

SORP COMMITTEE 16 February 2021

PAPER 3 - Engagement strand feedback: User of the accounts perspective

Introduction

This document draws out the main issues that have emerged from the exploration phase of the Charities SORP (the “SORP”) engagement process as they relate to the users of charity annual reports and accounts.

The approach we have taken to analysing the feedback from all six engagement strands is set out in the methodology below. The issues have been organised into six categories. The first four are those used to categorise the engagement strand’s interim feedback for the joint meeting of the Committee and convenors on 17 November. The last two are additional categories which have been added to capture key areas featuring in the final feedback received from the strands.

- The trustees’ annual report
- Presentation of financial statements
- Technical accounting points
- The structure and presentation of the SORP (no points identified)
- Tiering and reporting thresholds
- Education and training and accountancy qualification requirements.

The aim of this document will be to enable the SORP Committee, in partnership with the SORP-making body, to determine which of those issues are to be reviewed in the reflection phase. This is the next phase of the Charities SORP engagement process. The goal of reflection phase is to review the current SORP and related materials with the view to identify the changes needed and detail any shortcomings to be addressed in the problem-solving stage that follows.

Methodology

The submissions made by each of the seven panels (six engagement strands), were reviewed to identify which points were (or could be for) the benefit of the users of the annual report and accounts. There is a separate report to consider the issues from the standpoint of preparers of the reports and accounts and users of the SORP but because some points are likely to benefit both groups there is expected to be duplication between these reports. This reflects the fact that preparers are seeking to tell their charity’s story to the reader and so are likely to address their reporting to these needs.

Due to the number of points identified the report was discussed with the Engagement Strand Convenors to identify the key issues which they considered should be brought forward to the SORP committee.

The report is therefore split into two sections; the key points from the meeting and the more detailed summaries of the written responses.

Where some of the points reference a strand the following abbreviations have been used:

- A&R&PPI: Academics and regulators and proxies of public interest
- MFDGPB: Major Funders and donors and government and public bodies

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- L: Larger charities
- S&IE: Smaller charities and Independent Examiner
- PTS(A): Professional and Technical Strand A
- PTS(B): Professional and Technical Strand B
- T: Trustees

It is worth noting that not all the points put forward by the strands will have been recommend by every member of the strand putting them forward. Not all panellists are equally familiar with the existing SORP requirements and no assessment has been made as to how the existing SORP already address the issues raised as this falls to the reflection stage.

The comments have been grouped by category; identifying how many strands made reference to a particular category. The comments made by the strands have then been included.

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Feedback from meeting

At the meeting convenors were asked to identify the key issues that they considered should be highlighted to the SORP committee for consideration. The main feedback was in the area of the Trustees' Annual Report and the Presentation of Financial information where a number of strands identified key issues. There were also comments raised around the area of support costs and grant accounting. The analysis below identifies which areas were specifically identified as a strand as key; however it should be noted that there was in the main consensus over the points identified.

1 Trustees Annual report

- 1.1 **All the strands** identified the readability and information contained within the TAR as a key issue. The opinion was that the link between the TAR and the financial information needs to be stronger. There should be a greater focus on telling the charity's story; this may include infographics or other ways of communicating beyond just text and links to websites.
- 1.2 **Three strands** stated that some key financial information should be stated in the TAR or in a summary sheet. This would lead to improved usability of accounts as users could easily access information. This would also allow information to be extracted more easily to make comparisons across the Sector which would be used by academics and regulators. (A&R&PPI, L, PTS(A))

2 Presentation of the financial statements

- 2.1 **Four strands** identified reserves disclosure as a key issue. There should be greater clarity as to how reserves are calculated and there should be a greater linkage to performance against the policy. (S&IE, PTS(B), MFDGPB, PTS(A))
- 2.2 **Two strands** made specific comments on more disclosure around the going concern and financial viability of the charity; including disclosures reaching beyond the standard twelve month period (PTS(B), MFDGPB)
- 2.3 **Two strands** would like a greater focus on impact reporting (PTS(B),T)
- 2.4 **Two strands** Support costs highlighted calculations being interpreted differently causes problems regarding comparability (L, MFDGPB)
- 2.5 **One strand** identified the presentation of the SOFA clearly to link costs to the associated income potentially in the format of an upside-down SOFA (PTS(A))

3 Technical accounting

- 3.1 Remove requirements for comparatives for every item and therefore cut clutter (PTS(B))
- 3.2 Permit charities to account for grants using the accrual model (PTS(A))

Analysis of written submissions

1 The Trustees' Annual Report

1.1 Key Facts document

Four strands made reference to a potential 'Key facts' document being helpful; in one strand recommendation it was not clear whether this was to be the responsibility of the Trustees or the Regulator:

- While there is some merit in introducing a 'key facts' page, this should not be mandatory. A requirement to summarise the achievements and plans of the charity in a few bullet points at the start of the Trustees' Annual Report might however be worth considering. (S&IE)
- A suggestion that a one-page towards front of accounts that might summarise key data and indicate the type of charity might be a beneficial uniformly available page for all readers – it should not be complicated and not extend beyond one page, like an info-graphic- our strand suggested templates that already exist. (L)
- The Charity Regulators should consider producing or mandating a two-page summary of a charity's annual accounts and Trustees Annual Report, and share this publicly in a useable and accessible manner. (A&R&PPI)
- The SORP should encourage preparers to include a range of infographics to better inform readers of a charity's performance. Some data sets could be subject to a requirement in terms of format and presentation to ensure essential facts are communicated in a consistent manner to help understanding of a charity's performance and to aid benchmarking. (T)

1.2 Governance codes

Three strands referred to the governance code and to whether it is appropriate to include statements regarding compliance in the accounts:

- Should the Charity Governance code be built into a set of accounts?
Proposed options:
 - charities could adopt the 'apply and explain' principle in the charities accounts rather than making the Code mandatory.
 - compliance with the Governance Code could be included in the SORP as a 'best practice' item.
 - only 'larger' charities could comment in detail on their governance arrangements; charities could include a statement in the accounts to say they had considered/complied with the relevant Governance code. (PTS(A))
- Reporting of compliance with the charity governance codes (for each jurisdiction) should be considered (PTS(B))
- A statement within the TAR outlining which, if any, governance code or standard is applied and why, along with an explanation as to how it performs against that code or standard could help drive the recognition

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1.3 *Presentation of the TAR*

Two strands referred specifically to the presentation of the TAR:

- Better use of infographics could be promoted in order to enable readers to gain a more rounded understanding of the charity's performance; including successes and those activities which were not so successful (T)
- Bring some key financial figures into the narrative and/or mandate some financial information in the front-end (PTS(A))

1.4 *Public benefit reporting*

Two strands referred to the need for public benefit reporting in the TAR:

- Demonstrate in a narrative how the charity provides Public Benefit rather than just a bland statement that it does (MFDGPB)
- SORP guidance should be adjusted to place the governance and public benefit advice front and centre, given that these are purported to be the ultimate concerns of the Charity Regulators (A&R&PPI)

1.5 *Other points*

Other points raised by individual strands in relation to the Trustees Annual Report are as follows:

- Charities should be making more use of the annual report and should not, as is the case in some instances, seek to avoid including impact or similar information elsewhere so that it falls outside the scope of the external scrutiny report. (PTS(B))
- The charity needs to demonstrate that:
 - It has good financial management in place (MFDGPB)
 - The Trustees are aware of their legal duties and responsibilities, and that they have complied with those requirements, and that they have protected and not been profligate with the charity's assets. (MFDGPB)
 - That the Senior Management have also complied with their duties and responsibilities to service users, the general public and the staff (MFDGPB)

2 **Presentation of the financial statements**

2.1 *Reserves*

Five strands commented on the presentation of reserves information. The points raised were:

- We would like to see Fixed Asset Reserves shown in the Designated Reserves section for all charities. Currently funders find these anywhere in the Reserves section and sometimes not included at all,

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and more often there are no details as to how they have been calculated. (MFDGPB)

- More communication is needed on why different charities carry different reserves. (L)
- Reserves could be usefully tied into existing disclosures such as future developments in the business. (L)
- A reserves calculation together with a reconciliation to the primary statements could be included in the notes to the accounts. (PTS(A))
- A definition of reserves could be included in the SORP; this should be linked to explaining the liquidity position of the charity and to going concern disclosures. (PTS(A))
- Reinstate requirement that charities provide an explanation about why their actual reserves differ from stated reserves policy. (PTS(A))
- Reserves are often not calculated correctly. A lack of understanding of reserves can have a knock-on impact on the quality of a charity's financial review (PTS(B))
- A new note should be introduced requiring charities to report their 'free' reserves with appropriate guidance on how to calculate these. (PTS(B))
- Requirement to report cash balances and forecasts as well as reserves. (T)

2.2 *Impact reporting*

Four strands raised the point regarding a focus on impact reporting for all charities.

- Should reporting impact be a requirement for all charities? (PTS(A))
- Renewed or enhanced focus should be placed on proper impact reporting by charities, given that this is an area of interest to academics, regulators and the public alike. (A&R&PPI)
- Impact reporting requirements should be introduced to enhance reporting by charities on the difference they are making. (PTS(B))
- More focus on reporting impact rather than activity (supported by trustee survey results) (T)

2.3 *Linking narrative and financial information.*

Four strands highlighted a need for better links between the narrative and financial information in the accounts:

- The construction of the Statement of Financial Activities, and the volume and ordering of the notes to the accounts often makes it difficult to relate the accounts to the TAR, this might be mitigated by greater use of natural classifications. (S&IE)

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- Create a clearer link between the narrative and financial aspects of a charity's performance (supported by trustee survey) (T)
- There are occasions where the notes do not reflect the main body of the report, or accounts or where the notes are omitted or wrong because the narrative and numerical parts of the document are not joined up well. (T)
- Encourage the reporting of a charity's performance to be more rounded, linking it with the charity's approach to and management of risk (T)
- All relevant information (financial and non-financial is grouped under a theme (income, expenditure, reserves/resilience, public benefit). Requiring charities to bring financial and non- financial information to bear on addressing each theme would greatly enhance clarity and readability of annual reports. (A&R&PPI)
- There should be a greater focus on the report and accounts as a package which together tell the story of the charity and its finances. For example, risk management information should be more meaningful and closely linked to the accounting information (PTS(B))

2.4 *Support costs*

Three strands raised the fact that the current requirements around the calculation of support costs led to a lack of comparability in the financial statements:

- A subjective division of costs incurred, which varies from charity to charity, thus giving no direct comparison from one charity to another operating in the same field. By not allocating all costs to charitable support costs also gives the impression that some costs are 'bad' costs, whereas all charities necessarily incur admin costs in order to run the charity. (MFDGPB)
- The current approach to allocating support costs doesn't enhance the comparability of charity accounts and can have a knock-on effect on a charity's KPIs. (PTS(B))
- Further guidance for uniformity required plus clarity that all costs, once appropriate to a charity, are essential i.e., avoid any sense of 'overheads are bad'. There is a sense at the moment that charities are in desperate competition with each other to declare how much in each £ is spent on front line services and this leads to significant divergence on interpretation of support costs. (L)

2.5 *Going concern*

Two strands raised particular comments about the narrative reporting of going concern.

- There should be some narrative around the specific requirements of

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each charity to ensure that it is a going concern, as to how the Trustees calculate their requirement for Free Reserves based on their Going Concern requirements. There is a perception by some preparers that there is a statutory requirement to have a blanket three month provision. The current declarations are somewhat bland, short term and differ from charity to charity in their calculation. (MFDGPB)

- Enhanced disclosures around going concern should be considered for charities (PTS(B))

2.6 *Presentation of the SOFA*

Two strands raised specific comments on the presentation of the SOFA

- SOFA presented to clearly link costs to the associated income, where appropriate. (PTS(A))
- Upside down SOFA - should the SOFA be presented upside down, starting with what the charity does; then showing the cost of this to the charity and finally showing how the cost was funded. This could be more helpful when a charity is trying to raise funds. Another option would be to start with net resources available. Noted that would not fit all charities due to the requirement to be CA2006 compliant (PTS(A))

2.7 *Other points*

One strand raised each of the following comments:

- If there are disclosures in respect of payments for services from Trustees there should be an explanation as to why those services were not sourced outside of the organisation, and whether value for money was achieved. (MFDGPB)
- Better information on investments and private benefit to trustees. (A&R&PPI)
- Formatting accounts to meet user needs
- Should accounts be designed to meet the needs of stakeholders? (PTS(A))
- Details of future funding be included in the accounts, for example, a 3- or 5-year plan. (PTS(A))
- Review the approach taken in presenting the information in the balance sheet. Consideration to be given to a columnar balance sheet (by funds); but no consensus reached as this could be confusing. (T)

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3 Technical accounting

3.1 Income recognition and grant funding commitment recognition requirements

Four strands commented on this area, primarily raising concerns about distortion of the accounts and the ease of understanding by readers

- Concern that the SOFA can be distorted and the current rules result in confusion for trustees and funders - this distortion comes from recognising income and grant funding commitments relating to future years where no conditions are attached (PTS(B))
- Treatment of capital grants can be distortive to service provider debtors (MFDGPB)
- Provide the option for charities to account for grants using the accrual model too with additional narrative disclosures – this could help those more familiar with the concept of profit and loss to better understand a charity’s financial performance. The recognition of income in advance of related expenditure can give the impression that the charity’s financial position is better than it is and this may impact on funding applications (PTS(B))
- Donated goods and services – with the exception of donated buildings should be shown as a note rather than included on the SOFA . (MFDGPB)

3.2 Decluttering accounts

Three strands commented on the current requirements leading to clutter in the accounts

- Comparative figures make the accounts very cluttered and leads to more onerous requirements for charities and challenges in presenting these. Amendments to FRS102 may be required to resolve this issue but the possibility of a SORP-only solution should be investigated (PTS(B))
- One strand noted in particular that the inclusion of the full SOFA from the prior year seems unnecessary given the summary comparative information on the face of the current year’s SOFA and also the movement of funds note (MFDGPB)
- Consideration needs to be given as to what disclosures in the current SORP add little value and these could be removed, standards and regulations permitting. Also, what items could be removed from the TAR and replaced by a link to other information produced by the charity (PTS(A))

3.3 Reporting on the remuneration of executive/senior staff

Two strands suggested points on this topic:

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- Pay disclosures should be enhanced to provide more transparent information on executive/senior staff pay. Consistent with the needs of charities to be accountable to a wide group of stakeholders (PTS(B))
- If there are disclosures in respect of payments for services from Trustees there should be an explanation of why those services were not sourced outside of the organisation and whether value for money was achieved (MFDGPB)

3.4 *Cash flow statement – comments around the usefulness of this statement*

Two strands questioned how useful the statement currently is:

- One suggestion is that it would be more meaningful if it reported cashflows by different categories of fund (unrestricted, restricted and endowment). Consideration of how to improve the information contained in the statement and the accompanying notes may be worthwhile as might the criteria for preparing a cash flow statement since the complexity and not just its size could be a factor in determining whether a statement of cashflows should be prepared. (PTS(B))
- Another strand suggested that the statement is just not helpful as it contains historic information that cannot be found or verified elsewhere in the financial information. (MFDGPB)

3.5 *Pensions disclosure*

Two strands raised points in this area:

- Highly technical declarations often taken straight from actuarial reports. Often the longest note in the accounts inadvertently implying this is the most important information. Where a pension deficit is recognised there should be more narrative but this could be tied up with going concern too. (MFDGPB)
- Reporting for charities operating or participating in a defined benefit pension scheme should be revised to more accurately reflect the potential liabilities and ensure consistency between pension scheme treatment where the charity has more than one scheme. The information should be aligned to publicly available information relating to risks, reserves and other liabilities (T)

3.6 *Other points*

One strand raised each of the following points:

- Distinguishing expenditure as charitable and non-charitable is problematic as in normal circumstances all expenditure should be considered charitable (PTS(B))

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- Give greater prominence to the funds note (PTS(B))
- Materiality – providing a guide on materiality would help very large charities to be clear about what does not need to be included in the accounts and would therefore support better readability and brevity. (L)
- Better information on investments (A&R&PPI)
- The idea of consulting on and reviewing the possibility of introducing another accounting standard that bridges the gap between Receipts and Payments accounts and SORP accounts or incorporates some element of international reporting standards currently applicable to small or micro for-profit entities was suggested by one strand. That strand put forward an alternative to this as well which would be to develop an approach where charities are permitted to adopt those aspects of the SORP that benefit their reporting needs that would then be explained in the annual report and accounts with the reasons for the decision and perceived benefits of the approach. (T)
- The SORP Committee should publicly state how the work on IFR4NPO relate to that of the SORP in the medium and long term and consequently how that is likely to affect charities (T)
- Comparability – do we want to be able to compare one charity to another in terms of the accounts and how would this be built into the SORP? (PTS(A))

4 The structure and presentation of the SORP

The language of the SORP; jargon and inconsistent definitions is taken through to the accounts themselves; meaning that the readability of the accounts is adversely effected (T)

5 Tiering and reporting thresholds

Comments regarding thinking small first and reconsidering the thresholds for additional reporting requirements were made by the majority of the strands, mainly from a preparer's perspective. However, the need for simplification speaks also to 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.

6 Education and training

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Similarly comments on education and training were made by a number of strands, albeit from different perspectives:

In relation to the quality of accounts that are produced the major funders strand identified concerns about accounts that appear to have been prepared with no reference to the SORP and whether the accountancy profession needs to review this area.

The smaller charities and independent examiners strand considered education and training from a different perspective, expressing the view that charity trustees often do not understand SORP accounts. Charity trustees are potentially both users of the SORP and users of the accounts and so their understanding of the reporting requirements and the resulting accounts is clearly important.