

DSC Consultation Response

Research exercise on charities SORP

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1. 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 Charity Commission and the Office of the Scottish Charity Regulator, now the joint SORP-making body for charities, have launched a research exercise on five specific areas of the SORP to identify areas in need of changing in anticipation of a new SORP in 2018.

DSC has responded to this consultation as it affects the charity sector as a whole and its millions of beneficiaries. 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.

2. DSC’s interest in this consultation and the SORP

Small charities and grantmaking charities

DSC has a particular interest in charity law and in particular how policy and regulation affects smaller charities. DSC 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.

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.

3. Summary of key points

We have included detailed responses to the consultation questions in Part 4. Below we summarise our main points:

- **SORP importance and awareness** – the SORP is a critical part of ensuring charity transparency, via good reporting and accounting. The homepage of the charity.sorp.org website should offer a clear and brief explanation of what a SORP is, explain why charities should use it, and what it means for the public.
- **Regulatory cost/benefit** – Every pound spent on regulatory compliance by a charity is a pound that cannot be used to help beneficiaries – the very reason charities exist. Additional regulation must demonstrate clear benefits to the public because the burden of regulatory compliance ultimately impacts beneficiaries. Regulation should be proportionate, appropriate and enabling (see our principle at 6 below).
- **Regulatory overkill** – policymakers are increasing regulatory burdens (and direct financial burdens) on charity trustees, often with insufficient justification or a clear rationale for effectiveness. This risks charities' ability to recruit and retain trustees, and takes away resources from helping beneficiaries. Regulators need to consider beneficiary needs in reviewing and revising the SORP, yet they barely feature in any of the narrative.
- **Helpline** – volunteer trustees of smaller charities in particular need access to free telephone help and support from the Regulators, but this is increasingly restricted. Government needs to properly resource the Regulators to provide this support.
- **Accessible guidance** – providing guidance notes, prompts and best practice examples would help preparers better integrate the report and accounts as part of showing the difference the charity has made. However, more resource needs to be invested in making this happen; just changing the SORP won't necessarily improve the content.
- **Key Facts Summary** – this suggestion is bizarre given that the Summary Information Return was scrapped only a few years ago, on the grounds that it was a duplication. Regulators need to do more to educate the public about how to access, read and understand charity accounts, rather than assuming that extrapolating certain bits of information out of context will improve transparency (it could do the opposite).
- **Media scandals and individual charity failures are the wrong drivers for regulatory change** – DSC is very concerned that as a group, most of the themes proposed by the Regulators for consideration in the SORP read as a response to recent media headlines, rather than as a considered evolution of priority areas for the SORP.
- **'Solutions' based on misunderstandings of 'the problem'** - too many of the regulatory suggestions are the wrong solution to the problem or fail to sufficiently understand what the problem is. If 'the problem' is the lack of public awareness about charity regulation and reporting, the solution is not to randomly increase regulatory requirements.

- **The definition of ‘must’ and ‘should’** – these terms are confusingly worded and are substantially different from those definitions used in other guidance documents used by charities. There needs to be convergence with these definitions.
- **The publication of the names of donors** – this should be encouraged but should not be a requirement of the SORP. i.e. ‘should’, not ‘must’. The exceptions from disclosure afforded to trustees and senior staff members for reasons of personal safety should be extended to donors and expanded upon.

4. Responses to consultation questions

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

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?

Somewhat, but please see response to Q2 below.

Q.2 Is more assistance required to help smaller charities? If so, please explain what is needed and why?

Yes. Smaller charities are saturated with information for legal and reporting requirements from various regulators, which are often in the form of lengthy and complex documents. A useful service would be a regulators’ dedicated helpline (phone and email) for the use of small charities. There could perhaps be some sifting mechanism in place (perhaps based on charities’ latest annual expenditure) to ensure it services only smaller charities and to stop larger organisations or accountancy firms from ‘clogging it up’. An FAQ section on the regulators’ websites would also be useful for legal/reporting enquiries. Also the site could do with an improved search function so that smaller charities don’t have to spend an inordinate amount of time sifting through lists of guidance.

There is a capacity issue in terms of affordable access to help and advice for many small charities. Regulators and agencies across sectors are demanding more and more information, and increasingly charging (or proposing to charge) cash-strapped charities for the privilege. The Charity Commission, and the Government should invest funds to help train and develop trustee skills in financial management, but also in how to write effective annual reports that demonstrate the charity’s impact and effectiveness for the reader.

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?

While the distinction between the definitions of ‘must’ and ‘should’ are clear the individual definitions are obscure and are inconsistent with those used in other guidance documents used elsewhere by charities.

As per our response to the 2013 consultation, we propose the SORP committee adopt the definitions used by the Charity Commission for England and Wales as set in CC3: The Essential Trustee. For reference these are:

- ‘must’ means something is a legal or regulatory requirement or duty that trustees must comply with
- ‘should’ means something is good practice that the commission expects trustees to follow and apply to their charity.

It is clear from these definitions that ‘must’ is a legal requirement. It is clear that non-adherence would be a breach of legal duties. This is not as clear from the SORP, which defines the term as an indication of ‘those elements that are important to the reader of the trustees’ annual report that **must** be included within the report’. This is meaningless and is made less comprehensible by the fact that the word ‘must’, itself, is used in this definition in a different context.

The SORP describes the implications of non-adherence to a ‘must’ saying that it would be ‘a departure from the SORP’, which again seems meaningless to most charity professionals using the SORP who are not expert accountants. It says nothing of the implications a charity should expect should they not obey a ‘must’.

Likewise the Charity Commission’s definition of ‘should’ is far clearer. It is not necessary to say ‘recommendations aimed at advancing standards of financial reporting as a matter of good practice’ when it can just be called ‘good practice.’ Again, saying non-adherence ‘would not be a departure from the SORP’ is meaningless. It is not communicated that the person completing the accounts is expected to follow ‘good practice’ and therefore this is potentially misleading.

In summary, the Charity Commission achieves more clarity and certainty on its definitions of ‘must’, ‘should’ and ‘may’ in the space of 34 words than the SORP does in 260 words. We recognise that not all regions use the Charity Commission for England and Wales’ approach. However having definitions in each region, plus a completely different definition in SORP is messy and problematic. The SORP needs to recognise that the charities using this may not have, or be able to afford, expert accountants. Therefore, short, simple and clear is key.

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

Yes, SORP is extremely useful for the public, those looking for funding and those looking to give (legacies etc.). The charities SORP is also very useful to research organisations such as DSC, where researchers examine charity accounts on a daily basis and play a key role in making charity information more transparent and accessible. DSC provides information to a vast number of charities and individuals searching for funds. DSC researches thousands of charities in a year, particularly grant-making organisations, and SORP is very useful in quickly determining the information required. DSC also deals with many enquiries daily from organisations and having SORP in place helps our organisation deal effectively with these enquiries, most of which come directly from the users of the regulators themselves.

It is important to note that the Charities SORP is a bolt-on to the recommendations on financial reporting and accounting in the corporate sector. It is not specifically created for charities. As a result, it is long at nearly 200 pages and is worded in a highly technical way, which is not suited to the voluntary sector. The sector needs a SORP which is as much as possible designed for them and which takes their structure into account.

It is common for charities to not have the necessary accountancy skills to complete accounts. About 83% of charities exist on an income under £100,000 per annum. They are likely to have one or two staff members, if any. The SORP is somewhat helpful in this regard but it can be made far more accessible to those dedicated charity professionals and volunteers who lack the time and accountancy skills to deal with this highly complex area of regulation.

Society cannot function without these groups and so the answer to the problem is not to force charities to spend scarce charitable resources of expensive accountancy firms or training courses, but to start with a very clear picture in mind of what small charities need. The withdrawal of the FRSSE is something of a backward step as now not only is there no SORP specifically built for charities, but now there is nothing specifically for small organisations. A version of FRSSE should be reinstated.

Section 3.2: Implementation issues that require improvements to the SORP

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 they are and where possible please give examples.

See the response to Q2.

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

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?

The key question here is proportionality, but also cost effectiveness, where the regulatory cost must be balanced with the effectiveness of greater disclosure. Would three tiers be better than the current threshold at £500,000? Possibly, but on the face of it, without further information, DSC is not convinced. What would the extra reporting requirements

be? There is some logic with synchronising any thresholds with company law, but a compelling case needs to be made about the benefits (in terms of transparency and public confidence) of the additional regulatory burden for larger charities.

It also depends on how effective this third tier of reporting would be in terms of how the regulators will scrutinise and take action over problematic accounts. For example, the last few years of accounts for Kids Company very clearly reported their declining income (with no need for an extra 'third tier') with assets being drawn down, yet no action was taken by its trustees, accountants, auditors or regulator. Will additional information actually be used by regulators in risk analysis and management, or just collected?

Warnings can be issued by the regulators publicly even for what could be considered minor issues, which could damage the long-standing reputation of a charity. However there is nowhere on the regulators' websites where it states that a charity's accounts have been received and passed by the regulator. The regulators could guarantee to scrutinise compliance and approve accounts when income and expenditure are over a certain amount (DSC is not in a position to comment on what this amount should be, more consideration is needed on this). One suggestion is that there could be a colour code on the site that indicates when accounts are being reviewed by the regulators and when they are passed etc.

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 per Q6 above, we're not convinced that a compelling case has been made for a third tier for the largest charities.

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?

DSC supports the first point, namely providing guidance notes, prompts and best practice examples to help preparers better integrate the report and accounts as part of showing the difference the charity has made. However, as we indicated in response to Q2, more resource needs to be invested in making this actually happen in the real world. Sufficient progress is unlikely to be achieved simply by changing the document itself.

DSC is particularly concerned about the suggestion of key facts summary. The consultation document makes an assumption that 'the general public are interested in the annual report and accounts of a charity'. We don't believe this to be founded in evidence – in fact, far too few members of 'the public' even understand a) what a charity's report and accounts are b) that these can be found for charities above £25k income, c) how to read the report and accounts, d) what the Charity Commission's role is with respect to charity accounts, or even e) what the Charity Commission is and does in general.

This suggestion risks turning the problem on its head. Charities are required to comply with a massive amount of legal and regulatory obligations, which is certainly out of proportion

when compared to companies of similar size. Regulators should focus on educating the public about what they do, and how to understand this information, rather than looking for a ‘silver bullet’ solution based on an assumption that a few bits of information will educate the public.

Despite the intention that a Key facts summary would provide greater clarity, it may actually obfuscate a fair analysis. Further, the pendulum of regulatory complexity seems to be swinging back again. In the past there was something called the Summary Information Return, which attempted to do something similar. However this was removed, following Lord Hodgson’s red tape review, because it was deemed to be duplication and ineffective.

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?

Fundraising overheads are not a proxy for charity effectiveness or even necessarily fundraising effectiveness – some charitable causes by their nature are more popular and a less challenging fundraising ‘ask’ for the public, hence perhaps requiring less investment or generating higher returns relative to investment. Further, the lack of clarity about what is a fundraising ‘cost’ – even from the new Fundraising Regulator – does not help matters. DSC supports transparency but also where comparisons are going to be drawn between charities these need to be informed and fair, not simplistic. Fundraising can be extremely complex and attempting to strictly standardise reporting requirements on costs to make it ‘easier’ to compare charities’ fundraising practices is disingenuous.

We find the suggestion in the document that ‘funders find it difficult to assess the ongoing surplus/deficit of the charity’ quite bizarre. Charitable foundations, as charities themselves, should be intimately familiar with charity balance sheets and accounting practices – particularly where revenue or capital grants are concerned. Their staff (or trustees) should be able to assess charity balance sheets as a key function of evaluating bids, if that is part of their assessment criteria (which in most cases it is). So what is this statement based on? Statutory funders that have no understanding of charity accounts? If that is the case, they need to educate themselves.

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

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

As a group, these themes disturbingly read as a response to recent scandals and one-off ‘crises’ in the sector, rather than as a considered evolution of priority areas for the SORP.

DSC believes that there is plenty of information already provided by charities under the current reporting requirements. The issue is that people simply do not read it, take the time to understand it, or even know that it is there. Having further and more complex reporting requirements will serve to muddy issues, such as fundraising, rather than bring greater clarity. Further comments on specific sections are below:

Themes: making a difference for the public benefit

Public benefit reporting – There is a sense that regulators are not getting the answers they want (or they think the public want), so they keep asking the same questions in different ways. What is the actual issue here? Is it that charities are not adequately describing public benefit, and are treating this as a tick-box exercise? Is it that they are not demonstrating impact or effectiveness? Is it simply that there is not enough good explanation or clarity about what the charity does in the TAR? The precise ‘problem’ needs to be identified, so a logical, intelligible and non-duplicating reporting solution can be developed.

Beneficiary involvement – where practicable, beneficiaries should be involved in informing services and how charities operate. The level of that involvement is not something that can be prescribed by regulations. Charities must recognise the benefits of involving beneficiaries and decide for themselves what is appropriate. For those charities that provide services for clearly identifiable beneficiaries or groups, this may be good practice. In fact, charities might even welcome more beneficiary involvement if it was possible and feasible.

However the statement makes a number of assumptions about the nature of charities, such as a) they all provide services b) there always can be a clear connection between the impact of a service and a specific beneficiary c) beneficiaries are human d) beneficiaries are for whatever reason able to contribute to service design.

Theme: risk management

This reads like a response to the Kids Company collapse – a high profile, single case. In general it misses the point that no matter how well a charity is run, or how many regulatory checks are in place, nothing can prevent some charities from going under unexpectedly, with potentially negative consequences for beneficiaries. That is an unfortunate reality, particularly in the current environment.

Reserves – the phrase ‘advising if reserves are sufficient to avoid service disruption to the charity’s beneficiaries’ is a nonsense. A sensible reserves policy may be to keep sufficient reserves to allow the trustees to wind up a struggling charity in an organised way, hopefully including passing over key services to other organisations. It simply isn’t reasonable or possible to legislate for a charity’s continuing existence with a reserves policy (unless that policy includes a map for buried treasure or a packet of seeds for a money tree).

Financial controls – ‘whether all charities be required to explain what assurance they have that the charity’s financial controls are operating effectively’. In the case of charities above the audit threshold (such as Kids Company) is that not the auditor’s job? In the case of those below, whose job should it be?

Theme: going concern

Of course charity financial viability is a key issue, but we fail to see how the related suggestions are necessary above and beyond current requirements. If for example, if a charity had a pension liability that potentially affected their viability, wouldn’t the trustees be negligent if they failed to disclose or discuss that? What difference would creating a box on the form do in this case?

Themes: enhanced analysis of expenditure and disclosure of key facts

'IPSOS-MORI found that the overwhelming majority of people surveyed believed that charities should provide the public with information on how they spend their money and how they benefit the public.' Charities do that in great detail, at great administrative cost, in their reports and accounts. As we outlined above, the issue is not with more information, but lack of understanding and awareness about existing information. Requiring more and more information simply increases the burden of producing it at the expense of beneficiaries.

What purpose would greater reporting requirements serve when the general public do not appear to look at the regulators websites or charity accounts anyway? Charities already include great detail in their annual reports and accounts about the public benefit they provide and how they spend their money. Having enhanced reporting requirements will make little to no difference for the public who are by and large unfamiliar and unlikely to access information from regulators who most people don't know exist. The regulators may find their time better spent in challenging negative media portrayal of charities by drawing on the thousands of good examples of excellent charity governance and reporting in the sector. The regulators are the very bodies that should be defending the huge contribution that the vast majority of charities make to our society almost all led by committed responsible and dedicated unpaid charity trustees.

Theme: disclosure of who funds a charity

This is a very complex issue and should not be taken lightly. On the one hand we do not want to discourage a donor from giving if they do not want to be named, but on the other hand, especially where the donor is a company or an individual with company interests, there is a need for transparency where large sums of money are involved.

On balance we believe the need for transparency outweighs possible negative impact on charitable donations. We believe donors should declare their charitable donations, and where the donor is known to them, charities should do so as best practice i.e. it's a 'should' not a 'must'.

In many cases a donor may not wish to be named for personal reasons, perhaps because doing so would be a public indication of their religious beliefs, sexuality, health condition etc. Provision must be made so that a donor can give freely without fear of this personal information becoming public knowledge against their will.

SORP makes provisions to exempt a charity from disclosing 'the names of trustees or of the charity's principal address or the disclosure of the name(s) of any chief executive officer or other senior staff member(s) could lead to that person (or others) being placed in personal danger (e.g. in the case of a women's refuge)' (SORP 1.29). This wording should be applied to the disclosure of the names of donors and expanded to read '...a person (or others) being placed in personal danger or where disclosure would result in an undue violation of the individual's right to privacy with respect to personal beliefs, sexual orientation, health or other characteristics.'

The value of the donation being given is important. How much might a person have to give before the charity is required to identify the donor in their accounts? Small amounts of money are unlikely to result in undue influence over the charity and it would be impractical for a charity to name all of its smaller donors, which for many would number tens of thousands of names. It is not clear what level the Committee might consider appropriate for this.

Theme: making a difference for the public benefit

Having a more explicit explanation of the beneficiaries the charity works with could be useful and generally would be good practice. However, there should be some caution around it being a specific requirement that all charities should have their beneficiaries involved in service design as this may not be practical for all charities/beneficiaries. Beneficiaries should not be put in a position where they feel they have to be involved and indeed it may not be suitable for some beneficiaries to be involved in service design, e.g. charities working with people with very complex needs. It may be good practice to be advised by beneficiaries at a trustee level, but to go back to beneficiaries for decisions on complex services could be problematic. DSC strongly disagrees that this be made a requirement, and recommends if it is to be included that it is a 'should' not a 'must'. Charities that successfully involve beneficiaries in service design can and do report on this in their annual report anyway, without needing a specific requirement to do so.

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 do not support any of these suggested issues, please identify the issues that need to be addressed and explain your reasons why?

We believe we have done that in our responses above.

Section 3.5: Your ideas for items to 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?

DSC has nothing to suggest at this time.

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?

DSC has nothing to suggest at this time.

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?

DSC has nothing to suggest at this time.

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?

DSC has nothing to suggest at this time.

5. Conclusion

DSC strongly believes that the vast majority of charity staff and trustees need to be applauded for the excellent management of their organisations. Poorly researched, biased and sensationalised stories in the press should not be the driver for regulatory change in the charity sector. The regulators must listen to charity staff, trustees and preparers who have detailed and vast experience about the process, and most importantly, about the regulatory burden and how this may impact negatively on beneficiaries – which are the whole point.

6. 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.