SORP COMMITTEE 23 February 2021

PAPER 2 – Setting the scene for discussion

1   Introduction

This is the second of two Committee meetings in February designed to conclude the exploration phase of the new SORP development process. Each meeting will focus on issues from a particular user perspective and consider the feedback from the engagement strands on that user perspective along with other relevant research that the Committee looked at through the three meetings in November. The aim is to settle on the key issues and topics that we will take forward into the reflection stage, recognising that it may not be possible to take forward all points in this development exercise.

The previous meeting focussed on the user of charity annual reports and accounts and in our second meeting, our attention will turn to the user of the SORP, the preparers of charity annual reports and accounts.

2   Users of charity accounts

From the outset in this new SORP development process, we have indicated our intention to examine the needs of both users of charity accounts and users of the SORP recognising that many of their needs will overlap. We want charity accounts to be more helpful and useful to those reading them and this means that we need to have a framework that is sensible and meaningful for charities and the users of accounts whilst meeting the requirements of accounting standards.

3   Engagement feedback

Following on from the interim feedback provided by the engagement strand convenors on 17 November, each convenor has since produced a final report on their work within exploration phase and has prioritised a small number of issues that their strand see as the most critical ones to be taken forward. There is a large degree of commonality between the engagement strands with many of those key issues, albeit there are some different perspectives. Paper 3 provides the detail of the issues that the strands have identified as requiring further consideration as well as their key priorities for attention. The paper was developed based on the reports from the engagement strand convenors and a discussion with all convenors to identify their key priorities.

As part of the engagement work conducted so far, there have been some research exercises initiated by some strands. Not all of this work is complete yet so full results are not available for consideration by the strands or indeed the Committee but once these are available, these will be shared to support further consideration of issues being taken forward.

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4   Research

The retiring SORP Committee reported with four working groups identifying priorities for the next SORP and these also emerged from the exploration stage feedback (paragraph references in paper 3 in brackets).

- Smaller charities- disclosures (section A paragraph 3.2, and section C) section 1A of FRS 102 (section A paragraph 5) SORP structure (section A paragraph 4)
- Tiered reporting (section A paragraph 5)
- Governance – pay disclosures (section A paragraph 2.7), performance reporting (section A paragraph 2.2) and terminology (section A paragraph 4)
- Transparency- full story (section A paragraphs 1.3 and 2.3), key facts (section A paragraph 1.1), support costs (section A paragraph 2.4), fundraising costs (-) and digital and graphics approaches in reporting (-)

Discussion points from the series of research presentations

CCEW SORP paper had a user research focus. This paper generated discussion about charitable expenditure versus non charitable expenditure and at the time the committee considered there to be opportunity to start to re-educate so that the public might understand that direct and back office costs meets the definition of charitable expenditure.

Key facts discussion- It was noted that a 'at a glance' summary could promote accountability and transparency though it would need to be principles based so each type of charity would be able to produce the facts relevant to its individual circumstances and the charity's understanding of their users' needs. The committee noted that it was not just size that was relevant in deciding reporting needs but also to reflect the type of charity and what it does.

Income recognition- Committee members noted receiving feedback from clients that capital grants are an area the SORP may be able to provide more recommendations.

Senior staff pay- the Committee reflected on the fact that there were challenges to the sector in reporting remuneration in terms of what it is paid and the ratios that can be produced but care needed to be taken to add context to this information and it needs to be made clear is that all monies received go to the charitable causes.

In telling their charity's story, the PwC Building Public Trust Awards considered public sentiment and what is important to the public, with main reporting themes being:

- Charitable purpose and clarity
- Alignment of strategy, purpose and achievements
- Demonstration of a link between vision, strategy and values
- Measuring success and outputs
- Valuing impact

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Regulating in the Public interest Joanne Edwardes CCEW.There was a discussion around CEO pay following the public trust research report presentation.

Public polling- OSCR and CCEW fed back as to the results of their most recent surveys of the public. OSCR's survey found that the key factors to increase trust were around accountability and transparency, seeing the work that has been done with money donated, seeing how much is spent on administration and being open about what the charity is doing. CCEW's survey identified similar issues that are important for public trust in charities. The issue of charity CEO pay was again brought to the fore too. Our reflections at that time in terms of the impact for the SORP were summed up as *'there should be no numbers without a story and no story without numbers'*.

5   Committee discussions to date

At our December meeting, Committee members each set out their top three topics or conclusions from the exploration stage based on thoughts and materials reviewed at that point. The minutes of that meeting will provide a reminder of the thoughts expressed. Amongst others, there were common themes emerging around:

- Thinking small first
- Tiered requirements
- Support required for charities to prepare SORP accounts
- How emerging issues such as environmental and diversity are dealt with
- Reporting of expenditure

6   SORP convenor top preparer issues

At a meeting with the convenors of the engagement strands, the SORP-making body asked for their top concerns from a preparer perspective. Each strand had its own points for emphasis and these were:

Small Charities & Independent Examiners:

- Noted that there was an overlap between the two papers and that a lot of front end of the paper was directed more at users than preparers.
- The idea of numerical example did not come across clearly.
- The ability to use natural classifications should be made more prominent and this should be available to more charities. Most preparers are not aware of the availability to use natural classification.
- There are issues around recognition of income and definition of reserves. It would be helpful to have these things articulated more clearly.
- With regards to the trustees annual report we should not get to a point where there is an invitation to use SORP but rather people should be encouraged to think about what they want to say and say it in the appropriate way.

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Professional and Technical Strand A:

- Trustees Annual Report – unifying the 'front and back' to some extent by mandating the bringing forward of some key financial information in the narrative.
- Reserves – More guidance on how to calculate free reserves and how the definition of reserves should be tied into the liquidity of the charity and going concern disclosures. This is particularly pertinent with the situation presented by Covid.
- Adherence to FRS 102 – recognition that much is dictated by FRS 102 and that this is a standard based on for profit reporting that isn't necessarily fit for purpose for not for profit reporting. The inclusion of comparative figures for all items in the accounts causes them to become cluttered and causes difficulties for some charities.
- Build in an appendix with worked examples, or extracts of reports showing the accounting disclosures for certain complex areas.

Legacies were a particular interest and there was mixed opinion – some felt that it would be beneficial to have greater clarity on the accounting model to be adopted, to remove the need for Trustees to exercise judgements as to when to recognise the income. There was a question mark over whether flexibility should be maintained or a fixed treatment mandated.

Professional and Technical Strand B:

- The development of a tiered approach to requirements with a focus on 'think small first' or on requirements for less complex entities.
- Charities need to be more transparent than companies of a similar size but there is a sense that smaller charities are overburdened. The strand had a discussion around linking the tiered approach to the small company regime but the micro entity type approach would not fit the level of transparency that is needed for charities.
- Changes to the recognition of income and funding commitments. The main focus of discussion was around income and allowing for the ability to use the accrual model.
- Remove the requirement to allocate support costs with natural classifications used instead. The strand was thinking of putting a threshold on it or taking more radical approach of abandoning the support costs altogether. The current method is time consuming and is not done objectively as a result accounts of two different charities are not comparable.

Charity Trustees:

- Use of language, definitions and jargon makes it difficult for non-accountants to understand and apply properly.
- Agreed that tiered approach should be considered further.
- Need to provide education, training and resources to those who has no accounting background.
- Need to get back to the first principle - What is SORP trying to solve and does it solve these problems?

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Large Charities:

- Pointed out that the preparation of the trustees' annual report for larger charities can be a time consuming exercise.
- Matching principle – discussed issues around income recognition and its impact on the level of reserves. There is a need to explain why the level of reserves is higher than what it should be. This creates confusion. Strongly argued that there had to be more consistent/ common sense approach.
- Analysis of expenditure – it is a complex thing to do. This could be simplified and still be transparent.
- The development of a tiered approach to requirements with a focus on 'think small first' and add complexity as you go. Instead of giving everyone the option and then requiring smaller charities to decide what to take out we could do it another way around by making compliance mandatory and simple for smaller charities and let bigger charities do the hard work.

Major Funders, government and public bodies:

- Funders do not like charities with large professional fees for preparing their accounts. The strand would support the suggestion to focus on 'think small first'.
- The development of a tiered approach should be based on a number of different criteria rather than just based on income.
- Rules around Income recognition are confusing and this is something that should be looked at. The strand could not agree on legacy income and the convenor suggested some more debate around it.
- There is a huge difference between some of the abilities of those who prepare accounts for charities. Some preparers have no concept of the Charities SORP accounts and in a lot of cases the accounts are not SORP compliant.
- Raised issued around going concern. Trustees are legally responsible for everything that happens within their charity and there are no responsibilities on the CEO. Would like to bring in future proofing on charities with so many new government initiatives that are coming in. There is a lot of non-financial information that can help to tell the story.

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7   Our aim for today

We now need to consider all feedback received so far and relevant research presentations and decide on the key topic areas that we want to move forward with in the next phase. To help us do that, paper 3 provides a comprehensive readout of the engagement strand conclusions and priorities to support identification of the detail of the topics or areas to be considered further.

Paper 3 distinguishes those issues in common with the reader of the reports and accounts (section A), identified in the paper prepared for the previous meeting, from those issues that have a unique preparer focus (section B). It concludes with some nuances (section C) around matters that may lie outside of the gift of the SORP development process.

We should aim to have some firm conclusions from our discussion today to take into the reflection and problem solving stages:

- Those issues already agreed that are to be progressed from a reader's perspective that will also be considered from a preparer's perspective (section A)
- Those issues in section A to be considered from only a preparer's perspective
- Those issues unique to preparers (section B) to be considered
- Those nuances that will also be considered (section C), if any; and
- Agreement that all other issues noted in both the perspective from a reader's viewpoint and from this paper (sections A and B) that are not being taken into the reflection stage are instead carried forward by the CIPFA Secretariat for future consideration by the Committee at the drafting stage.