

SORP and tiered reporting - discussion briefing

Prepared by: Charities SORP-making body

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Purpose

To assist the engagement strands and SORP Committee reflect on the current approach to 'tiering' within the SORP and to undertake a problem solving exercise to identify:

- the option(s) for changing the SORP, if any and if so,
- a preferred option with a recommendation as to what the change to the SORP should be, if any.

Reflection - what does the SORP say about tiering?

The current SORP has little to say about tiering. There are two tiers - 'all charities' and 'larger charities' (income over £500,000 (UK) or €500,000 (ROI)) with more reporting requirements applying to 'larger charities'. Of registerable charities about 7% are classed 'larger charities'. Taking England and Wales only, about a quarter of those charities that must prepare 'true and fair' accounts are classed as 'larger charities'.

For context, the 2005 SORP also differentiated two tiers based on whether an audit was required under a charity law (income £500,000 or more). The simplifications offered for those below the threshold were explained in an appendix. The two tier approach found in the 1995 and 2000 SORPs was defined by reference to audit requirements. The link to the audit threshold was broken when the income threshold was raised in England and Wales to £1m income whereas it remained £500,000 in Scotland and Northern Ireland.

What is the reporting difference between 'all' and 'larger' charities?

The simplifications in the main are:

- In respect of the trustees' annual report, there are significant simplifications with less detail required (see module 1)
- In respect of the accounts, the option for a 'natural' SoFA (module 4), the Statement of Cash flows is optional (module 14)
- In respect of the notes to the accounts, only a few: analysis of staff costs if using natural categories (module 9), group accounting (module 24) and related treatment of associates (module 28) and joint ventures (module 29)

FRS 102 and the scope for changing the SORP to accommodate tiers

The SORP-making body intends to highlight to the Financial Reporting Council (FRC), the case for greater flexibility in order to accommodate the goals of simplification and tiering in respect of the accounting requirements. For the purpose of reflection and problem solving, the engagement strands should assume the request for greater flexibility would be granted. Please note that no undertaking to grant such flexibility has been as yet sought from, or given by, the FRC.

Section 1- the options emerging from the exploration stage

Engagement strands offered a number of options:

Comments from the engagement strands regarding tiering, 'thinking small first' and reconsidering the thresholds for additional reporting requirements were noted mainly from a preparer's perspective. The case put forward was that the needs of those using accounts who want to be able to easily and quickly find information that is of interest and relevance to them would be met if steps were taken to simplify reporting requirements and remove clutter.

- **5 tiers: Mirroring tiering under company law regulations was one option (micro, small, medium, large, listed).** Ideas emerging:
 - whether some of the requirements applicable to medium and large charitable companies should be brought into charity accounts e.g. environmental reports. (PTS(A))
 - whether a further tier to cover very small charitable companies is required (S&IE)
 - further consideration is required of whether the tiers should be better aligned with Companies Act thresholds. (S&IE)
 - tiering could be achieved by pegging the size criteria to the size criteria for a small company and micro entity which would mean that only the largest charities would have to comply with the full FRS102. (Changes may be required to the way section 1A of FRS 102 is applied and potentially to the applicable accounting regulations.) (PTS(B))
- **4 tiers:** There were a range of suggestions coming through here:
 - We would support redefining the different sizes of charities – starting from 'small' through 'medium', 'large' and 'supersized'. We would support a start small with bolt ons as size increases policy. (MFDGPB)
 - Using tiers to reduce the burden of disclosure. Five strands implied or stated support for tiering (MFDGPB) (L) (S&IE) (PTS(B)) (T).
 - Support was shown for reducing or not increasing burden on very small/smaller charities (MFDGPB) (L) (S&IE) (PTS(B)) (T).
 - Whether a further tier to cover very small charitable companies is required and whether the tiers should be better aligned with Companies Act thresholds requires further consideration. (S&IE)
- **3 tiers: There was general support for greater simplification of requirements for smaller charities and for a distinction between 'medium' and 'small' charities.** Thoughts here were that:
 - the option of using 'natural classifications' should be available to more charities, at least up to £/€1m (the audit threshold in England and Wales). (S&IE)

- there was also support for further simplification for charities with turnover below £/€250K, for example in the volume of notes to the accounts. (S&IE)
 - Should consideration be given to raising the £/€500k threshold for small charities under SORP to £/€1m? (PTS(A))
 - Should very large charities, say income over £/€10.2m, be required to provide more information/greater transparency than currently required by SORP e.g. environmental reporting, information on internal financial controls? (PTS(A))
- **Modified 2 tiers:** If tiering is to be introduced, a general sense is that under £/€1m and over £/€1m seems to be the point that makes sense (L) To help those under £/€1m it might mean less disclosures, more templates or examples and less “choice” i.e. make compliance mandatory and simple – too much choice actually makes it more complicated. (L)

Some suggested ways of reducing the reporting burden through tiers were:

- Less disclosures, more templates, or examples and less “choice” i.e. making compliance mandatory and simple. (L)
- Income recognition was specifically mentioned as an area which could be simplified for smaller charities perhaps by also providing a decision tree to assist them. (PTS(B))
- Natural classifications -if a ‘think small first’ approach is taken, the ability to use natural categories in the SOFA should be made prominent in the SORP. “This will make it more likely that smaller charities will be aware of this concession and will therefore use it.” (PTS(B)). Natural classifications were mentioned by two strands in relation to simplifying accounting requirements, either by increasing the amount of charities able to use the concession or increasing the prominence of the concession (PTS(B)) (S&IE).
- It was suggested that increased transparency could be asked of medium and/or larger charities and/or supersized charities. (MFDGPB) (PTS(A)) (T)
- Recommendation: The SORP should adopt a ‘small first’ approach, establishing minimum standards required of all SORP-compliant charity accounts. To recognise the size and complexity of the sector, the SORP should then provide additional accounting and reporting requirements to reflect the risks associated with larger, wealthier, more complex charities. (T)
- Recommendation: Consult on the definition of a ‘large’ charity and the threshold for applying the SORP. Incorporate the results of that consultation in the next iteration of the SORP. (T) Taking a new approach to defining a small entity or less complex entity.

Engagement strand abbreviations

Smaller charities and independent examiners	S&IE
Larger charities	L
Charity trustees	T
Academics and regulators and proxies for public interest	A&R&PPI
Professional, audit and technical strand A	PTS(A)
Professional, audit and technical strand B	PTS(B)
Major funders, donors and government and public bodies	MFDGPB

Observations from the SORP Committee:

- There is a need for greater flexibility for these smaller charities and possibly consideration needs to be given to producing guidance in different tiers.
- The SORP needs to be progressive, in terms of working from the smallest to largest sized charities, though it is recognised that any differentiation between sizes is hard to define.
- The SORP needs to be simplified for smaller charities. Consideration should be given to whether it is possible to have certain concessions or adaptations from FRS 102 to better present information relating to smaller charities. FRS 105 The Financial Reporting Standard Applicable to the Micro-entities Regime is similar but not recommended for the charities sector. Smaller first and a tiered approach is the best approach to producing the SORP.
- Irrespective of size, consideration should be given to the user (reader) of the accounts – who is the user of the accounts? The SORP needs to take into account these users when setting out its reporting requirements and the expectations for the trustees' annual report and accounts. Narrative reporting needs to provide a summary of the activities and financial performance and position of charities.
- Tiering is important – this should allow more accessibility to the SORP's provisions.
- Small charities being at the heart of the new SORP – consideration should be given to a building blocks (or jigsaw pieces) approach for the SORP's guidance. This would prescribe a 'base' position for small charities and the reporting requirements would increase where charities are larger or have more complex transactions. Small charities are the largest users of the SORP. A committee member commented that the main accounts preparers are external accountants and independent examiners.

The SORP Committee will be having its own discussion about what needs to be done and taking the evidence and views from the process as a whole, the Committee will settle on a recommended approach for drafting the SORP based on the evidence presented.

Section 2: What needs to be done?

Step 1- Making the case for change - a ‘basis for conclusions’

From the many opinions a coherent case is needed to define what the tiers should be, how reporting and accounting would differ between the tiers and a rationale for why these tiers make sense to both audiences - the reader and the preparer of the accounts. Without a case for change, no change will be considered because its rationale cannot be explained to those affected.

Step 2 - Identifying the change(s) required to the SORP

Having made the case for change (or retaining the current 2 tier approach) the detailed changes required to the SORP need to be set out. Consideration should be given in as much detail as possible for the reporting requirements for the trustees’ annual report and the accounts that would apply for each proposed tier. Where no detail is given, the assumption will be that the detail is left to the discretion of the SORP Committee and SORP-making body.

Deferred Step- Undertaking an assessment of the impact (savings or costs on the preparer and benefits or disadvantages to the reader)

The FRC will require an impact assessment but until the implications of change are fully worked through the SORP framework, the impact of a new approach to tiering is unlikely to be clear and so this will be deferred and considered at the drafting stage of the process.

Step 3 – Recommendation to the SORP-making body

The case made by each strand will inform the deliberations of the SORP Committee and so there needs to be a clear recommendation setting out:

- The number of tiers with the case for change as to why this is the best solution
- The criterion/ criteria to determine into which tier a charity would fall
- The reporting requirements that would apply for each tier

(If two or more strands wish to provide a combined recommendation then this can be accommodated.)