

3 Lyne Grove
Crossford
Dunfermline
KY12 8YB

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Charities SORP
Attn. Matthew Allen
CIPFA
77 Mansell Street
London
E1 8AN

Dear Mr Allen

Research exercise on charities SORP (FRS102)

I welcome the opportunity to respond to the above research exercise and enclose my response.

I am a voluntary charity independent examiner working mainly with smaller Scottish charities. My current involvement in the charity sector is as follows:

- Member of the Charities SORP Committee
- Member of the Samaritans Audit & Risk Committee
- Independent Examiner for 27 Scottish and 2 English charities
- Treasurer of 2 Scottish charities
- Secretary of the professional membership committee of the Association of Charity Independent Examiners and a regular speaker at their conferences.

As you will note from my response, my overriding view is that greater consideration (and simplification) is needed for very small charities as, numerically; these make up around 80% of the charity sector.

If any aspect of my response is unclear, or if you require any other information, please let me know.

Yours sincerely

Michael Brougham

Michael Brougham MCIBS, FCIE

Introduction

Before directly addressing the questions in the research exercise, I would highlight the following, all of which have a direct bearing on my responses:

Charity Sector

- 1 The charity sector is very diverse, ranging from a relatively small number of large charities, which collectively account for well over 90% of overall charity income, to a very large number of much smaller charities.
- 2 The current SORP (FRS102) defines larger charities as those with an income of more than £0.5M. Whilst this is welcome, I believe further differentiation is needed. In terms of the needs of charities and the users of their accounts, there is a considerable difference between a smaller charity with an income of £20k or less and one with £499k.
- 3 Whilst the SORP needs to cater fully for the requirements for the largest charities, this should not be at the expense of unnecessary burden on the smallest as these, by far, make up the bulk of charities in the UK.
 - 3.1 Around 70% of registered charities in England & Wales have an income of less than £50k, rising to over 80% where income is less than £100k. The proportion of such charities would be higher still, if the unknown number of charities exempted from registration with the Charity Commission were to be included.
 - 3.2 Whilst the number of charities in Scotland is much lower, the proportions of charities with an income of less than £50k and less than £100k are almost the same as registered charities in England & Wales.
 - 3.3 The SORP therefore needs to address the needs of small (not just smaller) charities as well as the largest ones.
 - 3.4 Although the legislation is different, it seems somewhat illogical that the burden on a small charity with an income of £20k preparing accruals accounts is considerably higher than a charity with an income of £200k preparing receipts & payments accounts.

Receipts & Payments Accounts

- 4 The SORP only applies to accruals accounts, not receipts & payments ("R&P") accounts.
- 5 R&P accounts are an option for around 75% of charities (i.e. those which are not charitable companies and which have an income of less than £250k). R&P accounts provide a greatly simplified means of accounting and reporting, compared with SORP based accruals accounts.
- 6 Whilst popular with very small charities, mainly those with voluntary independent examiners, the adoption of R&P accounts is substantially less than it could be, for several reasons:
 - 6.1 Regulations to allow conversion of smaller charitable companies in England & Wales to CIOs, which would then have the option to prepare R&P accounts, have still not been introduced. It is now almost five years since similar regulations were introduced in Scotland to allow conversion of charitable companies to SCIOs.

- 6.2 In general terms, the accountancy profession has not embraced the concept of R&P accounts for several reasons:
- 6.2.1 R&P Accounts are often dismissed as not “proper” accounts.
 - 6.2.2 The concept and format of R&P accounts is not properly understood.
 - 6.2.3 The software used by many accountancy practices will not produce R&P accounts, only accruals accounts. As a result, accruals accounts are often prepared, even although this may not be the most appropriate option for the charity or for the readers of its accounts.
- 6.3 Accruals accounts may be a better option for some charities that would otherwise be eligible to prepare R&P accounts. However the choice, if R&P is an option, should always be what is in the best interests of the charity and the readers of its accounts, not on what the independent examiner prefers.

Compliance

- 7 The SORP has evolved over 20+ years with each edition becoming longer and more complex than its predecessor. SORP 2005 (2nd edition – May 2008) has 121 pages, whereas SORP (FRS102) has 193 pages, albeit partly (but not entirely) due to the modular approach.
- 8 Whilst the SORP is a statement of “recommended practice”, it is effectively mandatory under charity legislation. Arguably, it should be an exemplar for the preparation of charity accounts. However, the value in developing an increasingly demanding and ever lengthening document, no matter how comprehensive and technically correct, is diminished if it is not followed.
- 9 In general terms, compliance with charity accounting legislation and SORP is poor. My experience on ACIE’s membership committee, suggests that around two-thirds of the accounts of small (and some not so small) charities, prepared on the accruals basis, are materially defective in terms of compliance with the SORP and charity legislation.
- 10 Reasons for non-compliance:
- 10.1 Legally, it is the charity’s trustees who are responsible for the preparation of compliant accounts and deciding the form of the accounts where R&P is an option. In reality, the trustees of many small (and some not so small) charities have little or no knowledge of what a compliant set of accounts should contain and therefore entrust the task to someone whom they expect will have the experience and knowledge to do so. In many cases, their choice of examiner may be unwise.
 - 10.2 Many accountants “do” charity accounts as a favour for a commercial client who is also a charity trustee. They may not have more than a handful of charity clients in their practice and, as a result, do not invest the time and effort in training that they would do in any other area of professional work.
 - 10.3 There can be a serious disconnect between what a small charity is willing to pay (if anything), and what a practitioner proposes to charge, for the work involved which can also lead to an unwise choice of examiner.

- 10.4 Most accountancy firms rely on computer systems to generate their charity accounts, but these may not be fully compliant with current requirements. I recently became aware of a charity that pointed out a deficiency in the accounts prepared by their examiner (a partner in a mid-sized firm), who responded to the effect “that is what our system produces and I cannot change it”. That charity has now changed its independent examiner.
- 10.5 There are no effective “policemen”. The charity regulators do not have the time or the resources to review every set of accounts in detail, thus it is left to independent examiners and auditors to maintain standards, which is a serious weakness. If there is no monitoring, the SORP effectively becomes aspirational rather than mandatory. Would all motorists comply with the speed limit on motorways, if there were no traffic patrols or speed cameras, simply because there are 70 mph signs?
- 11 What is needed are ways of facilitating compliance with what is currently required, not adding to it (beyond what is essential to meet accounting standards) as that will further diminish compliance. It is simply the “law of diminishing returns”. Where possible, simplification is needed as “less is more”.

Research exercise questions

- 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?
- *Separately identifying the requirements applicable to larger charities is helpful but could be made clearer (say) by the use of different background colour. This will become even more relevant if additional tiers of reporting are introduced (see Q6).*
 - *Whilst the ability, in the online version, to select the modules which are relevant to the user is welcome, it would be beneficial (for those working with smaller charities) if the download could also be restricted to the relevant parts of each module. Alternatively, a “mini SORP” for small charities, would be very helpful.*
 - *The statement that the SORP does not apply to R&P accounts does not appear until paragraph 17 of the introduction. I would recommend that this be moved to paragraph 2 and expanded to say that R&P provides a simpler option for charities which are not companies and which (currently) have an income of less than £250k.*
 - *An index (as in SORP 2005) would be very helpful.*
 - *Please include the year of issue (e.g. SORP 2019) in the title of the next edition. The current SORPs are often erroneously referred to as SORP 2015 (or even occasionally SORP 2016 when including Bulletin 1), which is potentially misleading as no such documents exist.*
 - *A “lie-flat” format (wire bound perhaps?) would greatly aid usability for those who prefer the printed format.*

Q2 Is more assistance required to help smaller charities? If so, please explain what is needed and why.

- *Yes! The current regime, in terms of compliance with charity regulation and the SORP, is simply not working for a great many small charities, primarily due to preparers and, even more importantly, examiners having insufficient knowledge of what is required.*
- *As indicated in the introduction above and in my answer to Q6, the differential between smaller and larger charities does not go far enough. 70% of charities have an income of less than £50k and the current SORP requirements are a significant burden for them.*
- *Example trustees' annual reports and accounts are needed for small/smaller charities. All the examples on the SORP website have an income of well over £1M. Whilst useful for preparers of accounts of charities of that size, they are far too complex for smaller charities.*
- *A SORP disclosure checklist for small charities would greatly assist trustees, preparers and examiners. The one by Crowe Clark Whitehill and CFG is excellent, but is longer and more detailed than is necessary for most small charities. The one by Civil Society Media is also far too detailed and at £95, for a one-time only use, rules it out for most 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?

- *The "should" category is confusing and needs to be removed. It seems completely illogical (to me) that you can omit matters of good practice, yet still be compliant with the Statement of Recommended Practice.*
- *I would suggest using "must" and "optional" with all matters currently described as "should" being reclassified as either "must" or "optional". As with the current SORP, items which are "optional" for small charities may be "must" items for larger ones.*

Q4 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.

- *The SORP is essential given that there are aspects unique to charity accounting (e.g. fund accounting) not covered by FRS102.*
- *Equally, it is unrealistic to expect preparers and independent examiners, particularly of the accounts of smaller charities, to use FRS102, a highly technical document of 378 pages, as their "bible".*

Q5 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 they are and where possible please give examples.

- *Paragraph 4.2 of the SORP (FRS102) requires that comparative information must be provided for all amounts presented in the SoFA, whereas FRS102 paragraph 3.14 requires that comparative information required for all amounts presented in the financial statements. It is unclear whether, in this context, the Notes form part of the financial statements. If so, the amount of additional comparative information becomes significant.*

Q6 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 am unable to comment on the merits, or otherwise, of introducing a "top tier" for the largest charities. If done, there would need to be good demonstrable reasons for doing so and which would reduce the burden on the tiers below.*
- *As outlined in my introduction, I believe that the needs of the smallest charities are not being proportionately met. There is a much greater need for a new "bottom tier" for the smallest charities, the greatest majority of which have an income of well below £500k as follows:*

<i>Category</i>	<i>Income Band</i>	<i>% of Total (E&W)</i>	<i>% of Total (Scot)</i>
<i>Large charities</i>	<i>Over £5M</i>	<i>1.3%</i>	<i>2.4%</i>
<i>Medium Charities</i>	<i>£500k up to £5M</i>	<i>5.3%</i>	<i>5.8%</i>
<i>Small Charities</i>	<i>£100k up to £500k</i>	<i>13.1%</i>	<i>12.5%</i>
<i>Very Small Charities</i>	<i>Up to £100k</i>	<i>80.3%</i>	<i>79.3%</i>

Even if you exclude charities preparing accounts on the R&P basis, the "very small" category will still be the largest by a considerable margin.

Q7 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 I work exclusively with charities with an income of less than £500k, I am unable to comment in detail.*
- *Assuming that an additional tier, or tiers, of reporting are to be added to the SORP, a full review of the SORP's requirements should be undertaken to determine in which tier (and above) each requirement should be placed on the basis of transparency of reporting, but without placing unnecessary burden on smaller charities.*
- *One obvious candidate for placing in the highest category would be cash flow statements, which seem to be despised by almost everyone.*

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?

- ***Integration of report with the accounts:*** *This not straight-forward and could become counter-productive. Spending and impact are not directly related. Guidance would be needed. It is unlikely to be practical for very small charities where getting the trustees to prepare any form of report is often the real challenge.*
- ***Detail of reporting:*** *Further guidance is to be welcomed, but it also needs to be tailored according to the different sizes of the charities.*
- ***Key facts summary:*** *It would be an unwelcome burden for most very small charities and of little value given their comparatively simple reports and accounts. Many of the largest charities tend to provide such a summary anyway.*

- **Reserves:** Paragraph 1.22 of the SORP (FRS102) reads "The charity must explain any policy it has for holding reserves ... "The implication here is that a charity is not required to have a reserves policy, only that it must explain its policy if it has one. Even charities preparing R&P accounts are required to have a reserves policy, thus it should be a requirement for all accruals accounts. I would support the suggestion for additional guidance as all too often what appears in trustees reports is little more than meaningless "boilerplate" that is simply repeated from one year to the next.

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?

- *I would agree with dropping specific disclosure of support costs for small charities. Many of them do not distinguish support costs anyway.*
- *To be of any real use to readers of the accounts, a designated fund for fixed assets needs to be shown as separate column on the face of the SoFA in order to separate the figures from unrestricted funds.*

Q10 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?

- *There are elements of all of the themes that could be helpful. However, not all aspects are relevant to small charities and care is needed to ensure that no unnecessary burden arises from any additional requirements.*

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

- **Public benefit:** *A common approach to reporting across all jurisdictions would be helpful. However, the object should be clear and succinct disclosure, not paragraphs of waffle or "boilerplate" that is simply repeated year on year.*
- **Risk management:** *Reserves see Q8 above. The remaining points should only apply to larger charities.*
- **Going concern:** *Asking smaller charities to explain why the charity is a going concern will likely result in yet more "boilerplate" text that will be of no value to anyone, and is simply repeated year on year. If the charity has material uncertainties, the accounts should not be prepared on a going concern basis and a full explanation must be provided. If this is not done, the examiner should be considering whether there are implications for the IE report.*
- **Analysis of Expenditure:** *All of this, if approved, should be for larger charities only. I would remove the requirement for disclosure of executive pay completely for those whose salary/benefits are less than £60k per annum.*
- **Charity Funding:** *Care is needed with disclosure of private/organisation donations, as many are given privately and may not be repeated if the source is disclosed.*

- *Key facts: This should be optional, not a requirement. Whatever, the “pence in the pound making it through to the end beneficiary” statistic is open to meaningless comparison, and must be actively discouraged. It is nonsense to compare a charity which is funded entirely by donations (cost of fund raising £Nil) with a charity with an equal amount of net income funded entirely through charity shops (cost of fundraising £significant).*

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?

- *FRS102 paragraph 3.14, which requires comparative information for all items in the financial statements, is excessive in relation to detailed analyses by fund type. The SORP committee should seek agreement from the FRC that paragraph 3.14 should not apply in relation to the analysis between funds.*
- *Assuming such agreement can be obtained, paragraph 4.2 of the SORP (FRS102), which requires comparative information for all amounts presented in the SoFA, should be amended to “optional” or (preferably) removed altogether. Very few readers of the accounts will require this information. Those that do can simply refer to the previous year’s accounts which in all probability will make for easier comparison if the reader has both documents side-by-side.*

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?

- *SORP paragraph 4.5 states that the SoFA should be prepared with the needs of stakeholders in mind. Paragraph 4.22 does not require smaller charities (around 98%) to report on an activity basis. I would suggest that the SORP should include a sample SoFA on a “natural classification” basis and that small charities be encouraged to adopt it.*
- *Paragraph (ii) of the opening summary to FRS102 reads “The FRC’s overriding objective in setting accounting standards is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users’ information needs.” The SORP needs to mirror this objective and ensure that the requirements for small charities, in particular, are kept to the minimum necessary.*
- *The cash flow statement, where one is prepared, consists of three distinct areas where cash is either provided or used: operating activities; investing activities; and financing activities. It seems illogical that the detail of the first area (which always applies) is banished to the Notes, whereas the second and third are shown in detail on the face of the statement. I would recommend, space permitting, that the detail of all three be shown on the face of the statement (something which a number of charities are now doing).*
- *To be of any real value, the cash flow statement should be presented in a columnar format analysed by fund type, as significant cash balances in restricted funds can easily mask a cash deficiency in unrestricted funds, and hence impact on the charity’s ability to continue to operate, if a single column approach is used.*
- *For the same reasons, I would recommend that the balance sheet is also presented in columnar format analysed by fund type (mentioned briefly as an option) and a sample included in the SORP.*

Q14 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?

- *As indicated in the introduction to this response, compliance with charity regulation and the SORP, particularly for smaller charities, is very poor. Very careful consideration is needed before adding anything to what is already a demanding regime, as the "law of diminishing returns" already applies. I have seen many examples of accounts, which should have been prepared under one of the current SORPs, that have been (very badly in many cases) prepared under SORP 2005.*
- *"Less is more" is much more likely to bring about improvements.*
- *I believe that it would be appropriate to revisit the decision to debar the use of any of the simplifications permitted by Section 1A of FRS102. Not all will be appropriate, but if there are ways of simplifying matters, particularly for small charities, these should be considered.*

Q15 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?

- *The requirement to disclose in aggregate the total amount of donations received (9.18), without restriction, from trustees and related parties is, for many charities, impossible to meet and should thus be removed. One example is churches collecting cash by means of an open plate or collection bag/box. Another example is national or local charities seeking cash donations through street or door-to-door collections. There is no way that these charities can possibly know if any of those donations came from a trustee or a person connected to a trustee.*
- *The requirement to disclose the basis on which debtors (10.67) and creditors (10.81) are measured is excessive for a small charity and is most unlikely to be of any value to the readers of the accounts. Similarly, the disclosure on "basic financial instruments" will be incomprehensible to many people.*
- *A full review is needed of all disclosures required by the SORP to determine if such disclosures are really necessary for small charities with income of (say) < £100k (which is around 80% of charities).*