

Report

To: Charities SORP Committee and Engagement Strand Convenors

From: Sarah Sheen, CIPFA, Secretary

Date: 8 March 2021

Subject: Objectives for SORP Development *[note this paper has been updated following comments made at the meeting these have been included in purple font]*

Purpose

The purpose of this report is to propose the objectives for SORP development and the grouping the agreed topics for the reflection and problem-solving stages in the development of the SORP.

Report

1. Introduction

- 1.1 Having previously held their own exploration discussions, the February 2021 meetings of the Charities SORP committee considered the topics raised by the engagement strands from the perspective of both the users of the accounts and the users of the SORP. Following consideration of the many suggestions, the committee agreed to take forward all sixteen topics suggested by the engagement strands but note the comments on paragraph 5.2 and section 6 below.
- 1.2 The SORP committee also agreed that it was important to set the role or objective of the SORP to inform SORP development generally but also to assist with the prioritisation of the topics put forward by the engagement strands. This exercise was last conducted in October 2017 and is in need of reconsideration in light of the new SORP development process: https://www.charitySORP.org/media/645890/sorp_statement_of_drafting_aims_oct17.pdf. However, the new engagement process which emanated from the [SORP Governance Review](#) in June 2019 has meant that there is a need to ensure that the objectives of the SORP meet the needs of the sector and the users of charities trustees' annual report and accounts.

2. Objectives of the SORP

- 2.1 At the 23 February meeting the SORP committee discussed the need to set the objectives of the SORP. This would enable the SORP committee and the engagement strands to consider the topics for SORP development in a more structured way and be useful to help prioritise topics to be considered for SORP development.
- 2.2 The discussion focussed on supporting good financial management, promoting the health and growth of the sector and social capital. The committee also agreed that promoting accountability and public trust and confidence should be included, particularly after considering the research topics from PwC and from the Office of the Scottish Charity Regulator and the Charity Commission for England and Wales.
- 2.3 It would be useful also for the SORP committee to consider the significance of the objectives currently described in the SORP to ensure that the progress made is continued. These objectives are included at paragraph 10 of the Charities SORP FRS 102 (second edition – October 2019) which is extracted in Appendix 1 of this report. The objectives of the current SORP comprise improving the quality of financial reporting, enhancing relevance and clarity of financial information but also assisting in the understanding of accounting standards and assisting accounts preparers.
- 2.4 To assist the SORP committee in its deliberations, the Secretariat has also included key standard setters' objectives for financial reporting [and the consultation on the Guidance anticipated to be produced by the IFR4NPO project](#). The standard setters [and IFR4NPO](#) are:
- The Financial Reporting Council (the FRC) – in FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*
 - IFR4NPO – the objectives for its Guidance in its recent [consultation](#)
 - International Accounting Standards Board – objectives (note these were included in *IFRS for SMEs*)
 - International Public Sector Accounting Standards Board – objectives from its Handbook of International Public Sector Accounting Standards.
- 2.5 Not all these standard setters are fully relatable for charity accounts but there are useful elements in the extracts, and they could also be used for comparison purposes to assist the Charities SORP committee in its deliberations.
- 2.6 Probably the most relevant to the Charities SORP are the FRS 102 extract and the IFR4NPO guidance. The FRC focus is on '*high-quality understandable financial reporting proportionate to the size and complexity of the entity*' and the IFR4NPO refers to improving the quality, transparency and credibility of non-profit organisations (NPO) financial reports.
- 2.7 The reference to proportionality will have clear applications for the users of charity accounts, as will the need to improve accountability by increasing transparency and credibility of financial reports. FRS102 requires that the benefits derived from information should exceed the cost of providing it and so the cost/benefit of application must be considered.
- 2.8 It is useful to note the common objectives across standard setters. These feature the need to ensure that standards provide high quality financial information. Most of the standard setters develop these objectives to consider the users of the accounts/financial statements so that

financial information allows the users of the accounts to take decisions (for companies 'economic decisions'). The users the IASB refers to may take different decisions from the users of charity or NPO financial statements though of course for many funders and donors some of the decisions taken may be similar i.e. choosing to invest in particular charities.

2.9 CIPFA as the Secretariat to the SORP Committee suggests that it is also important that the objectives cover issues and topics listed by the engagement strands. The objectives therefore could usefully cover:

- the substantial debate about reporting requirements reflecting charity size, 'think small first' and the need for tiered reporting
- the need to ensure that the financial statements do not obscure the key messages i.e. 'cutting clutter' but at the same time are able to communicate these key messages to the users (i.e. funders and donors).
- although legally responsible for the trustees' annual report, the trustees of smaller charities often do not engage with the preparation of their annual report and accounts because they are compiled by the independent examiner or accountant
- the readability of the trustees' annual report, the need to tell the charity's own story and to ensure that its presentation presents a fair and balanced view of the impact, performance and financial position of the charity
- addressing the technical accounting issues raised, and
- the presentation and usability of the SORP.

2.10 The Secretariat has combined the recent debate at the SORP committee, the topics and themes raised by the engagement strands, the objectives in the current SORP and practice from relevant standard setters to recommend SORP objectives as set out below.

Objectives of the SORP

The recommendations of the SORP are intended to achieve the following objectives:

- a) to improve the quality of financial **and other** reporting by charities so as to promote public trust and confidence and the stewardship of the sector generally and also demonstrate transparency and accountability in the use of the funds they receive;*
- b) to promote the provision of high-quality, concise, financial information in a way **that** is proportionate to the size and complexity of the charity, and provides a faithful representation of the transactions and relevant financial information to enable the users of charity accounts to take decisions;*
- c) to promote understandability and enhance the comparability of the information presented in charity accounts;*
- d) to provide clarification, explanation and interpretation of accounting standards in their application to charities and to sector specific transactions; and*
- e) to assist those who are responsible for the preparation of the trustees' annual report to tell the story of the charity in accordance with objectives a) to c).*

Recommendation 1

The charities SORP Committee and the SORP convenors are invited to consider the updated draft SORP objectives as the initial topic for discussion in the next stage of the process.

3. The User of the SORP

3.1 At its 23 February 2021 meeting the SORP committee also proposed that the users of the SORP should be expected to understand basic accounting concepts, principles, and terms. This recognises the implicit requirement in UK-Irish Generally Accepted Accounting Practice that the preparer has the requisite skills to understand and apply FRS 102. This is acknowledged throughout the SORP with direct cross references made to the applicable sections of FRS 102.

3.2 This approach is consistent with the current SORP which sets out at paragraph 8 that the intended users of the SORP:

'...are those involved in the preparation of the accounts and trustees' annual report of a charity'.

Paragraph 8 also stipulates that the SORP is relevant to auditors, independent examiners and accountancy practitioners involved in the scrutiny of the accounts. The SORP confirms at paragraph 9 that the users of the SORP will be familiar *'...with accounting concepts, principles and terminology and possess a reasonable knowledge of accounting practice'*.

Recommendation 2

The Charities SORP committee and the convenors of the engagement strands are invited to consider and comment on the expected capabilities of those preparing accounts under GAAP and as users of the SORP.

4. Accrual Basis of Accounting

4.1 The FRC's Policy on Developing Statements of Recommended Practice (SORPs (January 2021) requires that: 'A SORP must carry a Statement by the FRC confirming, as appropriate, that the SORP does not appear to contain any fundamental points of principle that are unacceptable in the context of current financial reporting practice, auditing practice or actuarial practice, nor does it conflict with an FRC standard or undermine the FRC's broader objectives. FRS 102 (paragraph 2.36) requires that entities prepare their accounts (except for cashflow information) on an accrual basis of accounting. GAAP standards therefore do not cover cash accounting. Therefore paragraph 14 of the SORP also specifies that:

Except where an alternative reporting framework sets out in legislation or regulation, or if another SORP applies, the accounting recommendations of this SORP apply to all charities in the UK that prepare accounts on the accruals basis to give a true and fair view of a charity's financial position and financial activities regardless of their size, constitution or complexity.

- 4.2 SORP provisions are therefore limited to charities that prepare accounts on an accrual basis. Paragraph 17 of the SORP is therefore clear that the SORP does not apply to charities preparing receipts and payments accounts,

Recommendation 3

The Charities SORP Committee and the convenors of the engagement strands are invited to note that charities applying the SORP prepare accounts on an accrual basis and the remit of the SORP does not extend to cash accounting (receipts and payments accounts).

5. The Topics Proposed by the Engagement Strands

- 5.1 At its 16 February 2021 meeting the SORP Committee considered the topics proposed by the engagement strands and agreed to take forward all the topics proposed which emanated from the perspective of the users of the accounts. These include:
- summary financial information/key facts page
 - reserves
 - impact reporting
 - support costs
 - presentation of the SOFA
 - technical issue a) removal of the use of comparison information
 - technical issue b) permit charities to use the accrual basis of accounting for grants; and
 - tiered reporting
- 5.2 At its 23 February 2021 meeting the SORP Committee also considered the above list of topics from the user of the SORP perspective. It agreed to take forward all the topics proposed by the engagement strands. However, it considered that technical issue a) removal of the use of comparison information could be considered under the Financial Reporting Council (FRC) 'listening exercise' as a part of the FRC triennial review of FRS 102.
- 5.3 At the 23 February meeting the SORP committee agreed to take forward the following issues which emanate from the perspective of the users of the SORP and preparers of the accounts:
- sustainability reporting
 - financial notes
 - income recognition
 - legacies
 - donated goods and services
 - expenditure classification
 - funds note

- activity reporting, and
- materiality.

6. Sequencing of the Review of the Topics

- 6.1 To address these topics, it will be important to consider the order under which the topics are reviewed, particularly as the tiering options will need to be resolved as they are likely to have an impact in some way on all the other topics.
- 6.2 Early discussions with the joint chairs confirmed this approach.
- 6.3 Tiered reporting, thinking small first and reconsidering thresholds were noted mainly from the accounts preparer perspective. However, allowing smaller charities to report only the information which is relevant to them and proportionate to their size would also have the potential to remove clutter from the accounts. Engagement strands have suggested:
- following the Companies Act 2006 sizing requirements
 - making greater use of natural classifications
 - using tiering or thresholds to ease accounting requirements
 - using tiering to reduce the reporting burden and simplify the accounts
 - taking a new approach to defining a small or less complex charity.

7. Groupings of Topics

- 7.1 With tiering and the removal of comparison information being considered separately there remain 15 topic areas raised by the engagement strands and agreed with the SORP committee to be taken forward into the next stages of the SORP development process. This is a large list of topics and to ensure that they are managed effectively they will need to be grouped.
- 7.2 An option for grouping topics might be to allocate them to the most relevant engagement strands. However, it could be argued that some topic areas might not fit easily into just one engagement strand.
- 7.3 An alternative suggested by the joint chairs is that the topics are grouped into four areas:
- narrative reporting
 - income
 - expenditure, and
 - presentation of the financial statements and notes to the accounts.
- CIPFA would note that this is very similar to the classification of the IFR4NPO topics considered. Some topics may be covered by more than one of these groupings, but they can be allocated into the grouping which is most relevant.
- 7.4 The remaining 15 topics have therefore been listed in Appendix 2 to this report. Each topic has been allocated a number and a brief description of the issues raised under each topic has

been provided. The final column indicates whether these topics are issues for either the user of accounts (UA) and/or the user of the SORP (US). This latter heading includes accounts preparers, independent examiners and auditors or other users interested in the scrutiny of charity accounts.

- 7.5 Grouping in this way appears to give a relatively even spread of topics over the four areas though the expenditure grouping is perhaps lighter than the other groups.

Recommendation 4

The Charities SORP Committee and the convenors of the engagement strands are invited to consider the groupings offered and whether they:

- **wish to offer any other alternatives to the proposed approach,**
- **consider that the topics should be allocated to an alternative grouping.**

8. Prioritisation of Topics

- 8.1 The presentation of the topics in groupings and the agreed objectives may provide some indication of the priority of the topics to be considered. Some commentaries from the engagement strands already give some indication of the need to review the issues which arise, for example, income recognition appeared not to require significant change.
- 8.2 The joint SORP-making body are considering two options for prioritisation of the topics:
- the joint SORP-making body will define the sequence/priority for reviewing the topics, based on the debates and the advice of the SORP committee; or
 - the engagement strands and the Charities SORP committee would be allowed to decide the sequence/priority for reviewing the topics at their discretion.

Recommendation 5

The Charities SORP committee and the convenors of the engagement strands are invited to comment on the prioritisation of the list of topics.

Objectives of Financial Reporting – Extracts from Standards Setters *and the Guidance Proposed by the IFR4NPO Project*

Financial Reporting Standard/ Guidance	Extract
Charities SORP FRS 102 (second edition – October 2019)	<p>The recommendations of the SORP are intended to achieve the following objectives:</p> <ul style="list-style-type: none"> • improve the quality of financial reporting by charities; • enhance the relevance, comparability and understandability of the information presented in charity accounts; • provide clarification, explanation and interpretation of accounting standards and their application to charities and to sector specific transactions; and • assist those who are responsible for the preparation of the trustees' annual report and accounts
FRS 102 <i>The Financial Reporting Standard applicable in the UK and Republic of Ireland</i>	<p>The FRC's overriding objective in setting accounting standards is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.</p> <p>In achieving this objective, the FRC aims to provide succinct financial reporting standards that:</p> <ul style="list-style-type: none"> (a) have consistency with global accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective; (b) balance improvement, through reflecting up-to-date thinking and developments in the way businesses operate and the transactions they undertake, with stability; (c) balance consistent principles for accounting by all UK and Republic of Ireland entities with proportionate and practical solutions, based on size, complexity, public interest and users' information needs; (d) promote efficiency within groups; and (e) are cost-effective to apply.
IFR4NPO Objectives of its Draft Guidance Included in the IFR4NPO Consultation Paper	<p>To strengthen the governance and financial management of NPOs...Guidance will be developed over a five-year timeframe to meet the following three objectives:</p>

Financial Reporting Standard/ Guidance	Extract
	<ul style="list-style-type: none"> • Objective 1: To improve the quality, transparency and credibility of NPO financial reports. • Objective 2: To support the provision of NPO financial information that is useful for decision making and accountability, balancing the needs of preparers and users. • Objective 3: To address specific NPO issues, which will promote the comparability of NPO financial reports.
International Accounting Standards Board (IASB) Extract from the Preface for IFRS for SMEs	<p>The objectives of the IASB are:</p> <ul style="list-style-type: none"> (a) to develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting Standards based on clearly articulated principles. These Standards should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the various capital markets of the world and other users of financial information make economic decisions. (b) to promote the use and rigorous application of those Standards. (c) in fulfilling the objectives associated with (a) and (b), to take account of, as appropriate, the needs of a range of sizes and types of entities in diverse economic settings. (d) to promote and facilitate the adoption of its Standards.
International Public Sector Accounting Standards Board Extract from Handbook of International Public Sector Accounting Standards	<p>The objective of the IPSASB is to serve the public interest by developing high quality accounting standards and other publications for use by the public sector around the world in general purpose financial reports.</p> <p>This is intended to enhance the quality and transparency of public sector reporting by providing for better public sector decision making. In pursuit of this objective the IPSASB supports the convergence of international and national public sector standards and the convergence of accounting and statistical basis of financial reporting where appropriate; and also promotes acceptance of its standards and other qualifications.</p>

Table of Topics Allocated over Lists of Areas

Topic Number	Topic Including Brief Description	User of the Accounts (UA) or User of the SORP (US)
Group 1 - Narrative Reporting		
1	<p>Summary financial information/key facts page</p> <ul style="list-style-type: none"> • Key financial information/key facts page including the use of infographics. • Summary financial information. • Summary financial statements? • This should not be a mandatory requirement. • Accessible information should be provided. 	UA and US
2	<p>Impact reporting (the difference a charity makes)</p> <ul style="list-style-type: none"> • More focus on impact reporting – should this be enhanced to demonstrate the difference the charity is making? • Should this be expanded to all charities? • More guidance needed but a balance as to whether this would be in the SORP or separate advice. 	UA and US
3	<p>Sustainability reporting</p> <ul style="list-style-type: none"> • In response to the need for transparency. • Different models of sustainability reporting- identifying whether to adapt an existing approach or to create our own. • Covers reporting on climate change, diversity and gender pay gaps- identifying the right content. • Future proofing the recommendations of the SORP. 	US
4	<p>Reserves</p> <ul style="list-style-type: none"> • Greater clarity (more guidance) about how reserves are defined and estimated, particularly free reserves. This guidance should make these issues easier to understand. • Linkage to reserve policy and performance against the policy. • Linkages to financial sustainability and going concern also needs to be understood by users and other stakeholders? • Reserves note explicitly in the accounts and not the trustees' annual report. • More or better narrative to support the reserves. 	UA and US
Group 2 - Expenditure		
5	<p>Support costs</p> <ul style="list-style-type: none"> • A need for consistency in estimation to improve comparability. • The amount of choice appears to be affecting this. • Education issues around understanding of overheads which are not allocated – these are seen to be 'bad'. 	UA and US

Topic Number	Topic Including Brief Description	User of the Accounts (UA) or User of the SORP (US)
	<ul style="list-style-type: none"> Distinction between charitable and non-charitable activity is seen as problematic. Cross reference to expenditure classification (topic 6) 	
6	<p>Expenditure classification</p> <ul style="list-style-type: none"> Suggestions around removing the requirement for the allocation of support service costs. How best to classify expenditure? Use of natural classifications of expenditure for smaller charities (see tiered reporting topic). 	US
7	<p>Activity reporting (describing how money was spent)</p> <ul style="list-style-type: none"> General lack of understanding by preparers of the accounts. The link between the cost of the activity and the income is often not obvious. Links also to topic 12 (presentation of the SOFA) and the links of the costs to related income where appropriate. 	US
Group 3 - Income		
8	<p>Accrual basis of accounting for grants</p> <ul style="list-style-type: none"> Permit charities to use the accrual accounting basis of accounting for some or all grants. Need to consider performance obligations to be able to recognise on an accrual basis – these are not always easy to identify. There are perceptions that this would distort performance particularly for smaller charities. Should a flexible approach be used? 	UA
9	<p>Donated goods and services</p> <ul style="list-style-type: none"> Need for inclusion in the SOFA was questioned. How does it align with FRS102? Should this be included in a note instead? 	US
10	<p>Income recognition</p> <ul style="list-style-type: none"> Some issues of interpretation on classification (though this appeared not to be a major issue). This is more of an issue on the smaller end of larger charities. Consideration of the recognition in the accounts of multi-annual funding. 	US
11	<p>Legacies</p> <ul style="list-style-type: none"> More guidance/clarity on accounting treatment. Issues around the need to make judgements. Note that current guidance is based on FRS 102. What might need to be changed? 	US

Topic Number	Topic Including Brief Description	User of the Accounts (UA) or User of the SORP (US)
Group 4 - Presentation of Financial Statements (including the Notes to the Accounts)		
12	Presentation of the SOFA <ul style="list-style-type: none"> • Link expenditure to income. • Use of an upside-down SOFA. • Link to activity reporting (topic 4). 	UA and US
13	Notes on financial information <ul style="list-style-type: none"> • Guidance on how to reduce the length and complexity of financial information presented – (note that this will be linked to the topic on materiality (topic 15). • Those disclosures that are required by the SORP only should be reviewed to ensure they are still necessary. • Reduce scope to apply the SORP with the use of boilerplate disclosures. • Reconsider the inclusion of complex pension information. (Changes required to FRS 102) • Can clutter be reduced using hyperlinks, signposting and cross referencing? 	US
14	Funds note <ul style="list-style-type: none"> • Consideration of making the funds note more prominent (though it is noted that the order of notes is determined by standards and/ or legislation). • Consideration of extra guidance on this note as this is one some charities can find it difficult to get right. 	US
15	Materiality <ul style="list-style-type: none"> • Guidance on materiality would be helpful (this is especially for larger charities to avoid including too much detail which might obscure the key messages of the accounts). 	US