

Independent expert group on expenses - issue for SORP Committee consideration

1 Background

- 1.1 An Independent Expert Group on Expenses was established by the National Council for Voluntary Organisations (NCVO) and the Charity Finance Directors' Group (CFDG) in August 2009. Its terms of reference stated:

“Further to the recent interest expressed in the disclosure of senior management’s expenses, the Independent Expert Group on Expenses has been set up to gather information and evidence on the disclosure of expenses by registered charities in England and Wales, to report on the findings and to make recommendations as appropriate, including on any further research or guidance or other work which may be required to address the issue.”

- 1.2 The Report by the Independent Expert Group on Expenses published in March 2010 highlighted the importance of good internal control procedures on the payment of expenses to trustees, staff and volunteers. The report also provides a timely reminder on the importance of meeting the SORP’s disclosure requirement for trustees’ expenses in the statutory accounts.
- 1.3 The report contained a number of recommendations to the sector, Charity Commission and to the Commission in its role as a joint SORP-making body.
- 1.4 A copy of the Report by the Independent Expert Group on Expenses and the Charity Commission’s response can be downloaded at:

http://www.charity-commission.gov.uk/charity_requirements_guidance/charity_governance/managing_resources/trustee_expenses_qa.aspx

2 Issue for SORP Committee

- 2.1 One particular recommendation of the Independent Expert Group on Expenses related to the reporting of internal controls over the approval and payment of expenses by charities. Our discussions with the Group persuaded them it would be inappropriate for financial reporting to contain an internal control statement on one specific area of a charity’s activities but not others. The recommendation framed in the report asked for consideration of including a statement of internal controls within the financial reporting requirement of charities. The report recognises that the process of amending the SORP may not take place until 2012/13 to coincide with the adoption of IFRS-based accounting standards. The recommendation states:

‘We recommend that the SORP Committee consider how the issue of expenses disclosure might be addressed as part of the development of the new SORP – for example, as part of a requirement for a statement of internal control’.

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3 What does the SORP currently require and what would need to be added to a broader internal control statement

3.1 The SORP currently states:

'A statement should be provided confirming that the major risks to which the charity is exposed, as identified by the trustees, have been reviewed and systems or procedures have been established to manage those risks'.

3.2 The Independent Expert Group on Expenses included a reference to the Turnbull Report which sets out best practice on internal control for UK listed companies, and assists them in applying the UK Corporate Governance Code. This would be a high standard for UK Charities to meet but is the most authoritative source for what an internal control statement should include.

3.3 The Turnbull Report states that 'the annual report and accounts should include such meaningful, high-level information as the board considers necessary to assist shareholders' understanding of the main features of the company's risk management processes and system of internal control, and should not give a misleading impression'.

3.4 Under the Combined Code (applying to listed companies) the Board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets. Turnbull states that 'as a minimum', Boards should 'disclose that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the company, that it has been in place for the year under review and up to the date of approval of the annual report and accounts, that it is regularly reviewed by the Board and accords with the guidance in this document'.

3.5 The thrust of this recommendation is contained within the current SORP's 'risk management statement'. Turnbull however goes into more detail, in particular:

- Confirmation that the risk management process is ongoing;
- The process has been in place all year; and
- Risk is regularly reviewed by the Board in accordance with Turnbull Guidance.

3.6 The Combined Code also states that 'the board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets'. Turnbull states that an internal control report should include 'an acknowledgement by the board that it is responsible for the company's system of internal control and for reviewing its effectiveness. It should also explain that such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can

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only provide reasonable and not absolute assurance against material misstatement or loss’.

- 3.7 Trustees’ annual reports often contain similar information in a ‘statement of trustees responsibility’ asked for by auditors to ensure clarity on the respective roles of trustees and auditors. However, such statements tend not to:
- State responsibilities for reviewing effectiveness of controls; or
 - Explain that the system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss’.
- 3.8 The Combined Code states that directors should, at least annually, conduct a review of the effectiveness of the group's system of internal control and should report to shareholders that they have done so. The review should cover all material controls, including financial, operational and compliance controls and risk management systems.
- 3.9 Turnbull states that the Board should summarise the process it (where applicable, through its committees) has applied in reviewing the effectiveness of the system of internal control and confirm that necessary actions have been or are being taken to remedy any significant failings or weaknesses identified from that review. It should also disclose the process it has applied to deal with material internal control aspects of any significant problems disclosed in the annual report and accounts.
- 3.10 The above reporting requirements go considerably beyond the SORP’s current requirement. In particular by requiring:
- A summary of the review process;
 - A review covering full ambit of internal control; and
 - An explanation of how significant issues disclosed in the annual report or accounts have been dealt with.

Turnbull also requires an explanation where required statements cannot be made.

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Does the Committee think that an internal control statement for charities should be developed for inclusion in the next SORP?

If so, should the requirements of that statement be based on Turnbull or modified for use by charities?

If modified, what particular aspects should be added to or deleted from the Turnbull statement?

Does the Committee agree that any new requirement for an internal control statement for charities should only apply to charities subject to statutory audit (those over the audit thresholds)?

Commercial Example: Management's report on internal control over financial reporting

Management of BP is responsible for establishing and maintaining adequate internal control over financial reporting. BP's internal control over financial reporting is a process designed under the supervision of the principal executive and principal financial officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of BP's financial statements for external reporting purposes in accordance with IFRS. As of the end of the 2009 fiscal year, management conducted an assessment of the effectiveness of internal control over financial reporting in accordance with the Internal Control Revised Guidance for Directors on the Combined Code (Turnbull). Based on this assessment, management has determined that BP's internal control over financial reporting as of 31 December 2009 was effective. The company's internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with IFRS and that receipts and expenditures are being made only in accordance with authorizations of management and the directors of BP; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of BP's assets that could have a material effect on our financial statements.