

Response to the research exercise published by the Charity Commission for England and Wales and the Office of the Scottish Charity Regulator on Charities SORP (FRS 102)

I'm writing this response to the research exercise purely in a personal capacity and not on behalf of any organisation which I'm connected with. I'm happy for my response to be on the public record and to amplify any of the points which I have made.

My background

For 17 years, I was the National Charity Specialist at Mazars LLP, based in London and supporting the firm's offices in England and Scotland. I stepped down recently and I'm now a freelance, working with charities and social enterprises on finance, governance, training and development. I continue to edit the Tolley's Charities Manual, writing the accounting, financial reporting, auditing and governance sections.

I was a founder Non-executive director at the Social Stock Exchange, where social impact investors and businesses work together for greater impact. There are now 32 members of the Exchange with a collective value of £2 billion.

As a volunteer, I spent six years as Treasurer of the national Quakers in Britain (Britain Yearly Meeting), which has an income of £10 million. I also spent twelve years as Treasurer of the Development Trusts Association and chaired the Merger sub-committee for the merger with bassac (British Association of Settlements and Social Action Centres) to form what is now the charity Locality.

I'm currently a trustee of Sussex West Area Quaker Meeting, which has members in West Sussex south of the South Downs and an income of £0.5 million. I'm a member of the Technical Committee of the Fair Tax Mark and I'm looking at the relevance of the Mark to charities.

Sector context

The findings of the 2016 Charity Commission study into public trust and confidence were produced by Populus on behalf the Commission. The overall level of trust and confidence in charities had fallen from 6.7 out of 10 in 2012 and 2014 to 5.7 in 2016. The study concluded that trust in the charity sector has five key drivers. One (honest and ethical fundraising) is perhaps outside the scope of this Research Exercise on the Charities SORP (FRS 102). Another is relevant to the financial statements (ensuring that a reasonable proportion of donations make it to the end cause). The final three drivers are relevant to the Trustees' Report:

- being well managed
- making independent decisions to further the cause they work for
- making a positive difference to the cause they are working for.

I will aim to address these latter four drivers in my response. I will also comment on how better governance arrangements can help the trustees in their financial reporting. I've also taken into account the Charities manifesto 2016, published in November 2016 by the Charity & Voluntary Sector Group of the Institute of Chartered Accountants in England and Wales (ICAEW), (my own professional body). The link to the manifesto is [here](#). In particular, I have taken into account Recommendation 1 of the Transparency and integrity section of the manifesto (Greater weight given to measuring and reporting on outcomes and impacts) and Recommendation 3 (User-friendly statutory reporting). Recommendation 3 talks about Trustees' Reports and accounts '*being overly long, complex and often unread. These are resource-intensive documents which contain far greater detail than would be expected of a similar-sized private company*'. The Recommendation calls for the

fitness of current charity reporting to be reviewed by the Financial Reporting Council and the Charity SORP-making body. It ends *'The principles of simplicity, accessibility and usefulness for users should be at the heart of good financial reporting'*.

I agree with the principles in the Recommendation but disagree with the application of these principles to financial reporting by charities. The transactions of a private company are exchange transaction under Financial Reporting Standard (FRS) 102, with value in a transaction enjoyed equally and reciprocally by both parties. Income and costs can generally be matched. The profit of a private company is enjoyed by the investors, usually on an annual basis.

In contrast, many transactions of a charity are non-exchange transaction, such as giving by individuals through gifts and legacies and beneficiaries enjoying services from the charity without charge. A charity must deliver public benefit and account for the different funds it holds. Income and capital received in one year may be spent in the following year. Trustees must strike balances between alleviating symptoms and dealing with the causes of the issues facing their beneficiaries and also prioritising the support of current and future beneficiaries. Charities enjoy considerable tax benefits compared with private companies. Many of these issues are explored in this research exercise. Public trust and confidence in charities will be re-built by better and clearer, but not necessarily simpler, financial reporting.

I read a great number of Trustees' Reports and find many quite bland, with more financial disclosures than stories and a lack of an over-arching narrative to justify the charity's existence and its work during the year in question. Yet when I talk to trustees about their charity and why they choose to serve and when I look at the charity's website, I am struck by the wonderful work which has been delivered with limited resources. I wonder if the new SORP needs to empower trustees to talk about their charities in a fair and balanced way and not feel constrained by the need simply to comply with disclosure requirements?

My response

Section 3.1 of the research exercise, The structure, format and accessibility of the SORP

Q.1 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? I'll leave others to respond on smaller charities. I believe that the modular approach works well, with the additional reporting requirements of larger charities set out separately. I like the distinction between disclosure which is a requirement, advice on good practice and information which can be provided if relevant.

Q.2 Is more assistance required to help smaller charities? If so, please explain what is needed and why. I'll leave others to respond on smaller charities.

Q3. Is the use of the terms 'must', 'should' and 'may' successful in distinguishing between those requirements that have to be followed to comply with the relevant accounting standard and the SORP from those recommendations which are good practice and those that simply offer advice on how a particular disclosure or other requirement might be met? If not, what alternative format should be adopted and why? I find the 'must', 'should' and 'may' distinction to be helpful.

Q.4 Given the requirements for financial reporting that are now explained in FRS 102, is the retention of a SORP still necessary in the charity sector? Please give reasons for your

answer. I think that, at the very least, a Charity SORP is needed to provide guidance on the preparation of the Trustees' Report. The financial reporting of a charity is more complex than of a similar-sized private company, because of the nature of non-exchange transaction and also the public benefit requirement, as noted above. The charity SORP helps the sector to share best practice in financial reporting and reduce variations in accounting and financial reporting for similar transactions or events between one charity and another.

Section 3.2 of the research exercise, Implementation issues that require improvements

Q.5 Do you have any suggestions as to the changes needed to address issues on implementation or in meeting the SORPs requirements? If so, please explain what are they are and where possible please give examples. I think that the SORP strikes a good balance between smaller and larger charities and between providing application guidance and referring the reader to the relevant sections of FRS 102.

Recommendation 3 of the Transparency and integrity section of the ICAEW Charity Manifesto 2016 talks of the Trustees' Report and accounts of charities as '*resource intensive documents which contain far greater detail than would be expected of a similar-sized private company*'. As above, I don't agree with this analysis. The Trustees' Report and accounts of a charity have to deal with non-exchange transactions and fund accounting. The Trustees' Report also has to deal with the outcomes and outputs of a charity's work for the benefit of the public. This is not the case for a similarly-sized private company, where the reader of the Directors' Report and accounts would be familiar with the company's products and business model, for instance those of a car dealership or a mobile phone company.

I'll leave others to provide a more detailed answer to this question.

Section 3.3 of the research exercise, SORP Committee member suggestions for change

Q.6 Do you agree that there needs to be a third tier of reporting by only the largest charities and if so at what level of income should that reporting requirement apply? I don't see a need for a third tier of reporting by only the largest charities. The Charity Commission statistics of the Register of Charities at 30 September 2016 showed that of 166,000 charities on the Register, only 11,000 had an annual income of over £500,000. These 11,000 charities have an income of £65 million, being 90% of the total income of the sector of £72 million.

I feel that it is fair and proportionate for these larger charities with an income of over £500,000 to be transparent and accountable in their financial reporting.

Q.7 If you agree that there should be a third tier of largest charities, what items in the existing SORP that apply to larger charities should be restricted to just these largest charities? As Q. 6 above.

Q.8 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? I agree with the four areas for review of the Trustees' Report. I have seen boards who, rightfully, take ownership individually and collectively for the Trustees' Report and accounts. I have seen others who 'abdicate' responsibility for these documents to the Treasurer or Chief Executive and 'rubber stamp' the draft documents.

Compliance with the 'story' approach to the Trustees' Report is patchy. A good report tells a story and is integrated with the accounts. I read a good Trustees' Report by an international development charity recently. The Report quantified the funds spent internationally, either directly by the charity or in partnership with local organisations, which seemed a relevant metric. The former approach was described as more cost-effective and delivered better outcomes in the short term. The latter approach tended to deliver better outcomes in the longer term and also built the local infrastructure of the country, helping the charity to become more of a facilitator of local activity and less of a 'doer' of work. I found the metric and story fitted together well, with evidence of stakeholder engagement in designing and evaluating the charity's work. I've also read Trustees' Reports which were disconnected from the accounts and the charities' work, often similar to the Report of the previous year, with only the financial information updated.

I find some Trustees' Reports contain too much detail, which does not aid communication. Sussex West Area Quaker Meeting, where I am a trustee, has eight branches between Chichester and Brighton. The charity's Trustees' Report covers activities, outputs, outcome and impact at a high level. We also produce a non-statutory report to cover the work of each of the eight branches in some detail, which we send to interested stakeholders.

A key facts summary is an interesting idea, see section 3.4 below.

I think that the reserves section of the Trustees' Report is often one of the weaker areas of the Report. I would like to see the approach to and policy on reserves linked to the risk section of the Report. In this way, the residual risks facing the charity would be integrated with the reserves held and the link between the two explained. Trustees should not hold an unduly high level of reserves as a 'comfort blanket' to make their life easier. Equally, trustees should not run down reserves to an unsustainable level to support today's beneficiaries to the detriment of tomorrow's.

Q.9 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? I agree with the two suggested areas for review of the accounts. I think we should continue to distinguish between expenditure to raise funds, which is non-charitable and charitable expenditure. I don't think that the concept of support costs has proved helpful to readers of sets of accounts. There is inconsistency of practice across the sector and the term has led to unhelpful comparisons as to whether one charity is more efficient than another. There are better measures of efficiency and effectiveness than support costs, which is a false proxy and not a useful metric.

Fundraising costs and the cost as a proportion of the relevant income can be emotional issues and can attract unwarranted media attention. I don't think that it is right for charities to gloss over the matter and deal with any criticism as and when this arises. I also think that it is misleading to say that '100% of what you give goes to the cause, is spent on frontline' if fundraising costs are incurred but set off against other income.

I think trustees should explain in the Trustees' Report why they consider that the fundraising activities are appropriate for their charity and that the costs of fundraising are proportionate to the income raised. I know of two membership infrastructure charities of similar size and complexity. The relationship between members and the membership charities is very close in both cases, so the cost of generating voluntary income is relatively low. One charity rents

its buildings and has no surplus space. The other owns its buildings and has considerable surplus space. The charity operates the surplus space as a hospitality business carried out through a trading subsidiary, with an income of £3 million. The costs of the hospitality business are relatively higher as a proportion of income than the costs of generating voluntary income. This is as you would expect and illustrates why simple, absolute ratios in this area are misleading and unhelpful. Trustees need to explain these matters in the Trustees' Report and accounts and also explain how any shared costs are allocated between the charity and the trading subsidiary.

Section 3.4 of the research exercise, suggested themes for making changes

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, and if you do not support any of these suggested themes, please give your reasons as to why not? I agree with the six themes for review of the SORP as proposed by the charity regulators and deal with the specific issues of each theme under Q.11 below.

Q.11 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 support none of these suggested issues, please identify the issues that need to be addressed and explain your reasons why?

Public benefit

Public benefit is at the heart of charitable status and charitable activity. I think the issue of public benefit is wider than as proposed in the research exercise. Depending on the circumstances of an individual charity, the trustees could explain:

- the history of the charity's public benefit
- how stakeholders, including beneficiaries, are involved in identifying activities and assessing effectiveness and impact. Not all charities deliver services.
- The high level governance arrangements to underpin public benefit
- The transparency and accountability of the charity over public benefit
- The relationship between how the charity raises and spends its resources and the public benefit which it seeks to deliver.

I would not expect the public benefit section of the Trustees' Report to change much from year to year, except that sources of income and activities carried on may change over time to reflect changes in a charity's operating environment and the needs of its beneficiaries.

Trustees have a key role to play in delivering public benefit. I read some Trustees' Reports and the only information given about the trustees is their names and dates of service for the accounting year in question. Social media does provide more information about most trustees, but I believe that the Trustees' Report should stand up on its own as a document. I would like to see a sentence or two about who each trustee is, what they bring to the charity and how potential conflicts of interest and loyalty are identified, managed and disclosed. I would also like to see a comment about the diversity of the trustees as a body, how this compares with the diversity of the beneficiaries and wider society and any plans which the trustees have to strengthen diversity.

Risk management

I agree with the issues set out in the research exercise. I think there is a need to link the risks and uncertainties faced by a charity with the level of reserves held to give the user of the accounts an understanding of the headroom (or not) between reserves held and risks faced. I suspect that larger charities do not routinely gain assurance that the internal financial controls and governance arrangements are fit for purpose. An explanation about such assurance would be helpful.

Charities can differ from commercial companies in the level of risk which the charity is willing to run and the level of risk can vary from charity to charity. For instance, one grant-making charity may make relatively 'low risk' grants, which deliver the desired outputs and outcomes. Another grant-maker may make 'higher risk' grants, some of which fail to deliver and others which deliver very significant outputs and outcomes. Both approaches have merit and I would find a comment about this in the Trustees' Report helpful. I find that successful charities which are risk-seeking, as opposed to risk averse, need trustees and senior staff who are resilient in the face of challenge and adaptable to change, rather than preferring the 'steady state'.

Going concern

I welcome increased disclosure of going concern, given all the political and economic uncertainty which charities face currently. I like the idea of a positive statement on going concern over a longer timeframe than 12 months, alongside an explanation of any material uncertainties regarding going concern. This issue can be linked to the issues of risk management and the level of reserves held.

Some, mainly larger charities, do have an issue over pension liabilities and there can be a significant effect on going concern. The pensions note in the accounts concerning a defined benefit scheme can be long and tortuous. The trustees should explain any financial implications in plain English and work closely with the trustees of the pension scheme concerned.

In my experience, a good understanding of going concern helps trustees to think strategically and not operationally, to build long term relationships with funders and to work proactively and not reactively.

Analysis of expenditure

As the research exercise notes, public trust and confidence in charity is built on an understanding of public benefit (as above) and, in turn, how money is spent. The public benefit section above ends with the link between the public benefit which a charity delivers and how it raises and spends its money. I think that this question is wider than simply how public donations are spent, though giving by individuals is a key part of the income of the charity sector.

I don't think that the term administrative costs is helpful as a measure of efficiency, because trustees can 'manipulate' the application of any definition to their charity and it becomes a false proxy for effectiveness. A military support charity was criticised in the media recently for the low level of overnight occupancy at its centres, compared with a budget hotel chain. An analysis of that charity's expenditure could have explained that its beneficiaries have

complex mental and physical health issues, compared with the general public and, where possible, prefer to be treated as day patients and not overnight patients. The overnight occupancy rate is not a relevant metric and better metrics need to be chosen.

Charitable expenditure outside the jurisdiction of the main registration would be a helpful disclosure. Implementing the National Council for Voluntary Organisations' (NCVO) proposals on executive pay disclosure for larger charities would be helpful, as would including the cost of interim and agency staff within the definition of senior management roles. I read some Trustees' Reports which refer in the administration section which refer to high rates of turnover of senior management staff. Increased disclosure in this area would be helpful to the user of the accounts.

I would like to see an explanation of how a charity allocates its spending across its main activities. If there are four activities, a charity could spend 25% of its spending on each activity. Perhaps more commonly, a charity could spend 45% of its spending on each of the first two activities and 5% on each of the other two activities. The charity could also explain which activities deal with the current issues of an activity for today's beneficiaries and which address the causes of those issues for future beneficiaries. The public could then make an informed decision as to whether to give to an individual charity or not.

Disclosure of who funds a charity

I'm not sure that government funding of charities is the main issue here. I welcome the names and amounts of material individual, corporate and government donations. There has been a significant shift in recent years from grants (which tend to give trustees more discretion) to contracts (where the funder tends to be more prescriptive as to how money may be spent). Where relevant, an explanation of the effect this shift in funding is having on a charity's activities would be helpful.

I do have a concern about who funds charities which are academic think tanks and which are active in the public domain. There can be a lack of transparency over who funds such charities and the risk of undue influence of funders and trustees over policies and activities. I think that these charities have a specific responsibility to explain how they operate for the public benefit, without creating private benefit.

Disclosure of key facts

I support the concept of a key facts section in the Trustees' Report. I think the key facts section should reflect the issues covered in this research exercise to avoid public confusion. I know of one small charity which received a large legacy in year one, a second large legacy in year two and sold a property in year three. The financial effect of these events on gross income would need to be explained. The spending of these three 'non-recurring' receipts lags behind the receipts by one or two years while the trustees consult and decide how to spend the funds. Part of the three receipts have been added to a financial investment portfolio to bring the reserves closer to the target level in the reserves policy. Another part has been invested in other properties owned by the charity to keep these in good repair and fit for purpose, in terms of energy efficiency and the quality of disabled access. A final part has been donated to charities with similar objects to promote their work. This 'non-recurring' expenditure and the lag of expenditure behind income would need to be explained in the key facts section.

I think that fundraising costs as a raw figure or percentage is more misleading to the public than helpful. I don't support the use of charitable expenditure as a percentage of total income as different charities operate in different environments. A church may appeal for funds from its members by leaving collection envelopes at the back of church for members to take home at the end of a service. The fundraising cost would be minimal, especially if the collector overseeing the appeal is a volunteer. This is in contrast to, say, a refugee or homelessness charity which advertise on television for donations by text during the run up to Christmas. I would expect these latter charities to have a higher fundraising percentage/ lower percentage of income 'going to the cause' than, say, a church. I would prefer to see this part of the key facts section explain a charity's fundraising activities and why the activities are appropriate, economic, efficient and effective. I think that this would be most helpful for the user of the accounts.

Section 3.5 of the research exercise, remove, change or add to improve the SORP

Q.12 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? I will leave others to respond to this question.

Q.13 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? I will leave others to respond to this question.

Q.14 Are there any items you would like to add in to the report or accounts? If so, what are these items and how would their inclusion help the user of the report and accounts? I will leave others to respond to this question.

Q.15 Are there any disclosures in the notes to the accounts that you believe can simply be removed altogether? If so please state the disclosure, the relevant SORP paragraph(s) and give your reasons as to why this disclosure is not useful to the user of the report and accounts? I will leave others to respond to this question.

I'm grateful to everyone who is participating in this research exercise for the next Charities SORP (FRS 102), including the joint chairs, Nigel Davies and Laura Anderson and Alison Scott (CIPFA), Secretariat.

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