

Impact case study (REF3)

Institution: Sheffield Hallam University		
Unit of Assessment: UOA17 - Business and Management Studies		
Title of case study: Establishing A New Era for Not-for-Profit Financial Reporting		
Period when the underpinning research was undertaken: 2008 – 2018		
Details of staff conducting the underpinning research from the submitting unit:		
Name(s):	Role(s) (e.g. job title):	Period(s) employed by submitting HEI:
Gareth G Morgan	Professor of Charity Studies	Jan 1995 – Dec 2015 & Feb 2016 – Mar 2018
Neil J Fletcher	Senior Lecturer	2008-present
Period when the claimed impact occurred: 2015 – 2020		
Is this case study continued from a case study submitted in 2014? No		

1. Summary of the impact

Sheffield Hallam research into accounting and reporting by charities and other non-profit organisations (NPOs) has led to:

- **Increase in the maximum size of charities in England and Wales eligible to use independent examination instead of audit**, which led to savings of £40M for such charities over the period 2015-20.
- **Regulatory policy changes, leading to much greater emphasis on smaller charities in the mandatory requirements for charity accounting and reporting in the UK and Ireland.**
- **An evidence base for common international standards for financial reporting by NPOs**, resulting in the establishment of a formal process to develop such standards.

2. Underpinning research

Financial reporting by charities and not-for-profit organisations (NPOs) is fundamental to their accountability. But how far that accountability is enshrined in legislation creates a range of demanding research questions, which Morgan's research has addressed over more than 15 years. Policymakers face critical choices, both in regulating the forms of reporting and with external scrutiny requirements: rules need to allow for differing charity law jurisdictions, and the implications of regulating small local charities alongside large international NPOs. Regulations have to cover the accounts themselves and supporting narratives (in the UK though the trustees' annual report – TAR), as well as external assurance through audit or forms of scrutiny.

In the UK, most charities with income of up to £250K are allowed to report on a cash (receipts and payments – R&P) basis. Above this threshold, the financial reporting requirements are specified in the Charities SORP (Accounting and Reporting by Charities – Statement of Recommended Practice). The SORP applies general purpose accounting standards to the specific context of charities, taking account of charity legislation. Most of its provisions are linked to regulations, so it is mandatory for charities outside the R&P regime.

From 2009 onwards, questions were being raised by leading commentators and regulators about: (i) the effectiveness of the narrative reporting in the TAR and whether charities were properly explaining how their resources were used for public benefit [R2]; (ii) the thresholds for external scrutiny of charity accounts [R1]; (iii) the accountability of those involved in developing the SORP and its relevance to users of charity accounts; and (iv) whether national frameworks such as the Charities SORP should be replaced by international standards for NPO financial reporting [R3].

Drawing on extensive prior work on charities' financial management, Morgan led a series of research studies at Sheffield Hallam University, in conjunction with Fletcher and/or with international partners. These studies examined various aspects of charity reporting and external scrutiny regimes, especially in relation to small/medium charities, across a range of jurisdictions (including differences between the three UK jurisdictions: England & Wales, Scotland, Northern Ireland). The aims of these studies were to examine the effectiveness of existing regimes from the perspectives of various stakeholders (especially users of charity accounts such as funders and regulators) and the case for future improvements.

- UK-based studies assessed the narrative reporting regime [R2], the R&P versus the SORP basis for accounting [R6], and the effectiveness of different external scrutiny arrangements for charity accounts. In particular in the UK, this involved when to require charity accounts to be subject to a full professional audit and when to permit a regime of independent examination (IE) [R1]. IE can be undertaken by a much wider range of persons than an audit but is still underpinned by regulations and charity regulators' directions.
- An international study led from Sheffield Hallam University with international partners (Victoria University of Wellington, University College Dublin and University of Dundee) examined the case for common NPO financial reporting requirements world-wide [R3, R4]. Sheffield Hallam was the accountable body for this work, winning a competitive tender from the CCAB (Collaborative Committee of Accountancy Bodies). Using an online survey circulated through a network of international gatekeepers, the study gathered attitudinal data from over 600 respondents concerned with NPO accounting, spread across 179 countries.

The research findings were as follows:

- Public benefit reporting in the TAR was found to be important to users of charity financial statements, but the requirements were challenging. Smaller charities in particular faced difficulties, whilst some larger charities devoted huge (disproportionate) effort to this [R2].
- The IE framework was found to be very effective, leading to substantial cost-savings for charities, and capable of being used more widely [R1] – but many charities misunderstood a key Charity Commission question when filing their accounts [R5], leading to users wrongly thinking accounts had a qualified IE report. (The Commission subsequently amended the question.)
- The R&P regime was found to be appropriate for many smaller charities in the UK, but others needed to follow the SORP for various reasons, such as perceived expectations of funders or the charity's constitutional form [R6]. For example, charities structured as companies (20% of UK charities) – are not permitted to produce R&P accounts.
- It was found that 72% of respondents to the international survey supported common international standards for NPO financial reporting, but 65% agreed with setting requirements in tiers, with less demanding rules for smaller NPOs [R3, R4].

Morgan's conference papers and research reports that led to publications R1 and R2 came to the attention of Lord Hodgson of Astley Abbots, who was appointed by the Government in 2011 to undertake a five year review of the Charities Act 2006. Hodgson's report, *Trusted and Independent: Giving Charity Back to Charities*, was published in 2012. The report made recommendations to Government on potential improvements to charity regulation - using detailed quotes and other references to research by Morgan and colleagues - to justify his conclusions [E1 pp.28, 42, 68]. In particular, drawing specifically on Morgan's work, Hodgson concluded that the independent examination regime was working well – especially for charities over £250K income, where the independent examiner is required to be a member of a professional body in a list specified in the s.145 of the Charities Act 2011 – the case for which had been established in earlier research [R1]. On this basis, Hodgson recommended that the audit threshold for charities in England and Wales should be further increased from £500K income to £1M income [E1 pp.67 & 128].

3. References to the research

- R1.** Morgan, GG (2011). The Role of Independent Examiners in the Accountability of UK Charities (*Public Money & Management* 31(3), May 2011, 183-192).
<https://doi.org/10.1080/09540962.2011.573229>
- R2.** Morgan, GG & Fletcher, NJ (2013). *Mandatory Public Benefit Reporting as a Basis for Charity Accountability: Findings from England and Wales* (Voluntas 24: 805–830).
<https://doi.org/10.1007/s11266-013-9372-7>
- R3.** Crawford, L; Morgan, GG; Cordery, C & Breen, OB (2014) *International Financial Reporting for the Not-for-Profit Sector* – monograph (London: CCAB ISBN 978 0 9928205 0 3) Available at www.ccab.org.uk/documents/IFRNPO-FullReport-Final-07022014.pdf
- R4.** Crawford, L; Morgan, GG & Cordery, CJ (2018). Accountability and not-for-profit organisations: implications for developing international financial reporting standards (*Financial Accountability and Management*, 34(2) 181-205).
<http://doi.org/10.1111/faam.12146>
- R5.** Kemp, JH & Morgan, GG (2019). Incidence and perceptions of “qualified” accounts filed by small charities (*Accounting Forum* 43(1) 62-84)
<https://doi.org/10.1016/j.accfor.2018.07.003>
- R6.** Alsop, E & Morgan, GG (2019). Financial reporting by smaller charities: drivers of the cash/accruals choice (*Public Money and Management* – published online Dec 2019, 1-11)
<https://doi.org/10.1080/09540962.2019.1689653>

All outputs were subject to a rigorous peer-review process prior to publication. The research has been accessed extensively by practitioners and policymakers and used as a reference point.

4. Details of the impact

Extension of the charity independent examination regime in England & Wales

In December 2014, The Cabinet Office (at the time responsible for charity law in England and Wales) launched a consultation process on the issue of increasing the charity audit threshold from £500K to £1M, to allow more charities to have their accounts scrutinised by independent examination. [E2] This consultation followed recommendations made in Lord Hodgson’s 2012 report, *Trusted and Independent: Giving Charity Back to Charities (Review of the Charities Act 2006)* [E1 pp.67 & 128]. The report had specifically drawn on Morgan’s research to conclude that the independent examination regime was working well – especially for charities over £250K income, where the independent examiner is required to be a member of a professional body in a list specified in the s.145 of the Charities Act 2011 – the case for which had been established in earlier research [R1].

The consultation drew 56 responses from a broad range of charities, accountancy professionals, umbrella bodies and individuals, of whom 85% were supportive. The Government then implemented the change by regulations (SI 2015/321 made under s.174 of the Charities Act 2011), with effect for charity financial years ending 31 March 2015 onwards.

The impact of this change can be quantified accurately through the Government’s own figures. The Cabinet Office’s Impact Assessment published with the consultation [E2] reported that for charities in the £500K to £1M income band, the average audit cost was around £4,750, compared to a likely fee of £2,500 if a charity in that income band were to have an IE. The regulatory changes would thus result in an annual saving of £2,250 per charity (mid-point estimates).

The Cabinet Office estimated that around 3,140 registered charities in that income band would be able to benefit from this change, resulting in an annual saving of over £7M to charities as a whole. Over the period April 2015 to December 2020, **charities in England & Wales have benefitted from total savings of £40M as a result of this change**. Since charities have to reinvest surplus, these funds have been translated into increased spending on activities for their beneficiaries.

UK and Ireland embrace new approach to development of the Charities SORP

A SORP-making body, appointed by the Financial Reporting Council (FRC), is responsible for the Charities SORP – currently comprising the Charity Commission for England and Wales (CCEW), the Office of the Scottish Charity Regulator (OSCR) and the Charity Commission for Northern Ireland (CCNI), with the Irish Charities Regulator (CR) in attendance.

The SORP Committee advises the charity regulators on updates to the SORP: these have a major effect on users and practitioners of charity financial reporting. However, the process has come under criticism, including the resignation of one member of the SORP Committee, primarily because of concerns that the Committee was unduly focused on accounting technicalities, rather than on what would be helpful for funders and donors as the main users of charity accounts [E3].

To address this, in 2018 the four charity regulators agreed jointly to establish a SORP Governance Review Panel, and appointed Morgan as independent chair, “*recognising his track record experience in charity accounting and research... across the UK and Ireland*” [E4]. Following a consultation with the charity sector and accounting profession, including events across the UK and Ireland, interviews by the chair, and 34 written responses - the Review made over 30 recommendations regarding the process for future development of the SORP [E5].

Most of the Panel’s **recommendations were accepted by the charity regulators** [E6] and substantial changes were agreed in the process for future development of the SORP. These include a new smaller SORP Committee from 2020, with greater representation from smaller charities. A new system of ‘SORP engagement partners’, in which funders, smaller charities and IEs all play major roles, became operational from autumn 2020 [E6]. These changes reflect key findings from Morgan’s research regarding the significant demands of the SORP and the narrative reporting on smaller charities [R7, R2], and the role of IEs in supporting them [R1, R6].

In the light of this policy change and the new process of SORP engagement from 2020, it is likely that the next SORP will provide for more straightforward financial reporting by smaller charities, leading to direct cost savings for approximately 90,000 charities under £500K income that are subject to the SORP (UK-wide, plus Ireland).

International standards for NPO financial reporting now in development

The conclusions of the study on international financial reporting by NPOs [R3, R4] were widely reported and considered by professional bodies and accounting standard setters internationally.

In particular, the IFRS Foundation (the body that issues International Financial Reporting Standards, mandatory in many countries) directly referred to the study report [R3] in a 2015 consultation on its future agenda. The first consultation question asked whether the IFRS Foundation should extend its remit to NPO standards, stating “*There are calls for international standards for the not-for-profit sector to be developed ... The [IFRS Foundation] Trustees continue to strongly support the need for transparent financial reporting requirements for not-for-profit bodies*”. It explicitly cited the [R3] study by Crawford, Morgan et al [E7.i, p10, fn.13]. The analysis of consultation responses published in 2016 reported: “*a substantial minority of respondents... supported such a proposal. Arguments in favour included the demand for international standards for NFPs, with many referring to the report*” [E7.ii, p17 and p41-2]. So, respondents to the IFRS Foundation were directly referring to the study [R3] in their arguments. The IFRS Foundation concluded by encouraging national standard setters under the International Federation of Accounting Standards Setters to take this forward. [E7.ii, p17]

In 2019 **an international consortium of standard setters announced plans for a major project** to be run from Washington DC that would actually develop comprehensive international standards for NPO financial reporting [E8]. The Project Chair confirmed that the research from Sheffield Hallam and partners was fundamental to this decision [E9].

With a Steering Group chaired by the Auditor-General of Jamaica, the consortium established a Technical Advisory Group (TAG) and a Practitioner Advisory Group (PAG) with members from 13 countries, supported by the international NGO, Humentum. By late 2019 the project had attracted US\$500K of funding, towards a target of \$4.6M, to develop international NPO standards [E10]. The TAG and PAG have met in Washington DC, London and Nairobi and published reports. The

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PAG includes Prof Carolyn Cordery, a member of the [R3] research team, so it is clear that this research is impacting the development of the new NPO standards. By November 2020 the consortium had conducted major consultations in the USA, Ghana and Nigeria, with other countries to follow, and expected that the initiative would lead to the full launch of international NPO reporting standards (effectively, an IFRS-type framework for NPOs) by 2024 [E10].

5. Sources to corroborate the impact

- E1. Hodgson, Lord R (2012) *Trusted and Independent: Giving Charity back to Charities (Review of the Charities Act 2006)* London: Cabinet Office
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/79275/Charities-Act-Review-2006-report-Hodgson.pdf
- E2. **Cabinet office reports:** *Charity Audit and Independent Examination – Consultation* (December 2014) and *Government Response* (February 2015)
www.gov.uk/government/consultations/charities-audit-and-independent-examination
- E3. **Article in Civil Society:** Preston, R (2018) 'Fundamental change' in charity reporting requirements needed, says report (Civil Society 8 Mar 2018):
www.civilsociety.co.uk/news/fundamental-change-in-charity-reporting-requirements-needed-says-report.html
- E4. **Letter from CCEW & OSCR:** to Sheffield Hallam University explaining why Morgan was selected as Independent Chair of the SORP Governance Review in 2018 (February 2020).
- E5. **Charities SORP Governance Review 2018/19:** *Guiding the Development of the Charities SORP: Report and Recommendations* Morgan, GG et al (2019).
www.charitycorp.org/media/647747/guiding-the-development-of-the-charities-sorp.pdf
- E6. **Charities SORP-Making Body:** i. Report: *The new SORP development process, what is changing, how you can get involved, and the impact we hope to make* (2019)
www.charitycorp.org/media/647696/the-new-sorp-development-process.pdf;
 ii. Engagement process: *Engage in developing the next SORP* (2020)
www.charitycorp.org/about-the-sorp/engage/
- E7. **IFRS Foundation, Trustees' Review of Structure and Effectiveness:** i. *Request for Views - Trustees' Review of Structure and Effectiveness: Issues for the Review*. (London: IFRS Foundation, 2015) https://library.croneri.co.uk/cch_uk/iast/miscrfv201507-201507#toc-4 ii. Trustees' Review of Structure and Effectiveness: Feedback Statement on the July 2015 Request for Views (2016) www.ifrs.org/-/media/project/2015-trustees-review/request-for-views/educational-materials/feedback-statement-request-for-views.pdf
- E8. **Article in Civil Society:** Preston, R (2019). *Project launches to develop international financial reporting standards for charities – with launch in Washington DC* (Civil Society 17 July 2019): www.civilsociety.co.uk/news/project-to-develop-international-financial-reporting-standards-for-charities-launches.html
- E9. **Email from Project Chair on behalf of the Technical Advisory Group of National Standard Setters, Chartered Institute of Public Finance and Accountancy (CIPFA)** corroborating the fundamental role of Sheffield Hallam research in the decision to develop comprehensive international standards for NPO financial reporting (July 2019)
- E10. **Humentum:** (2020) *An initiative to develop Internationally applicable Financial Reporting guidance for Non Profit Organisations* www.ifr4npo.org/