

## **Activity reporting by charities (PAPER 4)**

### **Introduction**

1.1 The purpose of this report is to consider the views of the engagement strands and SORP Committee working groups on the definition and reporting of activities in the Statement of Financial Activities (SoFA). The preferred options or a summary of recommendations from each engagement strand are reproduced in the annex (Paper 4.1).

1.2 A number of strands took a discursive approach to the topic and in these instances a summary is provided in place of a preferred solution. The full feedback submission of any strand can be requested by Committee members from the Secretariat.

1.3 The joint SORP-making body received responses from all seven Engagement Strands:

- Academics and regulators and proxies for the public interest (ARPPi)
- Trustees (T)
- Larger charities (L)
- Smaller charities and independent examiners (SCIE)
- Professional and Technical (A) (PTA), and
- Professional and Technical (B) (PTB)
- Major Funders & Donors and Government & Public Bodies (MFDGPB)

Additionally, two SORP Committee Working Groups combined to provide a response to the briefing paper following the meeting of the Charities SORP Committee on 1 December 2021 (referred to as WG).

1.4 This paper considers the feedback given against the following aspects of activity reporting:

- Whether to continue with activity reporting
- Charities that should be required to report by activity
- Suggested changes to the text of the SORP
- Ideas for additional help and support for preparers
- Other observations made about charity reporting

1.5 The paper concludes with recommendations for consideration by the SORP Committee. The default position of the SORP-making body is that if a case for change is not made for a particular topic, then the provisions of the SORP in relation to that topic will remain as they are at the drafting stage.

## **Whether to continue with activity reporting**

2.1 There was unanimity across the strands and combined working group to retain activity reporting for larger charities but that other charities should retain the option of reporting on a natural basis.

2.2 Several strands noted the overlap with previous discussions of support costs, the analysis of expenditure, and the structure of the Statement of Financial Activities (SoFA). That said activity reporting was not straightforward and there were still issues around ease and consistency of reporting on this basis. This is the case despite its original introduction within the 2005 SORP and similar issues have been previously highlighted in respect of reporting support costs (even though this item was first introduced in SORP 2000).

2.3 The link with the trustees' annual report was noted as an area that needed attention:

- Text could be added to the SORP highlighting the importance of consistently describing activities throughout the annual report and accounts (WG)
- There needs to be a better way for annual reports and accounts to 'marry' the figures with the narrative reporting to provide a more rounded account of the charity's performance (T)
- Clarity could also be provided on the provision of further analysis of charitable activity spending (SCIE)
- Understanding what is meant by 'activities'/ 'activity reporting' is really key to making a success of activity reporting. It is something that charities find it difficult to do well. The Charities SORP does provide requirements and guidance but there is no overall summary which gives charities a feel for what activity reporting is all about (B) (PTB)

2.4 Although support is across the board for continuing with activity reporting, the associated attribution/apportionment of costs and the merits of retaining a separation of support costs was noted as an area of both debate and variations in practice that affected the quality of reporting.

2.5 The handling of support costs is a consideration whether shown as a single row item in the SoFA (SORP 2000) or these are absorbed into activities (SORP 2005 and FRS102 SORP). The same issue arises even if only a single direct charitable expenditure figure is reported in the SoFA (SORP 1995) unless no breakdown of expenditure is given in the notes to the accounts.

2.6 This issue of attribution/apportionment does not arise with the use of a natural classification where expenditure is reported by its nature e.g. salaries, computer consumables, premises repair, materials etc. Several strands noted the importance of smaller charities having this choice. This alternative approach was introduced with SORP 2005 and retained in the FRS102 SORP (see module 4).

## **Charities that should be required to report by activity**

3.1 The majority of strands thought that the reporting of activities is required only of larger charities (higher tier charities). One strand had notable dissension with this view as by permitting different reporting formats the SORP impedes the user being able to compare all charities on an equivalent basis: The consistency and comparability of the activity-based reporting format is vital for the data that we wish to collect about charities and display on the Register of Charities (ARPPi).

3.2 The advantages noted by strands keen to retain the option of an alternative approach included:

- Permit the use of natural classifications for smaller charities (though we appreciate that the definition of a larger charity is different across the jurisdictions covered by the work of the SORP Committee). (T)
- It was generally accepted by the group, that activity reporting should remain in place for larger charities and that it would be a backward step to move away from this. The option to use natural categories for smaller charities should also be retained (A) (PTA)
- As a general point it is not always possible to link expenditure with income, and for smaller charities it is easier for them to report using natural classifications (MFDGPB)

## **Suggested changes to the text of the SORP**

4.1 A number of strands made thoughtful observations about how the SORP might be changed which extended beyond module 4 (SoFA) and the allocation of costs by activity (module 8) to include the trustees' annual report (module 1).

4.2 In respect of module 4:

- Table 2 presents Charitable Activities on a single row. This could lead to a single activity being seen as the default position. It was suggested that this Table could instead have indicative rows for Charitable Activity A, Charitable Activity B etc. to encourage charities to report more than one activity if relevant (WG)
- Clear information early on in the SORP about the three options available for accounts format – R&P, natural classification, activity based classification with a shift from the notion that activity basis is the preferred option with an alternative (SCIE)
- A natural classification example SOFA in the SORP may also be helpful, again just to give a visual cue that there is another option (SCIE)
- At the moment it appears that this can be just down to the total cost of each charitable activity split into activities undertaken directly, grant making and support costs (4.57 & 4.58). Further analysis only being needed for support costs and then the total salaries being shown in another note. We do see a natural classification breakdown of charitable activities from time to time and so it could be helpful if clarity was provided as to whether analysis into material items is needed or whether it can be omitted (SCIE)

- So, although the strand did not see a case for change from activity reporting altogether some changes were needed in the SORP in relation to support costs and expenditure disclosures (A) (PTA)
- Paragraph 4.29 gives some easy to understand examples of activity reporting. It may therefore be useful to introduce commentary on what activity reporting is and what it is seeking to achieve, along with examples, up front in the Charities SORP. Some additional examples would be welcome (B) (PTB)
- Paragraph 4.5 - change to a 'must' from an advisory 'should': "Charities reporting on an activity basis must ensure that those activities reviewed in the trustees' annual report are also reported on the face of the SoFA or in the notes to the accounts (B) (PTB)
- Consideration is given to introducing either requirements or guidance to the effect that activity reporting involves corraling activities in a manner which reflects the way the charity is managed and governed. Under this approach, most members of the Strand would favour fundraising activities being reported on in the SoFA separately from (other) charitable activities (B) (PTB)
- Increase the categories lines of expenditure in accordance with the above suggestion so that any explanatory notes can be more easily and simply reconciled to each expenditure line (MFDGPB)

#### 4.3 In respect of module 8:

- Also, on support costs – it should be made clearer – either by referencing the accruals pack or in a table referred to above, or within section 4 (it is already stated in section 8. . .) that all charities reporting on an activity basis must show the total support costs and an analysis of material items even if they only have one activity (SCIE)
- The guidance in Module 8 could still be provided but it should be clear that this is guidance only and that charities should use methods of allocating appropriate to their particular charity. The guidance could be more 'gentle' guidance rather than mandatory (A) (PTA)
- It was generally agreed that Table 4 should not be required but that Table 3 could be expanded to show the different type of costs across the top. Specifically, the support costs column would be removed and replaced by a number of columns of specific material costs e.g. wages and salaries, fundraising costs, IT costs etc. The costs would be allocated out as the charity sees fit. The detailed disclosures on methods of allocating support costs could be replaced by a general explanation of why such costs were incurred. In relation to comparatives, it was agreed that methods of allocating support costs should only be required for the current year; not the previous year as well (A) (PTA)
- Paragraph 8.6 - change from an advisory 'should' to a 'must'. "The activities reported must also be consistent with the significant activities noted in the trustees' annual report. The narrative provided by the trustees' annual report should help the user of the accounts to understand the nature of those significant activities and what has been achieved as a result of the expenditure incurred on them (B) (PTB) and (L) and (MFDGPB)

4.4 In respect of module 1, the observations were more general with several strands looking to better align the narrative with the reported expenditure:

- In general, there needs to be a better way for annual reports and accounts to 'marry' the figures with the narrative reporting to provide a more rounded account of the charity's performance. It is noted that trustees could provide additional information in their annual reports and accounts to provide a more holistic review, but the current structure of the SORP and the risk averse nature of some trustees may combine to limit further thinking on how to combine the 'facts and figures' (T)
- The trustees' annual report (TAR) should be telling the story of what the charity did or is trying to achieve. The numbers are part of that story but cannot tell the story on their own regardless of what basis they are prepared under and whether or not elements are linked (SCIE)
- The Strand envisages that these changes will contribute to the overall objective of the trustees' annual report and financial statements working together to tell the story of the charity. It is the experience of Strand members that there is a disconnect between the trustees' annual report and financial statements (B) (PTB)
- The narrative provided by the trustees' annual report should help the user of the accounts to understand the nature of those significant activities and what has been achieved as a result of the expenditure incurred on them (MFDGPB)
- The accounting framework needs development so it can better enable charities to be consistent and transparent about reporting support costs (as a category in their own right) and explaining how they contribute to achieving the charity's purpose (including by supporting effectiveness and good governance) (ARPPi)
- Module on the TAR written for non-specialists, accounting modules written in more technical language. Hyperlinks between the TAR module and relevant accounting modules could be used where relevant (WG)

4.5 The suggestion was also made to bring together the relevant matters in a single module. If followed this implies a similar approach is taken for the alternative to reporting on an activity basis: Drawing together the relevant information and guidance on activity-based accounting into a single SORP module would make it easier to follow (ARPPi)

### **Ideas for additional help and support for preparers**

5.1 A suggestion was made for more advisory support:

- Example accounts should be available for one fictional charity, prepared in the three basic ways – eg with income of say £200k so big enough to have more than one significant activity but not so large as to have complex issues and notes – just containing the most common items (SCIE)

### **Other observations made about charity accounts**

6.1 All the engagement strands noted that there were broader issues that needed addressing beyond the editing of the SORP involving awareness of the SORP and a wider understanding of how accounts are prepared.

6.2 Suggestions around these broader issues included:

- Need for an education piece on the importance of the TAR and the need for connections between the TAR and the accounts (WG)
- The changes to the SORP could be an opportunity to draw more attention to the impact a charity has made, aligned to a published theory of change for the organisation (T)
- Our central concern is that this lack of understanding is preventing charity staff and trustees from making informed decisions about which format of accounts to adopt and partly explains the low take up of Receipts and payments and also natural classification accounts, both of which may be more achievable and affordable to prepare to a higher standard (SCIE)
- More references in the SORP to the accruals accounts pack(s) *produced by the charity regulators* since these give a much clearer visualisation of how activities should be analysed in the notes (SCIE)
- A wider feedback point on importance of training and education as part of implementation of new SORP – this has come up multiple times on various topics i.e. in many cases the SORP guidance is good and adequate but poorly understood or inconsistently applied (L)
- Until there is an education programme that changes public perception about ‘charitable costs’ and other costs automatically being considered ‘bad’. This discussion will go round in circles (MFDGPB)
- Consistent views were on the need to help charities report clearly and transparently. There is a need for education and training to support this – the SORP cannot do it all. Agreement that many charities do not properly understand how they should report (ARPPi)

6.3 Not all saw this work as falling to the SORP to do: Some members of the working group argued that it is not the job of the SORP to train people/emulate a management accounting textbook (WG) whereas others looked to the charity regulator: Charity Commission to engage in an education programme to do away with the public concept of ‘bad’ expenditure (MFDGPB).

**Recommendations:**

**7.1 The Charities SORP Committee is invited to consider the views of the Engagement Strands and reflect on their Working Group discussion set out in this paper to conclude whether there is any case for changes to the SORP.**

**7.2 If a case for change is made, consider which suggestions and recommendations set out above, in Annex (Paper 4.1) to this report or in the original briefing paper should they be taken forward into the development programme for the SORP and in particular, the Charities SORP Committee is invited to:**

- **Decide whether the SORP should retain the choice between natural classification and activity based classification for smaller charities but continues to require activity reporting of larger charities?**
- **Agree to the suggestions to clarify and tighten the wording in modules 4 and 8 in applying activity reporting**
- **Note the other suggestions for changes to module 4, module 8 and module 1 for review in the drafting phase**
- **Advise on whether additional guidance be developed to assist with activity based reporting**