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The Kubernes Partnership LLP – Comments on Draft Charities SORP

November 2013

We are pleased to submit the following comments to the consultation on the SORP Exposure Draft as published in summer 2013.

About us

The Kubernes Partnership LLP is a small firm of charity consultants, nowadays working largely in the Yorkshire region. For more than 25 years (even before the 1995 SORP) we have provided support to a wide range of smaller and medium-sized charities on accounting and constitutional/regulatory issues, including acting as independent examiner in some cases, and training on these issues. We also provide second tier support to various smaller accountancy firms and charity umbrella bodies on technical charity issues.

The Senior Partner is Dr Gareth G Morgan who is also Professor of Charity Studies at Sheffield Hallam University, though the comments in this submission relate to the direct work of this firm.

Many of the comments below derive from a *full day workshop* we held in October 2013, looking at the SORP Exposure Draft in detail, with 10 participants: a mixture of charity finance officers and accountants specialising in work with small/medium charities.

Our comments

Q.1. 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?

Yes.

However, we suggest further thought be given to the status of core modules and specialist modules with a view to classing more modules as specialist and not needed by all. In particular:

- Events after the end of the reporting period are the exception not the norm, so Module 13 should be removed from the core.
- The cash flow forecast is not required at all by charities applying FRSSE so Module 14 should be removed by the core.

Q.2. 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?

Yes, in general the language is clearer and easier for smaller charities compared to SORP 2005.

However, we are concerned that the terms “small” and “smaller” charities are not entirely clear in the ED. We suggest defining the following terms and using them consistently throughout:

- Small charities – those below the audit threshold (currently those up to £500K income in E&W and Scotland unless affected by assets)
- Medium charities – those above audit threshold but eligible to apply the FRSSE (currently up to £6.5M income, though subject to assets/employees tests)
- Large charities – required to apply FRS102.

Whilst the drafting is generally much more understandable than before, there are exceptions. Module 12 “Impairment of assets” needs a less technical name for the module to make clear that it covers normal depreciation as well as other kinds of impairments, and the language throughout this module needs more explanation. For example, the first substantive paragraph, 12.5, needs to give non-specialist readers some indication of what is meant by “when impairment is indicated”. The term “impairment” is not explained in the glossary. (By contrast, Module 11 is a good example of explaining complex technical issues in reasonably clear language without assuming too much prior knowledge.)

It would also help enormously if all terms explained in the glossary could appear in a different font.

Q.3. 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 helpful, but we urge the SORP Committee to take care that the terms are used consistently. In the final SORP, please give further guidance on the status of “should issues” – we suggest charities following SORP should be obliged to apply all the “should” requirements in the SORP unless there are very clear reasons for departing from this (e.g. impracticality or true and fair override). For anything which is not that important, please downgrade to “may”.

Q.4. Do you have any suggestions as to how we can improve the SORP micro site and web navigation of the Exposure Draft?

If the option of FRSSE or FRS102 is to be retained it needs to be possible to extract versions of the SORP for each option. However concentrate on the final PDFs – no one at our workshop anticipated that they would mainly use the SORP as an online document.

Please make sure the PDFs print clearly even on black & white printers – so please use a darker colour than pale green for headings etc.

Please make sure printed copies of the whole document can be purchased at attractive prices, and when the new SORP is launched, make sure that details of how to get the printed version are clearly explained to all charities (e.g. in Charity Commission News, OSCR Reporter etc).

Q.5. Do you agree with the proposed structure and content of the trustees' annual report? If not, what changes do you recommend and why?

The new explanations are clearer but we are not sure about moving the legal information to the end of the TAR. When reading a TAR, the first thing one wants to know is the legal structure, governing document, charitable objects etc.

Public benefit reporting (para 1.18) is valuable for *all* charities – not just registered charities in E&W – so we suggest making this a “should” feature for all (and a “must” for regd charities in E&W).

The SORP could be clearer on the status of **excepted charities** in E&W which are not generally required to prepare a TAR (Charities Act 2011 s.168). Accounts without a TAR are unhelpful to say the least. At the very least the SORP could say that all charities preparing SORP accounts **should** produce a TAR – or that if the charity is taking advantage of s.168 the main features of the TAR should be provided as notes to the accounts.

Q.6. 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?

These are fine in principle, but it is odd that this part of the SORP is separated from the public benefit reporting requirement (para 1.18).

In terms of the additional requirements for achievements and performance for charities over the audit threshold (paras 1.40 to 1.46) it would be helpful to include a reminder that for registered charities in E&W the Charities (Accounts and Reports) Regulations 2008 require more detail on public benefit reporting.

We suggest bringing these together to encourage charities to explain the advancement of their objects for public benefit.

Q.7. Do you think there is any additional information which should always be included in 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?

Where the charity has a membership (e.g. a charitable association, CIO, or charitable company) the TAR should require disclosure of some information about the **members** of the charity – as a minimum the number of individual members, the number of corporate/organisational members, and an indication of how many members are also charity trustees as at the last date of the reporting period.

The members of a charity in these situations exercise ultimate control and they should be disclosed.

Where the number of members is fewer than (say) five they should be named (subject to normal exceptions in those instances where names can be omitted).

Q.8. 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.

The changes of headings on the SOFA in every successive SORP are a big cause of frustration to small/medium charities. Even if a charity has an accounting system or has set up spreadsheets which can generate the SOFA directly from the accounting records, it is a lot of work to re-do all the analysis of nominal accounts and allocate them to new SOFA headings every few years. If the nature of the functional split changes, former normal accounts may need to be split. (In most cases this is considerably *more* work than the conversion of opening balances for IFRS convergence under FRS102).

Proper use of the SOFA headings requires that every transaction in the charity's accounting records must be properly coded to a nominal account which will then end up on a particular line of the SOFA. If successive SORPs keep changing, charities will just use percentage splits with no consideration of the underlying transactions. (This is, of course, in addition to the allocation across different funds.)

So, we urge the SORP Committee to take a decision on the SOFA headings for the long term. The choice of SOFA headings is simply about making charity accounts as clear as possible – it does not derive from FRS102. So a final decision should be taken on the headings which give the clearest picture of charitable income and expenditure, and strongly discourage further tinkering by future SORP Committees.

Nevertheless we accept that the headings in SORP 2005 have not worked very well, especially the subdivision of fundraising costs, and in general terms we welcome the return to categories which are much closer to the SORP 2000 headings.

Main headings and totals

We welcome the main headings of "Income" and "Expenditure" (rather than "Incoming Resources" etc).

Where a charity has received endowments we suggest the first heading should be "Income and Endowments Received" or "Income and New Endowments" **not** just "Income and Endowments" which is very confusing as the word "endowment" on its own does not generally suggest an endowment that has come into the charity.

However the line "Net incoming resources before investments gains" is unbelievably verbose and will be totally confusing to the average reader. We suggest "Surplus/Deficit". (NB Many charities will show a surplus in one column of funds and a deficit in another column, so the norm would be to use "Surplus/Deficit" as a combined description.)

Income headings

On the income side, we feel the first line should be "Donated Income" (not just "Donations") . Many people do not think of grants, legacies etc as donations, but they would accept they are donated income.

The explanations should make clear that *all* grants other than performance-related grants should appear on the "Donated Income" line – the present wording (3rd bullet in para 4.32) still seems to leave scope for doubt on this.

We do **not** support the idea of combining investment income and other income which certainly will not help readers. Investment income is a crucial aspect of charity accounts (even though for many the amount is small) – it should never be combined with anything else.

The SORP should make clear that the lines “other income” (and “other expenditure”) are only to be used when a wholly exceptional form of income or expenditure where it would be misleading to include it under another heading. It should not be used simply for income or expenses that are seen as atypical or miscellaneous for the charity concerned.

Expenditure headings

The single heading cost of raising funds is much better than the three-way split under SORP 2005.

But we do **not** agree with the removal of the governance costs heading on the expenditure side – these costs are now fairly well understood, and showing these separately is very helpful in enabling trustees and funders to understand what is meant by charity governance.

However, the guidance should make clear that staff time spent directly on supporting governance activities should be included in governance costs when a functional split is used. For most charities this would include:

- time spent by chief executives or other senior staff on preparing papers for trustees’ meetings, attending trustees meetings etc
- administrative costs of trustees meetings and AGMs (staff time on agenda minutes, agenda, publicity and venues – including sub-committees where applicable)
- the time of finance staff dealing with statutory accounts and audit/independent examination (as opposed to the internal financial management of charitable activities) – this would include the time taken to implement the new SORP and any associated training costs
- staff time and other costs related to trustee recruitment
- staff time and other costs dealing with any kind of communications with charity regulators or with regard to the legal status of the charity.

Inter-fund transfers

We welcome the clarification that inter-fund transfers must total to zero, but we remain concerned that many charities are not using this line properly and the SORP could be much clearer on when inter-fund transfers should be shown.

It is not unusual to see charities with large numbers of restricted funds, with no inter-fund transfers at all, when in practice there will often be cases of restricted funds being wound up and balances transferred to other funds (hopefully with the consent of the funder) – but if these are not disclosed as inter-fund transfers, the notes explaining the reason for the transfer will not be provided. This may mean restricted funds are being spent in a manner which amounts to a breach of trust.

Whilst an expense may, of course, be apportioned between funds, we suggest the SORP should make clear that any explicit *recharge* from one fund to another should always be presented as an inter-fund transfer with appropriate explanation in the notes – for example when a restricted fund makes a flat contribution of “management costs” to the charity’s unrestricted funds.

Small charities

We welcome the continued policy to allow *charities below the audit threshold* to use headings of their own choice of SOFA headings, but the SORP **should** require them either to use the functional headings, or natural headings, not a mixture.

If the headings specified in the SORP are used, the SORP should state that even in sub-audit charities they **should** be used in accordance with the SORP principles – not redefined to mean something completely different. However, a concession allowing smaller charities to have a “Support costs” line, as in SORP 2000, rather than having to apportion support costs across other headings, would be helpful in encouraging smaller charities to use the functional basis.

Q.9. 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.

Yes, the columnar SOFA has been a hugely successful feature of charity financial reporting since it was introduced in SORP 1995. It has made a massive difference to understanding by trustees and by many charity supporters and funders.

Most trustees and funders now clearly understand unrestricted and restricted funds (even if they do not have a clue about issues like income recognition).

Charities which have to follow SORP should not be allowed under any circumstances to opt out of preparing a multi-column SOFA if the charity has more than one class of funds. (Even charities preparing receipts and payments accounts are increasingly using the multi-column format.)

However, the new SORP could encourage provision of prior year columns for each category of funds, not just for the “All funds” column. Given that only a very few charities need all three columns (unrestricted, restricted, endowment) this would not be excessive.

We recognise that there may be a case for showing endowment funds differently, but on balance we feel the current format is clearest, so that newly received endowments appear on the top half of the SOFA.

Q.10. 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?

No comment.

Q.11. 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?

Yes. Grant disclosures are a crucial feature of charity reports and accounts and must remain in the statutory documents – either in the accounts themselves, or in the TAR but with a note in the accounts referring to them (so that either way the grants list forms part of the accounts and is subject to audit/independent examination).

Q.12. 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?

We welcome such disclosures, but even smaller charities should be encouraged to give some information of this kind. Rather than saying “no employee is paid over £60K” they should give the relevant £10K band for the highest paid person – e.g. “No employee is paid over £30K”.

If a charity has no employees this should be stated explicitly.

Q.13. The Accounting Council has suggested that a clearer distinction is desirable between those disclosures required by accounting standards and those resulting 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.**

Retain the current approach – c.

Q.14. 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?

No comment.

Q.15. 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.

This is not an easy issue. In principle we support the choice of FRSSE or FRS102, but we would like to see the FRSSE updated to come closer to FRS102 principles, so that in effect all SORP-compliant charities would be applying FRS102 apart from specific concessions for charities under £6.5M income.

But the situation in the SORP where a FRSSE-using charity has to follow FRS102 if a new issue arises from which it does not have an accounting policy is a recipe for

massive confusion. This means newly formed charities will be pushed directly into FRS102 as they will not have previous accounting policies.

At all costs the current concessions at the FRSSE level must be maintained so that medium sized charities do not have to do a cash-flow statement, and are allowed to state longer term debtors and creditors without the need for amortisation and then subsequent recognition of financing costs. But if this can be achieved by some concessions from the FRC on FRS102 that would be clearer than the FRSSE/FRS102 choice.

Q.16. 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 does pretty well in a difficult situation – but if the choice is to remain a “SORP for FRSSE users” is needed without the FRS102 extras.

Q.17. 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?

No comment.

Q.18. 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?

No comment.

Q.19. 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?

No comment.

Q.20. 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?

No comment.

Q.21. 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?

Yes, definitely.

Q.22. 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

(a) We feel the distinction in Module 6 between “general volunteers” and other services provided voluntarily is unhelpful and difficult to define in practice (para 6.19). We agree that it should not be a requirement to value volunteer time, but where a charity has robust approaches to recording volunteer hours and has a meaningful basis for valuing their time, it seems odd to prohibit recognition of this, especially as other (non-general) volunteers can be included. We suggest allowing charities to value volunteer time (or not) as the trustees see fit, so long as the approach used is reasonable and is clearly disclosed in the accounting policies notes.

It would help, however, to have a separate income line on the SOFA for gifts in kind and time given voluntarily (in Module 4).

(b) We also agree with the comments of others that more guidance on the accounting treatment of retail gift aid schemes is needed.

(c) The note normally headed “Analysis of net assets between funds” is quite fundamental in charity accounts, but the guidance on this is extremely brief (para 10.99) and needs more explanation. We suggest this needs a table showing how the note should be presented, along the lines of tables 1 and 6. It should also be cross-referenced from para 2.29.

Q.23. 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?

No comment.

Q.24. 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?

No comment.

Q.25. 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 examples 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?

All examples are helpful, but try to publish them in a way which discourages their use as boilerplate text.