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Charities SORP
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Dear Matthew

Research exercise on Charities SORP (FRS 102)

We are pleased to have the opportunity to respond to the Invitation to Comment: "Research exercise on Charities SORP (FRS 102)".

BDO LLP is supportive of research relating to the Charities SORP, its use by preparers of accounts of a charity and how the SORP could evolve in future.

In particular, we are pleased to note attention given to ensuring that the financial reporting framework applicable to charities remains fit for purpose and to its future direction given the increasingly complex regulatory regime in which charities operate. We also welcome the opportunity to provide additional comments and recommendations on the role of the SORP in the framework and where the attention of the SORP Committee should focus in future.

Our detailed responses to the questions raised in the Invitation to Comment are set out in the attached appendix. If you wish to discuss any of the points further, please do not hesitate to contact either me (Tel: 01293 59 1084) or Rob Frost (Tel: 020 7893 3716).

Yours sincerely

Don Bawtree
Partner
For and on behalf of BDO LLP

APPENDIX I - RESPONSE TO QUESTIONS FROM THE INVITATION TO COMMENT**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?

We consider that the role of the SORP in the financial reporting framework for charities is to provide useful interpretation of the requirements of law and accounting standards for application to all charities to which it applies. However, as the accounting requirements contained within law and standards are complex, meeting the needs of all those preparing accounts for a charity is likely to be impracticable.

The SORP's role is further complicated by the addition of certain requirements which have been embedded within the SORP which are neither derived from law nor accounting requirements but are instead requirements added in furtherance of the aims and objectives of the regulators.

The current SORP has been written in a manner that, it could be argued, attempts to do too much for too many interested parties. This creates a rather unwieldy document which does not completely succeed in respect of any of the stated objectives for its use.

We consider that the SORP could be improved with a few, simple changes to how the SORP is designed and how the SORP Committee approach its development. Namely through:

- **being clear on its reason for existence.** The SORP Committee should be definitive on whether the SORP is a guidance document designed to assist preparers understand how the underlying framework should be applied or is a definitive, authoritative 'one-stop-shop' and ensure that the 'raison d'etre' drives the future development of the SORP;
- **ensuring that the SORP encourages understanding and application of the underlying framework rather than duplicating information wherever possible.** The SORP should only provide information or a requirement when it is providing a context for preparers of a charities accounts (in the application of FRS 102 for example) or where it is requirement that is not covered by the underlying framework. Any duplication of requirements should be removed. Consideration of the use of "must", "should" and "may" is set out in our response to question 3 below;
- **accepting that the SORP cannot meet all the needs of those preparing accounts and focusing on principles that can be applied by any charity regardless of size or complexity.** Granular requirements adds unnecessary complexity and introduces ambiguity and preparers of accounts of smaller charities would benefit from understanding the guiding principles on which their accounts should be prepared;
- **ensuring that the SORP is truly modular and tailorable to allow a preparer to clearly identify requirements on matters only relevant to their charity.** The modular approach, at present, is too basic in its presentation to be truly of use.

Our responses to the remaining questions below provide additional information and examples on our overall conclusions.

Q.2

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

Yes, more assistance is needed. The preparers of accounts of smaller charities are not likely to find the SORP, in its current form, simple to use. However, there is very little in the SORP which does not derive from a requirement of law or regulation or a requirement of the underlying accounting framework. This means both (a) that it would appear to be very little that can be removed from the requirements of the SORP that would be of significant assistance in simplifying the requirements for smaller charities but (b) that as this information is duplication, the SORP itself could be streamlined to “guide” rather than to “mandate” through replication.

In our view, two additional aspects of support for smaller charities which need full consideration are:

- 1) The thresholds above which full accruals accounts which are SORP compliant are needed. The level at which a non-company charity is required to produce such accounts is within the remit of charity law and accounting regulations and there is therefore flexibility in the application of thresholds to simplify the accounts regime for smaller non-company charities.
- 2) The ability of preparers to properly streamline the SORP to their own requirements and the limiting of SORP information to those areas that are “must” only.

It is also unclear why, when presented with opportunities to simplify the accounting framework for smaller entities, such as through the recent introduction of section 1A to FRS 102, such opportunities are not embraced and made available to charitable entities in full.

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?

We consider that the use of ‘must’, ‘should’ and ‘may’ is not as successful as it could be and creates ambiguity and uncertainty. We consider that this should be resolved once and for all in the next iteration of the SORP.

Our preference is for the SORP to contain only requirements. “Good practice” is usually too subjective in its definition or relevant only to certain types of charity to be easily incorporated into a document like the SORP.

As a minimum, the SORP Committee should address certain inaccuracies in the use of “must” and “should” which can be found throughout the SORP. There are a number areas of the SORP which present information as “should” which we consider ought to be “must” on the basis of underlying requirements or the principles on which the underlying framework is based. Such examples are evident from the opening paragraphs of the SORP and throughout, just 3 are replicated below (our emphasis added):

1.1. The primary purpose of the trustees’ annual report (the report) is to ensure that the charity is publicly accountable to its stakeholders for the stewardship and management of the funds it holds on trust. The trustees *should* consider the information needs of the primary users of their report. These may vary from charity to charity but will normally include funders, donors, financial supporters, service users and other beneficiaries.

1.8. The [trustees’] report provides important accompanying information to the accounts and therefore *should* be provided whenever a full set of accounts is distributed or otherwise made available.

5.23. Where terms and conditions have not been met or uncertainty exists as to whether the recipient charity can meet the terms or conditions otherwise within its control, the income **should** not be recognised but deferred as a liability until it is probable that the terms or conditions imposed can be met.

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.

As a shorter and more digestible standard when compared to the suite of standards it replaced, in one respect, the framework is arguably more basic and therefore more useable for preparers of accounts of charities. For the preparers of accounts of smaller charities, the relevant requirements should be more easily identifiable.

However, we note that FRS102 is still a technical document which is made complex through the limited amount of information that it contains. In many cases, an accountant experienced in the application of the information is needed to be able to fully understand the standard and its application. As the majority of registered charities in the UK have income of less than £500,000, but are nevertheless still required to produce accounts in line with FRS102 (unless a non-company charities with income less than £250,000) it is not realistic to expect that all charities will be able to afford to employ staff with the necessary expertise. At present, the SORP attempts to bridge this gap through provision information critical for finance staff within such charities which assists them in interpreting FRS 102.

We consider there to be a strong case for removal of the SORP in its current form and/or for the SORP to evolve into a document that guides charities in the application of FRS 102 and law without holding such an authoritative position within the charities financial reporting regime. The SORP could helpfully underpin FRS 102 through the provision of guidance assisting with interpretation of the standard in the areas of particular relevance to charities rather than through the replication and addition of other requirements.

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.

Smaller entities - as set out above

Public benefit entity requirements - although FRS 102 has a section dedicated to requirements for "public-benefit entities" which would appear to be tailor made to the charity sector, the SORP is not particularly clear on the application of these requirements to a charity.

Cost/benefit - The SORP could emphasise availability of cost/benefit exemption and how a preparer of accounts of a charity might interpret these requirements in a charity environment (i.e. when would cost outweigh benefit?)

Company versus non-company charities - We note an increasing trend towards differences in accounting requirements of a company charity compared with a non-company charity (e.g. fair value reserves, application of merger accounting, tax charge in I&E account etc). Although we understand that the differences arise from company law requirements and changes thereto, we see little reason for inconsistency in the reporting requirements or for excepting non-company charities from certain requirements purely on the grounds of legal status.

Primary statements - Company law allows parent entities to dispense with the requirement to publish a parent only income statement and cash flow statement where the parent financial information is included within the consolidated financial statements. There is no such exemption contained within charity law or the SORP. This has led to confusion amongst charity accounts preparers and charity auditors as to what the correct position is for charities. We feel it would be helpful for the SORP to be clear on what the requirements are in respect of these statements to avoid ongoing ambiguity.

Comparative information - We note a lack of clarity between the SORP and FRS102 in relation to the need to provide information for the previous year as is given for the current year unless there are specific exclusions contained within FRS102. Where information is required by the SORP (only, and not FRS 102), the SORP should make clear whether comparative information is required.

Business combinations - No guidance is offered in the SORP on how charities should interpret the requirements of FRS102 when 1 charity combines with another charity by way of acquisition (rather than a merger). We feel it would be useful for the SORP to provide guidance on the types of intangible assets which should be considered for valuation in such a situation (for example, FRS102 requires a value to be placed on customer loyalty - in the charity context would this equate to a value being placed on the acquiree's database of monthly givers?)

Related party transactions - The definition of related parties under the Charities SORP captures individuals or organisations that would not be caught by FRS102. Our experience is that charity trustees (and their finance teams) are unaware of the broader definition that must be applied.

It would also be useful for the SORP (or Charity Commission guidance) to provide a more easily understood guide to who is considered to be related to a charity.

The SORP also introduces the concept of 'business partners' as related parties. We note that this is not a term used in FRS102, nor is it defined within the SORP. To avoid confusion and ambiguity, we feel it would be beneficial for the FRS102 Charities SORP to define what is meant by a business partner.

Q.6 & Q.7

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?

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?

We consider that an examination of the thresholds beyond which a charity would be considered "large" and beyond which certain requirements will apply (or below which certain exemptions would be available) is a key concern as the next iteration of the SORP is developed. We consider the current level of income greater than £500,000 (and asset threshold) to be too low and captures too many charities, many of which find meeting requirements onerous and do not consider the SORP to lead to information of use to interested parties.

Whilst we do not agree that the creation of three tiers of reporting is necessary or desirable (as this introduces unnecessary complexity into the financial reporting regime), we do consider that it is necessary to set the thresholds for a 'smaller' charity at such a level so as to ensure that the SORP captures appropriate charities within its remit.

However, we accept that this will require considerations of the underlying law and regulation which is beyond the remit of the SORP Committee.

It is worth highlighting that even were a third tier to be introduced, we do not consider that there would be a significant number of requirements in the current SORP that could legitimately be restricted to a larger tier charity only given that most requirements derive from law or FRS 102. Instead we would be expecting additional information to be relevant to the 'largest' charity category (e.g. more detailed expenditure analysis, NCVO-style remuneration disclosures, KPI disclosure).

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?

Of the 4 suggested areas for review of the trustees' annual report, we are particularly supportive of any initiatives that encourage better integration of the report with the accounts.

In our view, this needs to be in the form of additional guidance material, prompts and other best practice examples rather than introducing new requirements into the SORP given that the existing requirements already encourage integration of information.

Although we support proposals to clarify the requirements in relation to the charities reserves policies, we feel that the suggested focus is already well addressed in the existing SORP.

We would not endorse pursuance of "detail of reporting" without a clear need identified for increasing the level of information required to be presented in the trustees annual report.

Any proposals for a "key facts summary" needs careful thought as to whether the SORP is best location for this guidance and whether such a summary should form part of the annual financial statements. Arguably, such information could be made available as a separate filing with the regulator or as part of the charities annual return.

One theme for improvement we would encourage is in relation to accessibility and understandability of the information presented. At present, we consider that in many cases, preparers use the SORP requirements as a checklist rather than a guide to providing the necessary level of detail. This leads to reports that are often verbose, difficult to read and do not convey the messages intended by trustees.

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?

We do not support either initiative as currently presented.

Support and fundraising costs - we are not clear what is being proposed. The definition of support costs is well understood in practice however, the manner in which support costs should be allocated and apportioned across other categories of expenditure is not. The result is often arbitrary and the basis used is not well explained or evidenced. We would support issuance of guidance on how support costs should be allocated and apportioned and how appropriate approaches can be developed.

Revenue vs capital expenditure - Adding additional columns would introduce complexity and unnecessary disaggregation which, as noted, would provide information that is usually presented in the notes to the accounts in any case. In our view, any extra information in this area should be presented as part of the trustees annual report or through additional disclosures.

We would support additional research in the following areas:

- **Reflecting charity specific requirements in FRS 102** - including the role in the SORP Committee to inform the FRC about matters pertinent to charities as part of their development of FRS 102 (e.g. to ensure appropriate use of public benefit entity requirements and exemptions in the standard) which may include whether a separate standard is needed for public benefit entities
- **Fund accounting and presentation of primary statements** - including whether columnar approach continues to be the most appropriate presentation of the SOFA and if so, whether balance sheets and cash flow statements would also benefit from additional fund analyses
- **Company vs non-company charities** - and in particular the need for ongoing inconsistency in requirements
- **Expenditure analysis** - whether reporting information on an activity basis (including whether it continues to be appropriate to allocate and apportion support costs across charitable activities) continues to be appropriate
- **Endowment funds** - how endowment funds should be presented within the financial statements including income and expenditure earned and incurred therein.

Q.10 & Q.11

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?

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?

We support all of the suggested themes to the extent that they are all matters worthy of additional consideration by the SORP Committee and that continue to be the focus of public interest following recent high-profile cases.

We are not necessarily convinced, however, that the SORP will be the appropriate location for the provision of the additional information suggested nor that the financial statements would be the appropriate destination for any output.

For example, the key facts summaries may be better suited to publication on a charities website or part of the annual return which could be based on information drawn from audited financial statements but not form a part of them.

In addition, we expect that the SORP information in some areas (e.g. in relation to going concern) is already sufficient, in terms of requirements, to cover the concerns noted. However, additional guidance materials are needed to allow preparers to understand expectations and how requirements could be met.

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?

In our view, it is not a question of blanket removals from the report or accounting requirements but instead to introduce sufficient flexibility in the requirements to ensure that they are scaleable and that charities respond to those requirements in a way that reflects the size and nature of the charity concerned.

The vast majority of the SORP has a reasonable basis in law and regulation and all information we, in virtually all cases, be relevant to some charities. The issue that needs further consideration is how the SORP can and should assist charities in identifying what is relevant and in how to apply the requirements in practice.

As above, we consider there to be little by way of detailed requirements or resulting presentation in the financial statements that could be removed if it is the continuing expectation that the SORP covers *all* aspects of charity financial reporting requirements.

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?

We consider that the SORP would benefit from a review and overhaul of requirements relating to remuneration and related party disclosures.

The adoption of FRS 102 has resulted in a significant amount of additional information required to be disclosed which has resulted in some unwieldy remuneration and related party disclosure notes being presented. The SORP could look to streamline this into neater summaries of the required information which would be more understandable for a user whilst remaining compliant with the underlying framework.

We also note that the themes for review include adopting the NCVO executive pay disclosures. If these were to be adopted, we believe the benefit of information such as (for example) the salary banding note is then superseded and then should not continue to be a separate disclosure requirement in the SORP.

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?

See responses to other questions. No additional items noted.

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?

None noted.