

# **DIRECTORY OF SOCIAL CHANGE**

**INFORMATION AND TRAINING FOR THE VOLUNTARY SECTOR**

## **DSC Response to Charities SORP Consultation Invitation to Comment on SORP Exposure Draft**

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## About the Directory of Social Change

The Directory of Social Change (DSC) has a vision of an independent voluntary sector at the heart of social change. We believe that the activities of charities and other voluntary organisations are crucial to the health of our society.

Through our publications, courses and conferences, we come in contact with thousands of organisations each year. The majority are small to medium-sized, rely on volunteers and are constantly struggling to maintain and improve the services they provide.

We are not a membership body. Our public commentary and the policy positions we take are based on clear principles, and are informed by the contact we have with these organisations. We also undertake campaigns on issues that affect them or which evolve out of our research.

We view our role as that of a 'concerned citizen', acting as a champion on behalf of the voluntary sector in its widest sense. We ask critical questions, challenge the prevailing view, and try to promote debate on issues we consider to be important.

## Summary of main points and recommendations

We have responded to each of the consultation questions in the final section of this document, which follows the sections on background and DSC's general views and interest in this area.

In summary, the key points we want to make in response to this consultation are:

- 1) **The necessity of clear guidance to support the SORP** – The new 'modular' format of the SORP is on balance more accessible and an improvement, but there remains a need for clear guidance and explanation of the relevant parts beyond the Exposure Draft itself, particularly for small charities and trustees without accounting expertise or access to specialist advice.

**It is imperative that the Charity Commission continue to publish relevant guidance booklets to support the SORP, and that it updates its existing guidance to reflect the revised SORP as well** (for example CC19: *Charities and Reserves*, which includes sections on small charities, and CC15b: *Charity Reporting and Accounting: The Essentials*).

In our view the Exposure Draft does not make sufficiently clear how or whether this guidance will be provided in the future. DSC is concerned that this may not be prioritised by the Charity Commission as it deals with severe budget cuts.

- 2) **Grantmaking charities' disclosure of grant awards (Q11)** - DSC researches the activities of thousands of grantmaking charities and we fully agree with the proposal in the Exposure Draft that they disclose the details of grants made in their accounts. It is our experience that too many trusts fail to provide information about material grants made upon request. This is important information which allows fundraisers to more effectively target their applications to the most appropriate funder. Further, it is in the public interest and the interest of the grantmakers themselves to be transparent about where charitable funds are given and for what purposes.
- 3) **Disclosure of senior staff salaries (Q12)** – DSC agrees with the proposal in the Exposure Draft that larger charities should be required to disclose the salary and job title of their highest paid employee. This is clearly a matter of public interest and charities should be transparent about how charitable funds are being spent for

whatever reason, including on paid staff who act for the trustees to achieve the charity's aims and objectives.

- 4) **Removal of requirement to disclose ex-gratia payments (part of Q23)** – The Exposure Draft lists a number of things which are proposed to be removed from the SORP for the purposes of 'simplification' including '*only requiring the disclosure of ex-gratia payments where regulatory consent for payment is required*'.

We believe this is unclear and are concerned at its proposed removal. The SORP committee needs to further clarify why this has been removed. In line with CC7 it is our understanding that trustees must always seek authority from the Commission before making an ex-gratia payment. If non-authorised payments are permitted we would see no benefit to removing the requirement to disclose these payments in the accounts. In fact, these are the very ones likely to go under the radar and therefore this proposal would not seem to aid or improve accountability or transparency. The SORP should make clear that disclosure of all payments made to trustees in particular (*ex-gratia* or otherwise) for whatever reason, is best practice.

## Background to the consultation: What's a SORP?

Statements of Recommended Practice, generally referred to as SORPs, provide recommendations for comprehensive accounting and reporting. In the charity world it is recommended that we follow the Charities SORP, (currently Charities SORP 2005).

The Charities SORP provides a mechanism which enables charities to meet the legal requirement for their accounts, to give a true and fair view, and also provides consistency in the sector's interpretation of accounting standards - detailing recommendations for annual reporting that are relevant to the charity sector and stakeholders' needs.

The Charities SORP 2005 was developed by the Charity Commission in conjunction with the Charities SORP committee, an advisory committee made up of charity finance directors, charity auditors, academics, charity advisers and charity regulators. The committee is also structured to reflect the different charity jurisdictions of the UK.

The Charity Commission and the Office of the Scottish Charity Regulator, now the joint SORP-making body for charities, have developed a new draft of the SORP to reflect various changes in accounting standards since 2005 (the Exposure Draft), in partnership with the current Charities SORP Committee.

DSC has responded to the consultation as it affects the voluntary sector and its beneficiaries – including many small and medium charities. The requirements of the SORP can affect these organisations on a daily basis and for many reasons; for example, in keeping good records of monitoring and evaluation for projects to report annually on public benefit, or say, in the case of grant-makers, to be transparent in who their beneficiary organisations are, in order to make applying for funds an easier task for applicants.

It is important that charities contribute to this consultation process in order to get the best outcome for those who have the often complex task of preparing annual reports and accounts, and also for those who will undoubtedly benefit from clarity, transparency and openness.

For further links to the consultation documents and further information about the SORP see [charitysorp.org](http://charitysorp.org).

## DSC's principle of Responsible Regulation

DSC believes that voluntary activity should be regulated responsibly. Some regulation is necessary to safeguard and maintain the interests of the general public, the beneficiary, and of the organisations and individuals being regulated. However, it should have a demonstrable benefit and should aim to empower and strengthen voluntary activity rather than control it unnecessarily.

We believe that:

- a) **Regulation should be proportionate** – it must strike a balance between perceived risk and intended benefit. It should recognise the diversity of voluntary sector activity and be developed and applied in a proportionate way.
- b) **Regulation should be appropriate** – it must be informed by the characteristics, capacity, and needs of the organisations and individuals that are being regulated. Insofar as is possible it should be focussed, rather than acting as a blunt instrument that has unintended effects.
- c) **Regulation should be enabling** – it should seek to empower rather than control voluntary activity. The reasons for the regulation and the regulation itself must be properly understood by those institutions which are applying it. It should be accessible and intelligible to those being regulated. It should seek as far as possible to encourage self-regulation rather than focus simply on enforcement.

## DSC's interest in the SORP Exposure Draft

### Small charities

DSC has a particular interest in charity law and in particular how policy and regulation affects smaller charities. DSC often promotes the interests of small charities in public debate and policy development, because we believe that too often the needs of such organisations are not well considered when policy is made or new regulations are brought in. We recognise and appreciate that the SORP committee has made efforts to bear the needs of small charities in mind when developing the Exposure Draft and the new modular format for the SORP. As we note above and in our responses below, clear and accessible guidance will need to accompany the new SORP to enable small charities to comply with their obligations.

### Grantmaking charities

DSC has campaigned for decades for greater transparency from grantmaking trusts and foundations, and publishes a range of directories such as *The Guide to Major Trusts* and *The Directory of Grantmaking Trusts* which detail their activities. Although much progress has been made in recent years, there is still room for improvement in terms of how these charities report their work.

In too many cases trusts fail to disclose lists of grants recipients upon request, or have not published such lists in a separate document that is publicly available. As we note above and in our response to Q11 below, DSC believes the SORP should require trusts to disclose this information in the accounts.

### Note on DSC's Chief Executive

DSC's Chief Executive Debra Allcock Tyler sits on the SORP committee in a personal capacity. To avoid any conflict of interest she has not had any involvement in preparing DSC's response to this consultation.

## Responses to the consultation questions

The consultation covers a range of often quite technical accounting questions which we have reproduced and responded to below. These should be read in the context of the consultation document itself, which offers more explanation and background in support of the questions. This document is available at [www.charitysorp.org](http://www.charitysorp.org), and we have chosen not to reproduce in full here in order to keep this document as succinct as possible.

**Q1. Do you agree that the modular format adopted in the Exposure Draft improves accessibility to issues and therefore better meets the needs of the preparers of charity accounts? If not, what alternative format should be adopted and why?**

DSC agrees that the modular format adopted in the Exposure Draft does improve accessibility. However, it seems to be necessary to read much that doesn't apply, before finding what does. The navigable website facilitates the identification of specific, relevant modules, and overall the website tool is useful.

It must be borne in mind that many charities or their trustees may find navigating online tools difficult. Paper based options and supplementary guidance must remain available.

**Q2. Do you agree that the Exposure Draft better meets the needs of smaller charities compared to the current SORP, if not, what are your suggestions for further improvement that will better help smaller charities?**

Again, as with Q1, the information takes some finding, though once found is easier to absorb. As currently is the case, separate leaflets should be published which refer only to 'Smaller Charities and SORP' and other relevant topics.

Simple and clear instructions about how to navigate the online tool and explaining the different sections are also needed to help make this accessible, particularly for small charities which may not be able to afford professional help.

**Q3. Does the use of the terms 'must', 'should' and 'may' when making a recommendation or explaining requirements clearly distinguish 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?**

Yes - this is standard Charity Commission practice and is straightforward, helpful and familiar to readers. The explanation at the top of each Charity Commission publication which reads: '*In our guidance, where we use 'must' we mean it is a specific legal or regulatory requirement affecting trustees or a charity. Trustees must comply with these requirements. To help you easily identify legal or regulatory requirements we have used the symbol next to the relevant bullet points'*' is good practice.

These definitions and explanation should be included in the Exposure Draft introduction, which includes a section on 'How to use the modular SORP'.

Is it not also the case that all 'must' points appear first in any explanation on a particular issue, with and 'should' and 'may' coming later in that order? If not, then perhaps this should be the case. Otherwise, these terms are clear.

**Q4. Do you have any suggestions as to how we can improve the SORP micro-site and web navigation of the Exposure Draft?**

It is clearly not possible to include all aspects of each module in each module's title. However, it is fairly crucial that those charities with limited resources and possibly expertise, should be catered for wherever possible.

For example, module 3's title 'Accounting standards' should make some reference to guidance for small charities, such as, 'including small charities' choice of reporting standard'. The web navigation of the Exposure Draft is very welcome in view of the size of the document.

**Q5. Do you agree with the proposed structure and content of the trustees' annual report? If not, what changes do you recommend and why?**

The structure and content of the trustees' annual report appears to give the public very clear information on a charity's financial situation, its governance, activities, outcomes, impact, public benefit etc. Again though, thinking about the smaller charity with potentially fewer resources and less expertise, if the module contain a fictitious annual report as an example, the specific details of which referring to the SOFA requirements and so providing a checklist for the person preparing the annual report, this can help trustees.

**Q6. Do you agree with the requirements and recommendations set out in the Exposure Draft for reporting a charity's achievements and performance. If not, what changes do you recommend and why?**

For the most part the requirements and recommendations appear to cover what is necessary for a charity to report its achievements and performance in a transparent and informative way. This meets the requirements of the yearly reporting of the public benefit the charity meets and the requirement to disclose what the charity has achieved with its funds.

However, we are concerned about the emphasis on and understanding of 'impact' in this context. Charities should seek to evaluate and communicate their impact – often for their own internal evaluation and improvement, or to describe their value to funders. However, this is likely to be different for different charities. In many cases the impact of a charity's work is obvious and can be told simply without recourse to complicated metrics or data.

The imposition of standardised metrics or tools for impact measurement would not reflect the realities or priorities of many small organisations, or the difference they make to their beneficiaries' lives. The absence of such metrics or tools should not be regarded as a lower standard of accountability or efficacy.

**Q7. Do you think there is any additional information which should always be included a trustees' annual report that is not required in the Exposure Draft? Alternatively, is there any information currently required by the Exposure Draft that you think is unnecessary?**

The trustees' annual report should contain information on any paid services carried out by trustees, or relatives of trustees, or any other potential conflict of interest which is known to the trustees, even though this information does have to be declared under the requirements of the SOFA. Current guidance from the Commission is not altogether clear for those unincorporated charities that do not account on an accruals basis:

*'We strongly recommend that all charities disclose benefits received by trustees in their report and annual accounts. This can help protect trustees from accusations that they are benefiting in a hidden way. It is a legal requirement for charitable companies, those non-company charities with a gross annual income or expenditure over £100,000, and smaller charities which prepare their accounts on an accruals basis, to disclose benefits to trustees.'*

This 'strong recommendation' should form part of the Exposure Draft Module 1, so that those charities are clear that these services/potential conflicts of interest should be included in the annual report where the 'story' of the last year of the charity's activities is told. Changing this to 'the trustees must' might not be possible based on current regulations but the statement needs to make clear who is not covered by the legal requirement and to say whether the declaration should be in the report or accounts or both.

**Q8. The format and headings of the SoFA have been simplified. Do you agree that these changes will assist preparers whilst still providing users of the accounts with relevant information about the income and activities of a charity? If not, please explain how the SoFA could better present information about a charity's income and activities.**

Simplifying accounts for both those preparing them and those reading them is welcome and explanations for combined amounts in the notes to the accounts is simpler for all concerned. However, the phrase '*However, this analysis can be undertaken if the relevant information provided by the charity in the notes to its accounts*' is not clear. Does this have to be declared in the notes?

**Q9. The current SoFA adopts a columnar format for presenting restricted income and expenditure from restricted funds. Do you agree that this columnar approach for reporting restricted funds in the SoFA should be retained? If not, please explain why you prefer a single column presentation combining restricted and unrestricted funds.**

The existing format should be retained - it's clearer and more accessible than having to refer to the notes.

**Q10. Do you agree that the Exposure Draft of the SORP addresses those issues which are of particular relevance to charity accounting and reporting? If not, are there specific accounting or financial reporting issues faced by the charity sector or in the sphere of activity that your charity operates in that the SORP should address?**

The Exposure Draft of the SORP appears to cover all necessary issues.

**Q11. The Exposure Draft proposes that grant making charities disclose in the notes to their accounts details of the name of institutions in receipt of material grants and the amount of such grants paid to them by the charity. Do you agree that this information should be given by way of note rather than in a separate publication that can be obtained from the charity on request as currently allowed by the existing SORP?**

DSC researches the activities of thousands of grantmaking trusts and foundations and we fully agree with the proposal in the Exposure Draft. There is no benefit (in fact there can be a cost) to producing a separate publication, and too often this is not publicly available or easy to access. It is our experience that too many trusts fail to provide information about material

grants made upon request. This is important information which allows fundraisers to more effectively target their applications to the most appropriate funder.

Further, it is in the public interest to know how charitable funds are spent, and the interest of the grantmakers themselves to be transparent about where money is being given and for what purposes.

DSC believes the SORP should require grantmaking charities to disclose information about material grants in the accounts. Where the numbers of grant awards are too great to be practically included, then material grants above a certain value should be described.

**Q12. The SORP requires larger charities to disclose staff salaries paid in bands of £10,000 for employees earning over £60,000. Should larger charities also be required to also disclose the job title and remuneration of their highest paid employee?**

Is the remuneration of the highest paid employee not already obvious from current required disclosure? Unless for example the chair is paid, which should be stated separately, would not the highest earner normally be the Chief Executive or equivalent anyway?

It is important for accountability to the public to know what senior staff are paid, but this also needs to be put into context, in particular because of the high level of public interest in this issue at the moment. There should be scope in the accounts to elaborate on this in a narrative format related to the disclosure of salaries.

Charities must be transparent about how charitable funds are being spent for whatever reason, including on paid staff who act for the trustees to achieve the charity's aims and objectives.

**Q13. The Accounting Council has suggested that a clearer distinction is desirable between those disclosures required by accounting standards and those resulting from charity law or from the higher level of accountability expected of charities.**

**Which one of the following options do you consider to be the best way of achieving this distinction?**

- a. Remove the disclosures related to accounting standards altogether and simply substitute with cross references to the relevant standard.
- b. Provide a brief summary to explain what disclosures are required by accounting standards along with cross references to the particular standard.
- c. Retain the current approach of the Exposure Draft but separately identify in each module those disclosures that are required by charity law or for the public accountability.
- d. Move the disclosures required by accounting standards into a separate appendix and refer in the text to the appendix and/ or accounting standards as necessary.

We think C is the best option - the Exposure Draft certainly doesn't need to be longer but it does need to be clear, and the majority of people reading the accounts aren't charity accountants. C provides the necessary information and transparency without recourse to another document.

**Q14. Do you agree that charities should not be able to adopt the reduced disclosure framework provided by FRS 102? If not, please explain why you think charities should be able to take advantage of this framework?**

DSC agrees charities should not be able to adopt the reduced disclosure framework for the reasons stated – for example, it removes the requirement for the disclosure of employment benefits of key management and does not lend itself to the higher standard of transparency demanded of charities.

**Q15. Do you agree that the next SORP should support both charities that prepare their accounts using FRS 102 and also those that are eligible and choose to use the FRSSE? If not, please explain why.**

Yes. Why shouldn't it? All charities need to be accountable and need the SORP for guidance.

**Q16. Do you agree that the Exposure Draft successfully supports the use of the FRSSE and FRS 102. If not what changes would you suggest and why?**

It appears to although it is not always clear in each module which one it is supporting (or both). For example, module 1 doesn't appear to state whether it applies to one or the other or both, whereas module 2 clearly states at 2.4 that it applies to both. Module 3 is clearest as it states at its first sub-clause - 3.1 how charities should read the module (whether reporting under FRSSE or FRS 102).

**Q17. Do you agree that investments held both to produce an investment return and also for the contribution the funding makes to a charity's purposes (mixed motive investments) should be classed as a component of financial investments and separately disclosed on the balance sheet or in the notes to the accounts when material? If not, what alternate approach to classification do you recommend and why?**

Yes, mixed motive investments, in the interests of transparency should be classed as a component of financial investments and separately disclosed in either of the ways suggested.

**Q18. Do you agree that an impairment loss arising on a mixed motive investment should be analysed as an investment loss in a charity's SoFA? If not, how else might the loss be analysed in a charity's SoFA and why?**

Such a loss should be analysed as an investment loss in a charity's SoFA - this is ultimately what it is.

**Q19. Are there any circumstances in which a separate corporate body can be regarded as a branch and included in a charity own individual entity accounts? If so, how would you distinguish a separate corporate body that is a branch from one which is a subsidiary and included in a parent charity's group accounts?**

DSC is not able to offer a view at this time.

**Q20. The Exposure Draft requires a charity's share of any surplus or deficit in an associate or jointly controlled entity to be shown as a single line in a parent charity's**

**consolidated SoFA. Do you agree with this accounting treatment? If not, should the charity's share of income and expenditure be shown separately so that the user of the accounts can better understand the scale of the charitable activities carried out by the associate or joint venture?**

The current reporting requirement of reporting separately would seem to provide more easily accessible information to the reader.

**Q21. Do you agree that income from government grants should be recognised on the same basis as other grants and donations? If not, why should government grants be recognised on a different basis?**

We agree – and we fail to see why government grants should be treated any differently from other grants and agree that the performance model gives a more accurate record of the grant's effect in a particular financial year.

**Q22. Do you have any comments on any other accounting principles or treatment within the Exposure Draft? If making a comment, please state: the name of the module(s) and the paragraph number(s); your suggestion for change(s) to be made; and the reason(s) why change is needed**

It's clear how much work has gone into the preparation of the Exposure Draft and it's unlikely that simplifications that could have been adopted have not been considered and implemented. However, trustees and staff of small charities will find this a burdensome document to understand and absorb.

As stated previously, the publication of guidance booklets dealing with specific issues by the Commission or the OSCR (as already exist for the current SOFA) *must* continue, as for many charities they will continue to be very necessary, especially in the light of the withdrawal of direct support and advice from the Charity Commission.

**Q23. Do you agree with the simplifications made to the current SORP's recommendations and if not why do you consider a particular requirement should be retained?**

We would comment on the second bullet point proposed in the Exposure Draft as a simplification: '*only requiring the disclosure of ex-gratia payments where regulatory consent for payment is required*'.

We believe this is unclear and are concerned at its proposed removal. The SORP committee needs to further clarify why this has been removed. In line with CC7 it is our understanding that trustees must always seek authority from the Commission before making an ex-gratia payment. If non-authorised payments are permitted we would see no benefit to removing the requirement to disclose these payments in the accounts. These are the very ones likely to go under the radar and therefore this proposal would not seem to aid or improve accountability or transparency. The SORP should make clear that disclosure of all payments made to trustees in particular (*ex-gratia* or otherwise) for whatever reason, is best practice.

**Q24. Do you have any suggestions for further simplifications to the Exposure Draft and if so what are they and what do you believe are the benefits of the additional simplification(s) you propose?**

We do not have any further suggestions at this time.

**Q25. In responding to the FRC's report 'Cutting Clutter' would you recommend that the joint SORP-making body:**

- a. cease publishing any illustrative examples of trustees' annual reports and accounts; or**
- b. publish only two illustrative example of trustees' annual reports and accounts, one for a charity adopting the FRSSE and a second for a charity adopting FRS 102 ; or**
- c. publish a series of examples for different types and sizes of charity?**

We would support option C. The samples should not be prescriptive but can help make quite complex terminology and guidance more real and able to be interpreted by the layperson.

It should also be noted that the FRC's Code of Practice also indicates that it will not normally be necessary for a SORP-making body to supplement a SORP with further guidance. We believe the continuation of such guidance will remain essential for many charities, and a series of examples would be an important part of illustrating that guidance.