



Consultation response:

Research exercise on charities SORP (FRS 102)

Response from the Association of Charitable Foundations

December 2016

1. **Association of Charitable Foundations (ACF)** is the membership association for foundations and charitable grant-making trusts in the United Kingdom. ACF's priorities include enabling trusts and foundations to achieve good practice in grant-making and helping them to be effective in the many ways that they use their resources for charitable purposes.
2. ACF has 340 members. They range in size from large foundations with paid staff distributing over £20m a year each, to small often local volunteer-run trusts distributing less than £100,000 a year. Together they give over £1.7 billion a year to a wide range of charitable causes.

This submission

3. This response is informed by direct contact with members as well as our own insight gained from working with funders for 25 years. Our members have a crucial perspective in that they have a dual role:
 - They are charities in their own right, required to produce their accounts and report in accordance with the SORP, but distinctive also in that the majority have substantial financial assets that they manage.
 - They are also organisations that use charity accounts and need to understand the audited accounts and annual reports submitted to them by charities seeking grants or other forms of financial assistance.
4. We represent trusts and foundations in their role as charities with assets and as a prime audience of charity accounts. For this reason, not every issue raised in the invitation to comment is of direct concern to our members. In fact, a key message from member consultations was that foundations, as readers of their applicants' accounts, are in a position to ask for further information of an applicant if it is necessary. Therefore clarity about what is required by the SORP is as important to funders as the disclosures themselves. Where foundations have no identifiable direct interest, we believe the response

submitted by Charity Finance Group adequately covers the concerns of those responsible for preparing charity accounts.

General comments

5. We are grateful for the opportunity to comment in this early stage of the research exercise to support the SORP Committee as it seeks to make charity accounts a helpful and transparent resource, and particularly one that is proportionate and reasonable for the management of charitable resources and purposes. At this early stage of research, we wish to draw the Committee's attention to the needs, concerns and ideas expressed by our members which the Committee may consider when revising and drafting the guidance. We are also willing to work with the Committee in drawing up proposals based on feedback from this research exercise.
6. In this response we wish to draw the Committee's attention particularly to three themes that emerge when consulting our members – good governance, clarity and transparency – when considering how the SORP might be further developed.
7. **Good governance.** Charities which are well governed and focused on their mission readily comply with the requirements of the SORP and will continue to meet the standards set by the SORP. Meanwhile less well-governed charities are less likely to comply. Further detail in the SORP could therefore add to the administrative burden of already compliant charities. Proposals to increase the requirements of the SORP to ensure compliance must be proportionate and coupled with other actions to ensure charities have the capacity to comply. For instance, there are many programmes which support capacity-building in charities, which in turn lead to better governance and better compliance.
8. **Clarity.** In calling for clarity, we do not believe that one-size-fits-all solutions which aim to standardize charity accounts would work given the diversity of the charity sector. Nor do we believe that greater clarity in the guidance is necessarily desirable if it increases the length of the SORP or the burden on charity administration. Rather the SORP should set a clear standard framework for a diverse sector and provide clarity to readers about that they can expect to find when reading charity accounts. This would facilitate the reader's understanding and enhance transparency and accessibility. In particular, we would highlight the trustees' report (see paragraphs 15 to 19) and support costs (paragraphs 24, 27 and 28) which are interpreted very differently within the sector, and further clarity in the guidance as to the purpose of such disclosures would enhance the standards of charity accounts.
9. **Transparency.** Several audiences have expressed a desire for greater transparency in order to maintain or increase public trust in charities. However, as further disclosures are required and the SORP grows in length, it becomes harder for readers of accounts to locate the salient points. Combined with the variation mentioned above, the result is that charity accounts in fact risk becoming *less* transparent. In addition, the desire to be transparent must be balanced with sensitivity to donor privacy as well as the administrative burden that further disclosures place on charities. Any additional disclosures or transparency requests therefore ought to be proportionate to the charities they affect, taking into consideration not only income but capacity, resources, stakeholder concerns and other features that vary among charities.

Responses to the SORP research consultation questions

Section 3.1: The SORP's structure, format and accessibility

Q1. Do you agree that the new format of the SORP meets the needs of all those preparing accounts using the SORP, including smaller charities? If not, what improvements should be made and why?

10. On the whole, feedback from funders suggests that the new format by and large meet charities' general reporting needs, although many commented that they have not seen accounts prepared under the current SORP so soon after it came into effect. However, one particular area to which we would like to draw the Committee's attention is that of charities with investments that take a total return approach to their management. A total return approach permits trustees to spend any part of the investment return from the endowment including income, dividend and capital growth. We believe that improvements must be made to the reporting of capital gains, as explained in detail in paragraph 29 of this response. The Committee might review the SORP taking into consideration the needs of many charities already taking the total return approach and the ease of reporting for any considering adopting a total return approach. The Committee may also bear in mind that in Scotland, the total return approach is not permitted, and this variation must be taken into consideration when addressing the highlighted issue.

Q4. Given the requirements for financial reporting that are now explained in FRS 102, is the retention of a SORP still necessary for the charity sector? Please give reasons for your answer.

11. Feedback from trusts and foundations has largely supported the retention of the charity SORP. It provides sector-specific guidance which is especially useful for smaller charities that may not have the capacity or resources to implement the requirements of FRS 102 without such bespoke support.
12. However, several members highlighted the important role that external accountancy and auditing firms play in preparing and auditing charity accounts. There are many cases in which an accountant or auditor may not apply any sector-specific knowledge; in such cases, the accounts are prepared in accordance with FRS 102 without reference to the charity SORP. Therefore the Committee should consider ways of promoting the charity SORP among external firms and even independent examiners in preparing and auditing charity accounts.

Section 3.3: SORP Committee member suggestions for changes to the SORP

Q6. Do you agree that there needs to be a third tier of reporting by only the largest charities and if so what level of income should that reporting requirement apply?

13. Feedback from trust and foundation practitioners has been mixed concerning this issue. The current demarcation of smaller from larger charities is mostly considered beneficial in acknowledging the

diverse reporting needs and capabilities of charities of different sizes, and so reducing the bureaucratic burden is a welcome relief for many smaller charities.

14. On the other hand, several disadvantages were highlighted to which we would like to draw the Committee's attention. Income alone is not a reflection of a charity's needs and capabilities. For example, there are many foundations that have relatively large assets from which they draw their income but which only employ a small number of grant-making staff as the vast proportion of their expenditure is made in the form of grants to other organisations. Defining boundaries based on income alone would be problematic in such a case without consideration for assets, endowments or staff. It is also problematic for charities whose income is fluctuating and which may shift them regularly between 'tiers', causing them to face different requirements from year to year. The different requirements may also add to the complexity of the accounts for the reader who may not find the information they expect. If the Committee wishes to consider defining boundaries then it must also consider whether the action may increase the complexity of the accounts given the varied models of charity finances.

Q8. Do you agree with one or more of the four suggested areas for review of the trustees' annual report recommended by the SORP Committee? If so, which ones do you support and if you do not support any of these suggestions, please give your reasons as to why not?

15. **i. Better integration of the report with the accounts:** The feedback from ACF members regarding the trustees' report was varied, and reflected their experiences of reading and preparing the report which revealed different interpretations of its purpose. We highlight some of these interpretations to demonstrate to the Committee that the purpose of the report could be clarified to enhance understanding of a charity's public benefit in the context of the accounting principles of the SORP.
16. Several members view the trustees' report as an opportunity for charities to demonstrate their impact in quite specific terms as well as tell their story. Other members however felt that the SORP was not the appropriate mechanism to encourage charities to demonstrate their impact and therefore read this section as providing a space to add contextual information to what is essentially a technical and financial document.
17. If the view is that the report should give greater priority to impact and outcome measurement, we would observe that – while charities should very clearly think about how to understand and communicate the difference they make – there must be a degree of proportionality and a recognition that doing so in quantitative terms is not always possible: for example for small charities working with complex social issues, promoting environmental protection or providing scholarship funds. There is then a risk that charities who find it difficult to measure their impact in quantitative terms might be perceived as 'less compliant', which would be misleading.
18. Although the current SORP provides guidance on the purpose of the trustees' report, experience shows that it is still open to interpretation, which leads to inconsistency and complexity that ultimately frustrate the desire for transparency. Further clarity in the guidance would ensure charities understood the requirements of the trustees' report, its purpose, and what is better reported elsewhere. Such clarity may also illuminate the relation of the trustees' report to the accounts, and the Committee may wish to use this as a point of departure when considering the integration of the two components.

19. While, as funders, ACF members generally desire more information and greater standardisation to achieve comparability, we acknowledge that this need must be balanced against the overall public interest in reducing the bureaucratic burden on charities, and maintaining the usefulness of the SORP as helping charity trustees understand, manage and account for their own organisation and in terms which make sense in their context.
20. **ii. Detail of reporting:** We are not clear what details the Committee believes are missing from current reporting. If there is a lack, then we suggest that addressing the purpose of the trustees' report, as outlined in paragraph 18, and providing clearer guidance may go some way to establishing what detail is necessary in relation to the accounts, and what detail would then be required in the accounts that is not already sufficiently covered.
21. **iii. Key facts summary:** Practitioners that we spoke to overwhelmingly expressed that the inclusion of a key facts summary is not necessary for several reasons.
22. Firstly, each funder has different procedures for making grants and therefore makes its own decisions on what can be considered 'key facts' in a charity's accounts. This is by necessity a subjective reading, and so a standard key facts summary would not be useful to every reader of charity accounts. A related consideration is that the diversity of the sector would not be fairly represented by a key facts summary. For example, when considering trusts and foundations as preparers of accounts, many with permanent endowments may appear to spend a small proportion on charitable activities, but the simplicity of a summary would not necessarily show that the endowment must be preserved in perpetuity and misrepresent the organisation's very long term objectives in relation to their 'charitable activities' and 'beneficiaries'. A key facts summary would create false comparisons and be neither a true nor fair representation of charitable expenditure in all its intricacies.
23. Secondly, **paragraph 4.4 of the SORP** states that "*[t]he statement of financial activities (SoFA) is a single accounting statement that includes all income, gains, expenditure and losses recognised for the reporting period. It provides the user with an analysis of the income and endowment funds received and the expenditure by the charity on its activities, and presents a reconciliation of the movements in a charity's funds for the reporting period.*" In this sense, the SORP is already a summary of the key facts from throughout the charity's reporting year. Adding a summary as an appendix only serves to add to the length and complexity of the SORP. The information presented as suggested by the Committee is already available elsewhere, for example and notably on the Charity Commission for England and Wales website. For readers who only wish to see 'key facts', this format should be sufficient, and if this is considered useful, the Committee should consider the ways in which the other regulators demonstrate charity data.
24. The Committee might bear in mind when considering expenditure as a proportion of income that as public benefit institutions, all expenditure by a charity serves the charity's beneficiaries in a direct or indirect way. The Committee might also consider how simple representations of charitable expenditure may lose that message and negatively shape public perceptions of support costs, which are vital to the running of any charity.
25. **iv. Reserves definition and guidance:** Further guidance on reserves would assist grant-makers in making independent and informed decisions regarding who to fund, but must be proportionate to the sums involved and the capacity of the charity. Although **paragraph 1.22 of the SORP** requires charities

to explain why reserves are held (usually expressed in the form of running costs for a number of months), it may be more useful to explain the rationale behind that decision under the circumstances of the charity. Many charities already choose to give such explanation, and any further guidance should of course be proportional to capability. But the availability of such information may better inform the reader of the financial sustainability of the charity and indicate the style of governance.

26. The Committee may also wish to review the inclusion of capital items in the reserves. Using the example of property, this cannot easily be liquidated in times of crisis and the sale of a property may hinder or even terminate the charity's ability to operate. The Committee might clarify the inclusion or exclusion of particular capital items within guidance on reserves.

Q9. Do you agree with either of the two suggested areas for the review of the accounts recommended by the SORP Committee? If so, which ones do you support and if you do not support any of these suggestions, please give your reasons as to why not?

27. **i. SoFA – more specific definitions of support costs and fundraising costs:** We are pleased that the Committee is considering reviewing support costs and fundraising costs. Given the diversity of fundraising and staffing models in the sector, we would argue, based on ACF member feedback, that 'support costs' can be a meaningless indicator of how well run, how efficient or how effective a charity is. In fact the evidence¹ suggests that high-performing charities spend *more* on administration costs than do weaker ones. As for fundraising costs, there are many ways in which charities raise funds that require vastly different levels of expenditure. Current guidance does not make it clear that this diversity in spending on support costs is related to the diversity of the sector and bears no true reflection of good or poor practice. Charities should not feel pressurised into believing that lowering their support or fundraising costs or redistributing them is necessary to secure public trust or funding.
28. Having said that, it would not be good accounting practice to remove support costs or fundraising costs altogether; as expenditure they ought to be disclosed. However their meaning may be made clearer to readers of accounts if the definitions were clarified. As it stands, some foundations observe that charities with greater resources are able to allocate support costs across a number of single activities (in accordance with **paragraph 8.7 of the SORP**) to minimise the amount deducted from unrestricted funds. This leads to inconsistent practice across the sector. Therefore specific definitions of what support costs include and how they should be allocated may be useful to encourage consistency and clarity. **Paragraph 8.7 of the SORP** could be clarified to ensure support costs are consistently and fairly reported in a way that does not add to the administrative burden on charities or the misconception that support costs should be reduced.
29. **Additional observation:** As mentioned in paragraph 10 of this response, the current SORP does not allow charities with investments taking a total return approach to their investment to account for it appropriately. A total return approach permits trustees to spend any part of the investment return from the endowment including income, dividend and capital growth. **Paragraphs 4.39 and 4.40** (covering all endowments) and **Paragraphs 20.3 and 20.8** (covering permanent endowments) **of the SORP** do not allow foundations to show the amount of capital that trustees have converted to income that year clearly in the total income column. The SORP requires the recognition of the income converted to

¹ <https://giving-evidence.com/2013/05/02/admin-data/>

capital in the restricted and unrestricted columns to have a corresponding amount of 'negative income' in the endowment column, as opposed to recognising that what is being converted are investment gains, not a withdrawal of the original gift. This can give the entirely misleading impression that expenditure is disproportionately high compared to income and that the charity is mismanaged. We suggest that the Committee might review these paragraphs to clarify how charities with investments might better show the conversion of capital gains in the endowment to income available for expenditure.

Section 3.4: Charity regulator suggested themes for making changes to the SORP

Q.10 Do you agree with one or more of the six themes for review of the SORP suggested by the charity regulators? If so, which themes do you support, or if you do not support any of these suggested themes, please give your reasons as to why not?

30. Our comments on the themes to review are given in the answer to question 11, paragraphs 31 to 43.

Q11. If you do support one or more of the suggested themes, which, if any, of the specific issues identified within each theme do you agree needs attention in the next SORP? Alternatively, if you do not support any of these suggested issues, please identify the issues that need to be addressed and explain your reasons why?

31. i. **Making a difference for the public benefit:** ACF members we spoke to are generally satisfied that current disclosures around a charity's public benefit are sufficient; by definition, charities work only for the public benefit and to expand on this would only add to the length of the narrative report. Charities which involve beneficiaries in service design should be encouraged to share their processes where appropriate, but it would be misleading to state this as best practice, as for many charities this is not feasible or proportionate to their capabilities.

32. There are some issues for trusts and foundations that ought to be considered. Firstly, foundations – because they fund other organisations who deliver services – are often themselves at some steps from their ultimate beneficiaries. Foundations therefore do not deliver a service in the way other charities do, and they must account for their impact on beneficiaries in ways that make sense in their context. Secondly, the Committee must bear in mind the situation of charities, including foundations, whose beneficiaries are not definable or tangible, for example those involved in environmental conservation or whose charitable objectives are general. Such charities would risk distorting their message or losing the nuance of their work for public benefit if further guidance required charities to summarise their impact in a particular way.

33. ii. **Risk management:** Members expressed that, from a reader's point of view, **paragraph 1.46 of the SORP** elicits sufficient information about a charity's risk management, and such requirements are a useful way to encourage charities to consider the wide range of risks they may face. There is a concern however that any additional requirements or guidance would only encourage 'boilerplate' or standard

form responses that would add to the length of reporting without adding meaningfully to the information disclosed.

34. Some members, as preparers of accounts with investments to consider, felt that risk management could be expanded to include the risk policy that trustees have in regard to their investments. The Committee therefore may wish to consider other types of risk that such charities face when the management of investments is a significant part of their operating model, and whether their situation is sufficiently taken into account by the SORP.
35. Nonetheless, the nature of funding for the charity sector and in many cases the work they undertake is inherently risky. The Committee might ensure that any further disclosures around risk management are appropriate, realistic, and reasonable in light of the circumstances facing charities.
36. **iii. Going concern:** Similar to point the made in paragraphs 33 to 35, it was felt by funders we spoke to that **paragraphs 1.23 and 3.38 of the SORP** are sufficient to address uncertainties around the ability to continue as a going concern. Further disclosures may elicit 'boilerplate' or standard form responses along the lines of 'we will seek alternative funding', and add only to the length but not the value of the overall report.
37. **iv. Enhanced analysis of expenditure:** While listing grants by country could conceivably be helpful in demonstrating the type of work a charity undertakes, overall we find it difficult to see the public interest in providing this sort of break down and urge the Committee to reconsider introducing this sort of proposal.
38. We appreciate that the Committee has not suggested that grant recipients should be named, but feedback from ACF members highlighted that listing grants by country may for example put recipients in certain places at risk of persecution or unwanted exposure. Funders would have to tell their grantees of the disclosures required and this would have to be factored into the grantees' risk register.
39. For foundation themselves, it may also attract attention to their work in fragile environments and contexts where their inconspicuousness is vital. Equally importantly, such listing could utterly misrepresent the work a funder does by classifying their grant-making by geography when they may be applying an entirely different filter to their work in pursuit of an outcome not related to 'place' at all. Likewise, grants made to institutions such as the UN or World Bank funds cannot be reasonably traced by the grant-maker to their final destination.
40. For foundations without the capacity or resources to mitigate such risks, listing grants by country could even act as a deterrent from funding certain places to the very great detriment of vulnerable sets of beneficiaries who may have few sources of charitable income.
41. **v. Disclosure of who funds a charity:** We understand that it could be interesting to know who has funded a charity. In fact several ACF members who make grants expressed that it is useful to know of other organisations which have funded a charity. However, the disclosures suggested by the Committee could have unintended consequences and must be carefully considered. Disclosing the names of major donors who are individuals would affect the living settlors of many foundations. For some such individuals, anonymity provides the necessary conditions for them to donate their wealth without unwanted attention – for example where their giving is religiously motivated. So, while there is a

chance that such transparency measures will help in the fight against fraud and tax evasion, the more likely impact is that many individual donors may be deterred from donating material amounts, and ultimately the charity sector will lose income.

42. We feel however that different considerations may apply with regard to government and corporate donations and contracts. The Committee may wish to consider the implications for transparency if in particular corporate donations and contracts are not disclosed in cases where they carry undue influence.
43. **vi. Disclosure of key facts:** See paragraphs 21 to 24 of this response.

Section 3.5: Your ideas for items to remove, change or add to improve the SORP

Q12. Are there any items in the report or accounts which could be removed? If so, what are they and what are your reasons for removing them?

44. All members consulted in forming this response felt that the SORP was too long which reflected in long and complicated reports and accounts, and they had varied suggestions as to what could be removed. We suggest that the forthcoming review period will provide the Committee with the opportunity to reflect on the primary purpose of the SORP and the information and disclosures that relate to good accounting practice. As a result, it will highlight items that do not relate to the SORP's main purpose and therefore may merit removal.

Q13. Are there any items in the report or accounts which could be changed to improve the information provided to the user? If so, which items would you change, what would the change be, and how would it improve the information to users of the report and accounts?

45. A number of items were highlighted for clarification by ACF members.
46. **Paragraphs 5.3 and 5.4** do not mention investment income in the "*two broad categories of income*". The lack of specific reference to investment income means these paragraphs are open to interpretation and may produce inconsistent results.
47. **Paragraph 5.6** could be reviewed to define 'performance-related grants', as opposed to 'specific purpose grants', and why performance-related grants are classed as voluntary income, as opposed to earned income from contracts. The inclusion of many performance-related grants from government in voluntary income gives the misleading impression that the sector has access to much greater unrestricted income than is the case.
48. **Paragraph 16.8** goes some way towards demonstrating the activities of a charity and to encouraging charities to break down their expenditure, and we appreciate the option for exemption when necessary. Further disclosures around expenditure would better inform potential funders of the activities for which their donation may be used.

49. We wonder whether the Committee might explore if some clearer guidance might be given to provide greater consistency of reporting, while remaining proportionate to charity capability and without creating more burdensome requirements.
50. **Paragraph 16.10** could specify that 'direct service provision' by the grant-maker may be to beneficiaries themselves through the funder's own programmes, or to the service-providing organisation, in the form of what is sometimes called 'grants plus'. This would include financial and other expert advice, networking opportunities, policy, advocacy, campaigning and communications back-up, all of which come at a cost to the funder but which deliver public benefit 'downstream' for the organisations which they are supporting.
51. Similar to the concerns raised in paragraph 48 of this response, **paragraph 16.17** could be clarified to indicate an appropriate and proportionate level of disclosure. One suggestion from researchers is that guidance could encourage charitable grant-makers to aim for comprehensiveness in particular areas, for example total number of grants or grants made by topic areas. This would be preferable to greater detail on a smaller number of grants and would provide a better picture of the charitable activities undertaken in that year.
52. **Paragraph 16.18** should be clarified in conjunction with any clarifications made to **paragraph 16.17**. The interpretations of a 'sufficient' and 'material' number of grants are unclear and inconsistent, and the Committee might wish to review the two paragraphs.
53. **Paragraph 21.13** demonstrates some ambiguity in the presentation of ethical, socially responsible, and mission related investments as a distinct 'investment class'. For example, **Paragraph 21.13** states that "...the adoption of ethical, socially responsible or mission related investment policies does not create a separate class of investment asset that is presented separately in a charity's balance sheet..'; while **Paragraph 21.22** states that "[m]ixed motive investments must be disclosed either as a separate line on the face of the balance sheet or identified as a separate class of investment in the notes to the accounts". The explanations of these two paragraphs should be made fully consistent, especially now that the statutory power to make social investments has been enacted and the Charity Commission Guidance on Investment Matters (CC14) has been updated in relation to mixed motive and programme-related investments.

Additional point

54. Some member feedback highlighted an issue with the SORP that is not addressed by the questions above, but which the Committee might wish to consider in the future development of the SORP. The point has been raised regarding the SORP's relation to charity regulation in England and Wales, and we note that we are not aware of similar issues with regulation in Scotland or Northern Ireland.
55. The Charity Commission for England and Wales requires non-incorporated charities to prepare accounts as required by regulations made under the Charities Act 2011 and the relevant regulations. The Charities (Accounts and Reports) Regulations 2008 have not been updated by the Cabinet Office (or now by the Department for Culture, Media and Sport [DCMS]). These regulations still refer to SORP

2005. Therefore charities in England and Wales face the choice of abiding by regulations and an outdated SORP, or breaching regulations in accordance with the current SORP.

56. The Charity Commission for England and Wales, in their publications CC15c (and now CC15d) suggests that the latter choice is preferable using the principle of a "true and fair override" which the regulations permit. But the issue requires further clarity for charities who feel uncertain of which takes precedence. The Committee may wish to consider working with DCMS, and exploring the relation of the SORP to existing charity regulation in England and Wales.

Concluding remarks

57. We are grateful for the opportunity to give early feedback to the SORP Committee, and believe that the committee has identified areas to review which are of interest and concern to our members. We hope that this response will help the Committee to review the SORP with consideration for the great diversity of the charity sector in terms of needs, capacities and models. We also reiterate the importance of good governance, clarity, and transparency as basic principles on which the SORP can be a meaningful and useful resource for those within the charity sector and the wider public. However finding a balance is crucial; the SORP should not add to the administrative burden on charities, nor should any requirements put the wellbeing of the beneficiaries at risk, or distort further or feed into current misconceptions about the sector. We look forward to receiving the Exposure Draft in 2017 and would be very willing to be part of further discussions as the next version of the SORP is crafted and finalised.