size.
- There is a question as to why the definition of materiality focuses on economic, not other (e.g. strategic, compliance, or regulatory) decisions.
- There are some matters that the engagement strand would consider 'material by nature' and which should always be reported. These include:
 - conflicts of interest
 - benefits to trustees and other related party transactions
 - salaries above £60,000 and remuneration of key management personnel
- More scenario-based guidance that illustrate how to apply materiality principles in different circumstances would be helpful.

Engagement Strand: Professional and Technical (B)

A. Comments and Recommendations

- It would be helpful if there was more commentary within the SORP around the concept of 'materiality by nature' and how this interacts with the 'materiality by value' to assist accounts preparers to arrive at suitable judgements.
- The engagement strand recommended that a separate definition of 'material by nature' or qualitative materiality is included within the glossary of the Charities SORP.
- Further guidance is needed around the presentation and disclosure of restricted funds, which could include individual restricted funds which are material by value and/ or multiple restricted funds which are material by value in aggregate. Some charities have thousands of funds so treating these as being material by nature, without consideration of materiality by value, would make the financial statements of some charities excessively long.
- Consideration needs to be given when updating the SORP to distinguishing more clearly between requirements, good practice guidance and other guidance, for example, by having requirements and guidance paragraphs numbered separately or highlighted separately.
- Guidance would be helpful to assist preparers in determining 'materiality' in relation to their circumstances, particularly in relation to 'materiality by value' and in relation to the disclosure of funds on the face of the SoFA (as permitted by paragraph 4.13).

- The engagement strand was keen for the Charities SORP to provide clarity on how charities with multiple restricted funds should present and disclose these in the financial statements
- The engagement strand was of the view that the Charities SORP should include wording to explain to preparers of financial statements the link between the concept of materiality and the 'true and fair' view.

Engagement Strand: Professional and Technical (A)

A. Comments and Recommendations

- The SORP cannot be overly prescriptive around which transactions are material.
- The assessment of what is material cannot be defined too tightly as one needs to factor in the users of the accounts and their needs when making the assessment, undoubtedly this will vary for different charities.
- As items can be qualitatively or quantitatively material, the issue can be complicated. It may be possible to provide examples where items are clearly immaterial or clearly material, particularly for smaller charities (not subject to audit), but there will be areas which are inherently subjective and which require judgement.
- The explanation of materiality in the SORP refers to 'economic decision-making by the user of the accounts'. Economic decision-making does not easily translate to a not-for-profit entity so the SORP could provide more guidance on how this may apply in the context of a charity to aid preparers of the accounts.
- Some engagement strand members felt that tiered reporting should not influence materiality.
- A revised SORP should encourage/re-enforce disclosure of such areas as critical accounting judgements in relation to materiality.

Engagement Strand: Large Charities

A. Conclusions

On reflection, the engagement strand did not feel there was a need for much change in the SORP.

Charities SORP Working Group (A)

- SORP Para 3.18 sets out that SORP requirements only apply to material items, but this is not always considered by accounts preparers. It would be helpful to highlight this in each section of the SORP so it is not missed.
- Examples within the SORP would help users decide which transactions are material.

- Note that Trustees will need to work with their accountants to determine materiality by nature if the charity does not complete the accounts in-house.
- Related party transactions are material by nature rather than size – clarity is needed on which transactions are material.
- It is particularly difficult to determine materiality within smaller charities.
- Materiality is about the economic decisions of the **user** of the accounts, adding complexity to determining which transactions are material. Examples will help.
- Comments included that it would not be possible to include a benchmark/method of calculating materiality (e.g. 5% of income) in the SORP. But consideration could be given to the possibility of the information to be considered when assessing whether a transaction is material e.g. size compared to income, gross assets, net assets and also in relation to the result for the year.
- It would also be helpful to try and explain the concept of materiality in layman's terms.
- Consideration of materiality important **at the outset** to avoid the preparation/inclusion of unnecessary disclosure in the accounts.
- As this is likely to be an area where there are training needs, inclusion of examples and illustrations in the SORP will be key:
 - These should include examples that touch on fraud.
- It was noted that care needs to be taken to avoid examples being written that preparers will follow without consideration of charity-specific circumstances or nuance.
- There needs to be clarity on the link between materiality and required level of disclosure, and this needs to be obvious within the SORP.

Charities SORP Working Group (B)

- A suggestion to include in the pro forma accounts an item that was excluded on the basis of materiality to demonstrate such exclusion is possible.
- To clarify within the SORP those transactions that would be considered material by nature (for example related parties, trustee expenses, more discussion will be required to produce a full list).
- To consider a de minimus limit under which disclosure is not required, for example a limit above which trustees' expenses are disclosed
- To emphasise within the SORP that the accounts are only required to disclose those items that are material
- To consider education about how materiality is applied. This may extend to trustees and preparers of accounts using software packages that tend to result in disclosure of all matters, whether material or not, and to use judgement on what to disclose.