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accountability: findings from England & Wales**

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Mandatory Public Benefit Reporting as a basis for Charity Accountability: Findings from England & Wales

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ABSTRACT

Charitable status is inherently linked in many jurisdictions with the requirement that an entity must be established for public benefit. But, until recently the public benefit principle had relatively little impact on the operations of most established charities. However, in England and Wales, reforms linked to the Charities Act 2006 led to a new requirement for public benefit reporting in the trustees' annual report (TAR) of every registered charity. This new narrative reporting requirement had the potential to affect the understanding of accountability by charities. The paper investigates the impact of that requirement through a study of over 1400 sets of charity reports and accounts and subsequent qualitative work with trustees and others involved in preparing TARs.

KEYWORDS

Charities; Charity Regulation; Trustees Annual Reports; Narrative Reporting; Accounting Narratives; Charitable Status; Public Benefit; Public Benefit Reporting; Charity Accounting; Charities Act 2006; Charities Act 2011; Charities SORP; England and Wales; UK.

1. INTRODUCTION

Considerable attention has been given by researchers to the published accounts of charities in the UK as explained below, but there has been less focus on the narrative information in the trustees' annual report (TAR)¹. Yet from the origins of the present regime for charity financial reporting in England & Wales, which began in 1996, all registered charities are required to publish a TAR alongside their accounts² and the production of a TAR is widely seen as an important aspect of charity accountability.

The TAR provides a wide range of information about the work of the charity, largely in narrative form, and the significance of the TAR has arguably been increasing over the years (Connolly & Hyndman 2003). In particular, the current standard on charity accounting and reporting, SORP 2005 (Charity Commission 2005) places great emphasis on the linkage between the charity's accounts and the TAR.

The focus of this paper is an analysis of a new requirement for the TAR which took effect in England and Wales for accounting years starting from 1 April 2008 (i.e. years ending 2009 onwards) concerning "public benefit reporting" (PBR). The TAR must now include: (i) a report of those activities undertaken by a charity to further its charitable purposes for the public benefit; and (ii) a statement by the charity trustees as to whether they have considered the Charity Commission's guidance on the public benefit requirement (the nature of this is discussed in section 2 below). The PBR requirements appear in the Charities (Accounts and Reports) Regulations 2008.³

The study draws on two stages of research which were undertaken on behalf of the Charity Commission (Morgan & Fletcher 2011). The first stage examined the TARs and accounts of over 1400 charities across four income bands to ascertain their PBR practices in what was, for most, the first year of the new regime. The second stage sought evidence from discussions with 30 charities which had at least moderate compliance with PBR, exploring the processes by which they prepared their TARs and their narratives for PBR in particular.

Using the findings from both stages, two research aims are explored in the present paper. The first aim is to consider how far (if at all), the requirement for PBR has affected the understanding of accountability by charities. Has, it, for example, led charity staff and trustees to focus more clearly on public benefit consideration in their day to day decisions? The second aim is to consider more broadly

the extent to which a mandatory system of PBR has developed the framework of charity accountability: for example, can society as a whole have any greater confidence in charities because of PBR?

The research finds that PBR has brought about a new sense of accountability which many charities embraced positively, often with renewed focus on their mission. However, the sanctions for non-compliance are limited, as explained in the conclusions to the paper. The interview and focus group evidence suggests that high levels of compliance are explained not by sanctions for non-compliant reporting, but rather by issues for certain charities whose trustees had high levels of concern on maintaining their charitable status and others for whom compliance with regulations is a key element in their sense of legitimacy.

The paper is structured as follows. The next section outlines the background to the public benefit requirement and the broader issues of charity accountability. Previous literature on charity accountability through financial reporting, and by narrative reporting in particular, is considered in section 3. Section 4 explains the research methods for the two phases of investigation discussed in sections 5 and 6. Section 7 assesses the implications of these findings for charity accountability.

2. THE PUBLIC BENEFIT PRINCIPLE IN CHARITY ACCOUNTABILITY

In countries such as the UK which offer a specific legal recognition of charitable status, there are typically three elements to such recognition which can be summarised in terms of regulation, reputation and tax relief (Morgan 2010). Charitable gifts are afforded special protection, with the courts and regulators having extensive powers to intervene if attempts are made to divert charitable assets to other purposes. However, such protection is only afforded to gifts and property which are seen to be worthwhile to society in a broad sense, by meeting a 'public benefit' requirement: nature of this requirement and its implications for charity accountability are briefly summarised below. But, once charitable status is recognised, it is much easier to persuade donors to support the cause because of the inherent reputation of charities. Furthermore, in recognition of the benefit to society, charities (and their donors) are afforded tax concessions provided their resources are applied exclusively to charitable purposes.

In English law, attempts to define ‘charity’ are generally traced to the preamble of the English 1601 Statute of Charitable Uses (Luxton 2001), and its subsequent interpretation through four centuries of case law. But it was only in the Charities Act 2006 that ‘charity’ was defined in statute (Morris 2011) – provisions which are now consolidated in the Charities Act 2011. In the period leading up to the 2006 Act and subsequently, the term has been subject to extensive legal debate and campaigning for clarity both by lawyers and by the voluntary sector itself (McGregor-Lowndes & O’Halloran 2010; Morgan 2012).

The definition of ‘charity’ applicable in England and Wales technically relates to the *purposes* of a charity rather than its activities. The Act states that for a purpose to be charitable it must first fall within a list of 13 heads and secondly the purpose must be ‘for the public benefit’⁴. However, this was by no means new: since the 18th century the courts have concluded that a purpose is only charitable if it is ‘for the public benefit’.⁵ But whilst the 2006 Act placed the public benefit requirement in statute, it did not define the term except by reference to existing charity law⁶. It thus left the public benefit requirement to be interpreted by reference to case law, with two major cases being heard in 2011.⁷ The fundamental issue is that a charity must have purposes that benefit the wider public or at least a section of the public, rather than a small private class of beneficiaries – and hence its activities need to be conducted on that basis.

The 2011 cases largely confirmed the existing case law that there are two principles to be met in order for a body to be established for public benefit – firstly, that the purpose itself must be beneficial to society and secondly, that the benefit from the purpose must extend to a sufficiently broad section of the community (Luxton 2001; Morris 2011).

This public benefit requirement implies that all charities are accountable to the wider public – not just to their trustees, donors, or immediate service users – and the practical expression of that accountability through the specific demands of PBR is the theme of this paper.

Even though the 2006 Act did not define the term, it introduced five changes which collectively have led to much greater attention on the public benefit requirement. Firstly, the Act stated that no particular purposes were to be presumed to be for the public benefit⁸ (Lloyd 2007 p16; MacLennan 2007, pp12-

15). Secondly, it created new objectives for the Charity Commission, including the ‘public benefit objective’ which is ‘to promote awareness and understanding of the operation of the public benefit requirement’.⁹ Thirdly, the Act required the Commission to issue guidance in pursuit of its public benefit objective (see below).¹⁰ Fourthly, the guidance is given particular force because the Act requires charity trustees to ‘have regard to any such guidance when exercising any powers or duties to which the guidance is relevant’¹¹. Fifthly, whilst it had long been a requirement for the charity trustees of registered charities to prepare an annual report (a TAR) each year complying with regulations¹², new regulations were issued which included a specific requirement for reporting on public benefit¹³, as outlined in section 1 above.

The Charity Commission’s statutory guidance set out two central principles of public benefit, as explained above, which were divided into a total of eight sub-principles, as shown in table I. Based on its analysis of case law, the Commission considered these principles to be fundamental in considering whether an institution has charitable aims which are for the public benefit. The general guidance (Charity Commission 2008) explained these principles and more detailed guidance was issued for charities in particular fields (poverty, education, religion) and on the issue of fee-charging and public benefit. The publication also includes recommendations (Charity Commission 2008 pp.28-31) on the implications of the PBR requirements, and suggested questions for trustees to address in their TARs.

[Table I about here]

As a result of the *Independent Schools Council* case¹⁴ in 2011, principle 2b(ii) was deleted, the specific fee-charging guidance was withdrawn (pending revision) and new draft guidance has now been published (Charity Commission 2011b; 2012). However, during the period of this study all eight sub-principles shown in table I were applicable.

The regulations do not require charities to comment directly on all of these principles as part of PBR, but trustees must “have regard” to them, and the Commission makes clear that charities should therefore consider addressing these issues (where relevant) in their TARs.

Including the supporting legal analysis, the Commission issued over 400 pages of material on the public benefit requirement, some of which has been heavily contested. So it is not possible to summarise all the nuanced issues in this paper, and in any case the public benefit requirement impinges very differently on charities with differing objects (see Morris 2010). The rationale of PBR is to require charity trustees to explain to the readers of their annual reports and accounts how they understand the public benefit requirement in relation to their the specific charity concerned, and how it is carried out in practice.

3. PREVIOUS LITERATURE

3.1 Accountability of Charities through Financial Reporting

Research interest in charity financial reporting and the associated impact on charity accountability in the UK is generally traced to the work of Bird and Morgan-Jones (1981). The issues were developed in a wide range of studies in the 1990s such as Hines and Jones (1992), Gambling et al (1993), Gambling and Jones (1996), Palmer (1997), Palmer and Vinten (1998), Williams and Palmer (1998), Morgan (1999; 2011), Harrow et al (1999), which all raised major questions around the regulatory framework, the extent to which charity accounts complied with relevant standards and hence how far they met the needs of users.

The 1990s saw major development in charity reporting in England and Wales, notably as a result of mandatory accounting requirements in the Charities Act 1992 (these were consolidated in the Charities Act 1993 and subsequently in the Charities Act 2011). The heart of the requirements lay in a *Statement of Recommended Practice* – the Charities SORP (Charity Commission 1995) which was endorsed by the Accounting Standards Board – although the smallest charities (up to £100,000 income¹⁵) were exempted from SORP accounting, and allowed to prepare accounts on a receipts and payments (R&P) basis. Subsequent versions of the SORP appeared in 2000 and 2005. The first charity accounts for which the SORP was compulsory had to be filed with the Charity Commission in 1998¹⁶.

A number of studies in the early 2000s specifically investigate issues of SORP compliance (e.g. Connolly & Hyndman 2000; 2001; 2003; Palmer et al 2001) and associated issues of accountability. In particular, Connolly and Hyndman (2004) argue that “the concept of accountability seems inextricably linked with the view that accounting should provide information to satisfy the needs of users.” Some

studies have also been undertaken by regulators (Charity Commission 2007; OSCR 2008). As systems of compulsory charity financial reporting have developed in other jurisdictions such questions have received attention elsewhere, notably in New Zealand (Hooper et al 2008; Cordery & Patel 2011).

Compliance studies tend to report (not surprisingly) that compliance is stronger in larger charities – a conclusion clearly supported by the present research – but there is relatively little research on the motivations for compliance or non-compliance in charity reporting. In a Belgian study, Verbruggen et al (2011), examine motivations for compliance in nonprofit financial reporting in relation to resource dependency and coercive isomorphism (the pressure to behave in a similar way to other organisations). But there appears to be little research on how far those running charities see compliance with accounting and reporting requirements in terms of their accountability to wider stakeholders.

More recently a number of scholars have raised broader questions about the nature of accountability in the not-for-profit sector. Crawford et al (2009) consider six levels of charity accountability, drawing on Stewart's ladder model. They address the thorny issue of "accountability to whom?" by listing a wide range of stakeholders as possible users of charity accounts. Stone and Ostrower (2007) note that in most cases the ultimate accountability for non-profits rests with the board, but they raise significant doubts on the extent to which non-profit governance embraces acting in the public interest (a notion close to the public benefit principle in charity law). Hyndman and McDonnell (2009) explore the link between governance and accountability for charities: in particular they argue that more or better regulation of the sector has the potential to increase accountability because of the "large information asymmetry problems associated with the sector". Some have argued that a focus on altruism is central to the accountability of nonprofit organisations, but Helmig et al (2009), reviewing a number of papers in this field, raise a central question concerning "the manner in which management does or does not mesh with the altruism which underpins the efforts of charities". Valentinov (2011) discusses the problem of "designing effective mechanisms of nonprofit accountability". He concludes that nonprofit accountability must embrace "more than mission outcome-related measures" because of the wider public interest in the activities of nonprofits. Cordery (2013) argues that even a light-handed system of charity regulation must be rooted in public interest principles by "careful attention to the information asymmetries of users".

In the light of these debates, both Stone and Ostrower (2007) and Valentinov (2011) call for further research on accountability regarding the development of mechanisms for communicating this public interest dimension. It is suggested that the PBR requirement for charities in England and Wales, and the insights of this study may offer a useful development on that road.

3.2 Narrative Reporting by Charities

Over the years, narrative reporting has received considerable attention from researchers in relation to company accounts (e.g. Smith & Taffler 1992, 2000; Clatworthy & Jones 2001; Sydserff & Weetman 2002; Jones & Smith 2011) but much less attention has been given to narrative reporting by charities.

However, the body of work concerning narrative disclosures by charities is increasing. Narrative reporting practices are considered by Christensen and Mohr (2003) (regarding museums) and in small-scale compliance studies by regulators (Charity Commission 2004; 2007). Connolly and Hyndman (2003) explore narrative reporting in relation to the broad arena of performance reporting. Jetty and Beattie (2009) examine disclosure practices by charities including some discussion of narrative information in the TAR.

Connolly and Dhanani (2006; 2009) offer more extensive studies focusing specifically on narrative reporting by charities. They offer a detailed analysis of the behavioural and theoretical arguments for narrative reporting in the sector, but their analysis in the 2009 report is confined to the 104 largest registered charities and it focuses on financial years immediately post-2005: which predates the public benefit reporting requirement.

It therefore appears that the present study offers the first detailed analysis of an aspect of narrative reporting across the entire income range of registered charities, and there does not appear to be any previous analysis of the interaction between the public benefit requirement (which is so central to charity accountability) and the actual reporting practices of charities. Even so, charities' PBR practices can only be at best a very limited proxy for their operational practice, so no attempt is made to speculate on the latter. The focus of this paper thus lies in the extent to which charity accountability may be demonstrated through PBR.

4. RESEARCH METHODS

The data collection comprised two distinct phases. In order to consider the impact of PBR on charity accountability, it was first necessary to assess the levels of compliance with the various elements of the requirement. This was the focus of phase 1, using a desk based survey of TARs from a wide range of charities. To explore more specifically the behavioural motivations for PBR, data was obtained in phase 2 from a series of focus groups and telephone interviews with individuals involved in preparing TARs.

4.1 Phase 1: desk based survey of Trustees' Annual Reports.

4.1.1 *Sample selection*

Of the 151,929 main charities on the Charity Commission register at the commencement of the study, 1,402 were successfully included in the review (nearly 1% of the register) using a sampling process as explained below. Within this sample, a second year's TAR was examined for 140 charities (thus extending the study to 1542 TARs in all) to see if there were any major changes in PBR from one year to another – however, only modest variations were found between different reporting years, and these longitudinal comparisons are not considered further in this paper.

The study was limited to *registered* charities in England and Wales, as it is only registered charities which are required to prepare their TARs under the 2008 Regulations and hence to address the requirements of PBR. However, there are many charities in England and Wales which are exempt from oversight by the Charity Commission or excepted from the requirement to register as charities (see Morgan 2010). For example, there are some significant English and Welsh charities that are not regulated by the Charity Commission, such as further education colleges and universities in England, and many churches under £100,000 income are currently excepted from the requirement to register. Likewise, the study did not consider charities registered in Scotland, as whilst they have to prepare a TAR under the Charities Accounts (Scotland) Regulations 2006¹⁷, there is no explicit requirement in terms of PBR (and in any case, a different definition of 'public benefit' applies under the Charities and Trustee Investment (Scotland) Act 2005).

The sample population was stratified into four income bands as shown in table II. Starting from the entire register of charities, a random sample was made within each income band.

[Table II here]

The boundaries of these bands were selected to tie up with accounting thresholds in the legislation¹⁸ – at each threshold additional accounting requirements apply as follows:

- above £5K income, most charities in England & Wales are required to register with the Charity Commission¹⁹
- above £25K income the accounts must be subject to external scrutiny at least in the form of an independent examination, and for registered charities, the AR&A must be submitted to the Commission
- for financial years commencing 1 April 2008 and earlier, the accounts of charities over £100K had to be on an accruals basis, complying with the Charities SORP – below this, the accounts can generally be on a receipts and payments (R&P) basis for charities not structured as companies²⁰
- above £500K the accounts must be subject to a full audit (rather than an independent examination) and the TAR must also contain additional information.

It was felt these different accounting requirements would affect the approach to the TAR, and this is borne out by the findings which, on most variables recorded, showed substantial differences in the results for each band.

Charities over £25K²¹ income are required to file their Annual Report and Accounts (AR&A) with the Charity Commission each year, and the sampling for bands (a) to (c) was thus confined to the majority of registered charities which had filed accounts for at least one financial year commencing on or after 1 April 2008 when the PBR requirements took effect. Charities under £25K income are still required to prepare an AR&A complying with the regulations, but there is no requirement for the AR&A to be filed with the Charity Commission. A few cases were found of charities in band (d) which had lodged accounts with the Commission, but most of the AR&As in this band were obtained by writing directly

to the correspondents of these charities enclosing a reply-paid envelope with a request for a copy of the charity's latest AR&A.

The initial sample size for each band was 400. The variance from 400 seen in bands (a) to (c) is mainly due to charities whose income band had changed between the sampling and the year of the actual set of accounts considered. The number of charities actually included in band (d) reflects the total number where it was possible to obtain the AR&A within the timescales of the research. So, in interpreting the results for band (d) it should be noted that those charities which provided their AR&A might be expected to show higher levels of compliance, and the true level of compliance in this band is therefore likely to be lower than these findings. However, even in bands (a) to (c) similar issues apply (albeit to a lesser extent) as charities were excluded if they had not filed accounts with the Charity Commission for a financial year since the PBR requirement took effect.

4.1.2 Phase 1: analytic framework

The selected AR&As from charities in all four bands were assessed using a specially developed assessment framework combining qualitative and quantitative criteria based largely on narrative analysis of material provided in the TAR. Every TAR was read in full. The data capture involved recording 26 variables for each charity – some factual (such as the charity's total income as shown in the accounts) and some which required detailed judgement of narratives in the TAR, such as the extent to which the TAR showed a clear identification of the intended beneficiaries. A team of eight research associates (RAs) was recruited and trained in applying the framework.

The framework, together with broader guidance on the underlying principles of public benefit and PBR, was documented in a manual for each RA (Morgan & Fletcher 2011, 76-83). This was developed through a review of the key legal and regulatory documents relevant to PBR namely: the Charities Act 2006, the Charities (Accounts and Reports) Regulations 2008, and the Charity Commission's guidance on the public benefit requirement (Charity Commission 2008).

An initial draft of the framework was revised taking account of input from a sector specialist, from Charity Commission staff, and from an expert in documentary analysis. The key features of PBR were

ascertained and questions were developed that analysed the way that a charity had coped with the demands of PBR. The five core questions were:

- How clearly had the charity described its aims? This could be expressed in a statement of charitable purpose or objects. (2008 Regulations – reg 40(3)(1).)
- Was there an unambiguous statement that the trustees had had regard to the Commission's guidance? (2008 Regulations – reg. 40(2)(c)(ii).)

The requirement for the charity to explain the activities undertaken by the charity to carry out its charitable purposes for public benefit (2008 Regulations – reg. 40(2)(b)) was broken into three elements:

- How well did it identify the beneficiaries? (Charity Commission principle 2 – see table I.)
- Was there a clear description of the activities carried out for public benefit (as the regulation requires) excluding fundraising activities, governance activities etc?
- Was it clear how these activities actually benefited the intended beneficiaries? (Charity Commission principle 1.)

These particular questions were assessed on a sliding 0-4 scale, where a 4 indicated that the TAR appeared fully to meet the legal requirements on the issues being assessed, and 0 indicated that the TAR contained nothing towards the point being assessed. Scores of 3, 2, or 1 indicated some attempt being made towards compliance. A number of steps were taken to ensure that this scoring system was consistently applied across all items surveyed and between the various RAs undertaking the analysis.

In addition, baseline data was noted for each charity from the accounts – the actual income in the accounts, the method of accounting (SORP or R&P), whether the accounts had been audited or independently examined, etc. Certain additional issues related to PBR were also noted – for example information on harm or detriment (Charity Commission principle 1c – see table I) and any evidence of fee-charging and discussion of attempts to mitigate the restrictions which might arise where benefits were limited to those who could afford the fees (Charity Commission principle 2b(ii)). Additional reporting requirements which apply under the regulations for charities in band (a) were also considered.

A key issue for the research design was how to bring together the results from the distinct variables. The work of Marston and Shrives (1991) would suggest that it might be appropriate to create an index to rate the overall quality of reporting, although, as Stanley et al (2008) point out, the very creation of an index is subjective in nature. However, it was judged that an overall rating would be useful and an overall score was thus given to each TAR on the level of PBR compliance, with scoring now extended to a level 5, based upon the following criteria:

- 5: Excellent example of public benefit reporting – such that it might be highlighted as an example to other charities.
- 4: TAR clearly addresses all mandatory public benefit reporting requirements, including reference to consideration of Commission guidance.
- 3: On balance the TAR appears to meet legal requirements, but lacks clarity on some issues.
- 2: TAR describes the work of the charity to some extent, and partly addresses the requirements for public benefit reporting.
- 1: TAR is provided but with no discussion of public benefit.
- 0: No TAR at all.

4.2 Phase 2: focus groups and telephone interviews

In order to gain a deeper and richer understanding of charities' approaches to PBR a further, qualitative, phase of research was conducted. It was intended that this phase would supplement the compliance data from phase 1 with explanations of PBR practice and behaviour which would reveal the extent to which the PBR requirement had affected perceptions of accountability.

From the original sample of 1,402 charities, 166 charities were selected which appeared to have dealt reasonably well with the PBR requirement and which appeared to be within reasonable distance of the locations planned for the discussions. Each of these charities was contacted and a trustee, or a representative of the charity, was invited to attend a regionally located focus group to discuss PBR. It has been argued that any form of interviewing is not truly natural (Morgan, 2001) and focus groups were chosen instead of one to one interviews because it was considered that the social networking element of such an event would create a more natural environment for relevant discussion than a one to

one interview of a potentially technical subject. However, many respondents expressed a willingness to take part but were unable physically to attend the focus groups, and such respondents were interviewed by telephone. Recourse to telephone interviews was made to boost the sample size used in this phase of the research. Focus groups were arranged in London (two sessions), the English Midlands, the North of England, and South Wales, though the Welsh participants elected to take part purely by telephone interviews.

In total four focus groups (each with a duration of 2.5 hours) and 15 telephone interviews (typically 40 minutes) were conducted, capturing a wide range of carefully expressed views. Twenty three trustees and ten staff took part, giving a total of 33 participants from 30 charities. The charities were spread across a wide range of fields, including advice, almshouses, arts (2 cases), education or training in specific sectors (2), general grant-making, independent schools (2), international relations, medical (5 – including two hospices and two medical grant-makers), relief of poverty or poverty awareness (3), religion (5), rural support (2), social care (4), and wildlife/conservation. The majority were in the two larger income bands (£100K - £500K income or over £500K) with two in the £25K-£100K band and none in the smallest band. The participants cannot be considered representative of registered charities as a whole, as the selection was based on charities which had made reasonable progress on the PBR requirement, and then on individual trustees or staff from those charities who were sufficiently interested in the TAR and able to give time to participate in the research.

The focus groups were moderated by the authors as persons with experience of charity accounting and reporting, and the telephone interviews conducted by the same researchers. A semi-structured schedule of questions was used in both contexts, but the aim was to facilitate discussion rather than seeking answers to set questions. As is common in such studies, participants often took an opportunity to express personal agendas (Horton 2005), but this increased the richness of the data collected rather than detracted from it. The focus groups and interviews were partially transcribed immediately after each interaction retaining many verbatim quotations. (Full transcription was not possible due to budgetary constraints.)

The analysis of findings from this phase sought to explore the meanings given by participants to their PBR practices. The analysis followed a primarily interpretivist paradigm, rather than a representative

sampling of opinions: written records of the sessions were analysed by identifying dominant themes and comments. These were grouped together using a coding structure that maintained the anonymised identity of each participant (Moll et al, 2006). Linkages between the codings and the role of the respondent and the type of their respective charity were also investigated, maintaining contextualisation of the participants' comments, as recommended by O'Dwyer (2005).

5. PRINCIPAL FINDINGS – STUDY OF TARS

As might be expected in any study of compliance issues, especially a new requirement, only a minority of charities studied in phase 1 were judged to have met the full requirements for public benefit reporting.

5.1 Provision of valid TARS

Some charities failed to address any aspect of PBR as the AR&A was found to contain no TAR at all: this applied to 8.9% of charities in the sample (primarily in the lower income bands). Many others had TARs which had not been properly approved by the trustees, so it was not always possible to be sure whether the document was in fact a trustees' report under charity law, a more informal document, or simply a draft of a possible TAR.

Across the whole sample only 53.4% of charities had a TAR which had clearly been approved by the trustees within the statutory timescale of 10 months after year end; even for charities over £500K the proportion with a validly approved TAR was only 70.6%. (In the cases with no clearly approved TAR, the separate elements of PBR were assessed and recorded within whatever document was provided, but the overall score for TAR quality was limited to a maximum of 2 on the 0-5 scale used.)

5.2 Compliance with the Five Key Elements of PBR

The five central questions of the analysis framework regarding PBR practices (see section 4.1.2 above) were considered for each TAR, and assessed on a 0 to 4 quality score for each requirement following the processes explained. On each of these distinct elements of the PBR, the proportions of charities judged to have clearly met the requirement (i.e. those which achieved a score of 4 for the requirement) were as shown in figure 1.

[Figure 1 here]

On each measure, the level of compliance increased across the income bands, but even for the charities over £500K income there were significant shortcomings.

Most charities included a statement of the charitable aims (objects) which is an essential starting point for any discussion of PBR, as it is impossible to explain how a charity advanced its objects for public benefit if the objects themselves are unclear. However, even on this basic requirement in the regulations (which pre-dates PBR) the proportion clearly stating their objects (i.e. with a score of 4) was under 50% for charities in the lowest income band.

Stating whether or not the trustees had had regard to the Charity Commission's guidance on public benefit is, at first sight, just a yes/no requirement, but a number of TARs had vague references to the Commission without being clear whether or not the trustees had actually considered the public benefit guidance. So this requirement was assessed on a 0-4 scale as for other issues. The proportion of TARs with a clear statement that the trustees had considered the guidance ranged from 10.9% in the smallest income band to 71.9% in the largest.

The real focus of public benefit reporting lies, however, in explaining the activities undertaken by a charity to advance its charitable purposes for public benefit – in other words, an articulation of the linkage between the purpose, the beneficiaries, the activities undertaken, and how these lead to benefit for the beneficiaries: three factors which were separately assessed in the TAR narratives.

In some cases a very simple explanation of activities covered everything expected: for example a pre-school whose objects were concerned with education for children up to age 5 provided cogent explanations of the children who attended, the educational activities they undertook, and the benefits to their personal development. But in other cases, the TAR contained little or no description of activities, or focused purely on fundraising activities rather than work carried out with the charity's beneficiaries. Charities with obvious service users were generally gave stronger explanations than those whose work sought to benefit an entire community in fields such as conservation or religion. Grant-making charities usually referred to grants made but often said little about the ultimate beneficiaries.

Within these explanations, identification of beneficiaries was the strongest element: full compliance (those with a score of 4) ranged from 21.8% of charities in the lowest income band to 74.1% of the largest. A meaningful description of the activities furthering the objects was rarer (7.6% to 55.8% clearly complying). The element most frequently lacking was any explanation of how the activities led to benefit for the beneficiaries – even amongst the largest charities, only 36.2% were clearly showed this linkage.

5.3 Overall TAR Quality for PBR

As explained above, each TAR was assigned a rating for overall TAR quality in terms of the PBR requirement. The proportion of charities in each income band judged to have clearly met the requirements for public benefit reporting under the 2008 Regulations (i.e. those who scored at least 4 on overall TAR quality) are shown in figure 2.

[Figure 2 here]

It should be noted that for most of the charities in the study the analysis was based on the first financial year where PBR applied, but across all income bands only a minority of charities met the full requirements.

Aggregating the four bands²², the proportion of charities reaching each level of compliance (0-5) in terms of the overall PBR assessment is indicated in figure 3.

[Figure 3 here]

5.4 Analysis of findings by charities' fields of activity

The findings for overall TAR PBR quality were also analysed in relation to the different areas of activity in which charities operate. This was based on the activity codes on the register of charities, which charities select as part of the Annual Return process. Of the 1402 charities in the sample, 47% had selected more than one activity code so it was not possible to allocate them to a single activity area, but the overall PBR quality score was analysed in relation to the remaining 746 charities. After

grouping a number of small activity areas with fewer than 20 charities into a category of “other” the categories of charities and their mean PBR quality scores are as shown in table III.

[Table III here]

Across the 746 charities, the differences in mean scores for TAR quality between those in the different activity areas were found to be significant at the 0.05 level using a one way analysis of variance ($F_{(7,738)} = 2.50$). It thus appears that the charity’s field of activity is a significant determinant of PBR compliance. (Whilst some of the activity areas had a higher proportion of larger charities which might have been expected to score higher, this was not a major distinction: the variance was found to be significant even when controlling for charity income.)

The strongest level of compliance was found from charities in the field of *accommodation and housing* with 19.4% meeting the full requirements in the 2008 Regulations, whereas only 3.3% of charities classifying their activities under *general charitable purposes* met the full requirement.

6. PRINCIPAL FINDINGS – FOCUS GROUPS AND INTERVIEWS

6.1 Narrative Reporting and the Process of Preparing the Trustees' Annual Report

The discussions with trustees and other charity representatives sought first to investigate participants’ overall perceptions of narrative reporting via the Annual Report and Accounts (AR&A). If, for example, participants saw no point in publishing narrative information in a TAR alongside their accounts, their views on PBR would no doubt be clouded by this.

All accepted the value of narrative reporting at some level (no one felt it was pointless) – but this is perhaps unsurprising as participants for this phase were selected from charities in phase 1 which had made reasonable progress on PBR. However, some saw it as a minimal compliance issue whilst others perceived real benefits in governance and communication with external stakeholders through an effective TAR.

However, a variety of processes were found for preparing TARs. Several participants reported that the staff of the charity prepared the TAR and trustees had no significant involvement in the actual drafting. In other cases the chief executive or a senior administrator prepared an initial draft TAR which was then subject to detailed review by a subcommittee of trustees to *'thrash out the detail'* as one person said. In charities with income of less than £150K the TARs were often prepared by a single trustee. Two instances were identified where the charity's independent examiner (IE) or auditor had prepared the TAR (both with incomes around £200K) with little or no input from trustees. The role of the auditor/IE was also highlighted more positively by many interviewees, especially in identifying the need for the TAR to deal with PBR issues.

As explained above, PBR requires a charity to explain how its activities lead to benefit for the charity's beneficiaries. The interviews found that for most of these preparing TARs it was straightforward to consider whether an *activity* created a charitable benefit, but some found it hard to conceptualise and hence to communicate who the actual *beneficiaries* of their charities were – especially for charities where the day to day work involved little or no direct contact with beneficiaries.

6.2 The Impact of PBR on reporting behaviour

Discussions explored with participants whether their charities had behaved any differently as a result of the introduction of public benefit reporting requirement. Three categories of response were discerned.

6.2.1 Little impact

For several charities which historically had reported about their activities in detail, the introduction of PBR appeared to have caused very little extra work. It was *'business as usual'* according to one small arts charity trustee. *'No changes were required - the beneficiaries are clearly defined and always have been'* said the CEO of a £400K social care charity. *'We took it in our stride, it didn't make a big impact'* observed another trustee. In these cases there appeared to be no added sense of accountability beyond the issue of normative compliance with a regulatory requirement.

6.2.2 *Impact on governance but no substantial changes*

Others reported that their charities had been influenced to reconsider their activities and beneficiaries, so it had prompted new levels of reflection by trustees – which might suggest a new sense of accountability.

For example, a trustee of a £75K charity said that the PBR process had been a *'helpful trigger'* in explaining their work to potential supporters. A trustee of £1M religious umbrella group organisation, touched upon the interaction with governance, and said that he had used the PBR process as *'a very useful agent of change in getting the charity out of its shell'*.

6.2.3 *Wider impact linked to concern on PBR*

For some, there was a clear sense that if they failed to address PBR properly it was much more than a reporting issue and could have much wider consequences – including a sense for a few that the entire charitable status of the organisation could be at risk. For example, the Charity Commission had conducted 'public benefit reviews' of a number of charities and in some cases it had sought significant changes to their methods of operation in order to ensure they were operating for the public benefit (Charity Commission 2009). *In extremis*, a charity unable to meet the public benefit requirement could theoretically lose its charitable status and then be forced to transfer its assets to other charities, so potentially this was a high risk issue for some charities.

No participant articulated such concerns directly, but nevertheless some saw PBR as a major challenge. *'[PBR is one of the] increasingly onerous responsibilities on trustees,'* said one. One independent school had placed *'a huge amount of effort'* preparing the TAR, forming a group of governors specifically to manage the issue. However, their effort was described as being driven by a desire *'not to stand out [from other schools]'* rather than out of a desire clearly to explain their activities and beneficiaries. But conversely, others said: *'[PBR] is fairly low down on the list of worries of compliance issues'* and *'[PBR] is not that demanding compared to other issues of compliance'*.

6.3 **PBR and levels of concern**

The findings suggest that charities could be categorised as having low- medium- and high-concern in relation to PBR, with different behavioural consequences. Not surprisingly, for charities with high

levels of concern about the public benefit requirement, the process of reporting on public benefit was seen as requiring more attention.

Charities with low/medium concern on the public benefit requirement, which had previously reported very briefly upon activities and beneficiaries, generally spent time enhancing the quality of their reporting on these matters. However, despite some extra work of this kind, these charities generally had very positive views on the process. No participant in this phase saw the PBR requirement as a meaningless exercise.

Participants from four charities appeared to have high-concern on public benefit issues: these included two independent fee-charging schools, a religious conferencing charity and a charity involved in extensive campaigning work which was often directed at politicians. For different reasons, the trustees of each of these charities were aware that their charity was potentially close to the boundaries of charitable status. It was evident that the PBR requirement had led to an exceptionally clear focus being applied to the reporting of activities and beneficiaries for these charities.

The campaigning charity stated that *'It is very important that we explain the link between our activities and the relief of poverty'* – this was something they had not done prior to the PBR requirement. For the religious conferencing charity the focus in PBR was to distinguish clearly between the charitable activities open to those of all faiths, and those which were specific to participants in the faith concerned.

7. DISCUSSION AND CONCLUSIONS

7.1 PBR practices as an indicator of understanding of charity accountability

The first aim of this paper was to ask what charities' practices in terms of PBR imply for their understanding of charity accountability.

Both phases of the study revealed some charities which had focused extensively on the PBR requirements, and it had undoubtedly shaped their approach to narrative reporting. Some instances emerged from the interviews and focus groups where PBR had prompted more communication than had previously been the case between trustees, members of staff, and auditors or independent examiners. So, at that level, PBR would appear to be influencing the shape of charity financial reporting, by

placing more emphasis on narrative reporting in relation to aims, activities and beneficiaries. Such emphasis suggests that charities are prepared to embrace greater accountability through narrative reporting.

However, the findings of both phases suggest that there remains a good deal of confusion about the purpose of the TAR, and whether or not narrative reporting is worthy of time and effort, especially in the smaller charities. At one end of the scale, phase 1 found many smaller charities provided no TAR at all, and even amongst larger charities there were documents perhaps intended as TARs but with no indication of trustee approval. In terms of the specific requirements of PBR, the proportion of charities which were assessed as clearly meeting the requirements in the 2008 Regulations (i.e. a score of 4 or 5 on the scale used) ranged from only 2% of charities under £100K income to just 26% in the case of the auditable charities (over £500K income).

This is firm evidence, therefore, that many charity trustees either lack understanding of what was legally required under the 2008 Regulations or do not see compliance with the statutory requirements for a TAR as being a high priority issue. It is also possible that some recognise an accountability obligation in the numbers they report in their financial statements, but attach much lower significance to accountability through narrative reporting in the TAR.

The second phase found that even in charities which had achieved a reasonable standard in PBR, some saw it as a low priority issue, and many trustees were happy to leave the reporting to a member of staff or accountant. Indeed, several cases emerged where the TAR included the statement that 'the trustees had had regard to the Charity Commission's guidance on public benefit' but in reality the trustee being interviewed had no real understanding of what this meant. The findings from this phase are not generalisable to the whole sector, but they indicate that even where compliance was reasonable, trustees did not necessarily perceive PBR as being important in terms of accountability.

Some charities in phase 1 had met all the requirements for PBR, on occasions with extensive discussions going beyond the legal requirements. Phase 2 found cases of charities which had set up special committees or otherwise invested great effort in meeting the PBR requirement. But in the latter case, the trustees' motivation appears to have been largely because of high concern on issues of the

public benefit requirement more generally, rather than because of a belief in the importance of narrative reporting and a desire to explain the charity's work clearly to readers of the TAR. In one or two cases the desire to avoid differentiation from other charities (the coercive isomorphism identified by Verbruggen et al 2011) appeared to be the main issue. So even when PBR prompted great effort, it may not necessarily have meant a greater sense of accountability.

These findings contrast somewhat with those of Connolly and Dhanani (2009, p59) who report that most charities recognised a duty to account to stakeholders – but the latter study was based on large charities which were likely to have a clearer understanding of accountability.

Nevertheless, the high concern around public benefit and charitable status showed by some implies a recognition that charitable status is not automatic. This suggests a sense of accountability to the inherent legitimacy of that status. Whilst some of the participants were unhappy with the Charity Commission's approach to public benefit, all of those in the "high concern" category recognised that the public benefit requirement implied a requirement to account for what they were doing in order to justify the privileges of charitable status and they were therefore prepared to invest time and effort in PBR. Even where it was a low- or medium-concern issue, several participants reported that PBR was valuable in helping a charity refocus on its aims and beneficiaries, or was useful in enabling them to 'tell their story'. In other words, there was an acceptance that it was right to be accountable on public benefit issues.

It is difficult to assess these finding in relation to other studies on accounting narratives, as much previous work focuses on listed companies or, where applied to charities, focuses on the largest, where omission of mandatory information is relatively rare. The seminal work of Smith and Taffler (2000), for example, is an analysis of *discretionary* disclosures by manufacturing and construction companies listed on the London Stock Exchange – although the authors conclude that careful analysis of narrative information can help to distinguish between financially distressed firms that fall into bankruptcy and those which ultimately recover. No attempt was made in this study to correlate the quality of PBR with the longer term success or failure of charities, but it seems intuitively probable that charities with good PBR have a clearer focus on their aims and beneficiaries, and hence are more likely to succeed long term in fulfilling their charitable purpose.

Beyond the regulatory sphere, in some cases accountability to other stakeholders through PBR was mentioned: for example some charities in phase 2 saw PBR as a means to tell their story clearly to funders (though this may simply indicate compliance prompted by resource dependency). For these charities, PBR had a double benefit of showing funders that the charity was legally compliant and enabling them to explain the wider public benefit of their work in terms which reinforced their charitable status.

It is possible that some of the non-compliance with PBR can be explained by the limited sanctions. The Charity Commission had publicly indicated that prior to 2011 it was not routinely reviewing charity reports and accounts filed²³, so trustees may have concluded that the risk of regulatory enforcement was too low to merit action. If so, this would imply little sense of accountability to the public as a whole – or at least a refusal to exercise such accountability through preparation of a TAR and accounts complying with regulations. All the charities in this study had produced accounts of some kind, and 91% had provided something approaching a TAR. It would seem improbable that they would comply in part but deliberately neglect PBR (especially given that many participants in the second phase reported that PBR had not generated substantial extra work). It seems more likely, therefore, that most of the non-compliance was due to ignorance rather than a deliberate rejection of the accountability which PBR implies. In any case, it is widely accepted that in areas such as charity regulation “self-regulation or development of good practice may be more appropriate than compliance-based law” (Morris 2011, p46).

The fact that many charities have embraced PBR effectively, and others made strong attempts, suggests that there is an acceptance of the wider accountability which stems from charitable status, and the widespread poor compliance may be a result of ignorance rather than hostility to the underlying principles of accountability. Ignorance has been cited as a major explanation for non-compliance in other studies of charity reporting (Crawford et al 2009).

It therefore appears that PBR has led to significant progress in many charities' understanding of the principles of public benefit. Whilst there are many shortcomings in compliance, there appear to be a considerable acceptance (amongst charities in all income bands) of the accountability of being established 'for the public benefit'.

7.2 PBR and the framework of charity accountability

The second aim was to investigate more broadly how far a mandatory system of PBR has developed the framework of charity accountability. Compliance with PBR forces a specific change in behaviour by charities (even if only a reporting change) in a way that is capable of systematic observation. This study thus makes a contribution to considering how far charities have or have not embraced a new understanding of accountability as a result of the changed focus on public benefit in the Charities Act 2006.

The study has found that mandatory requirements do not necessarily lead to high levels of compliance, though it appears this may be more due to ignorance than rejection of the associated accountability demands. The fact that PBR is a mandatory requirement may not be obvious to many charities if it is not actively enforced and it may therefore contribute little to the problems of information asymmetry for users of charity reports and accounts.

However, whilst more extensive monitoring of charity reporting is applied in other jurisdictions (e.g. OSCR 2009) it would require colossal resources for charity regulators to enforce every aspect of charity reporting. In practice much of the onus rests on charity auditors and independent examiners. But whilst the study found some auditors and IEs had been very helpful in drawing charities' attention to the PBR requirement, other charities were concerned that their auditors or IEs had not mentioned this. Some auditors or IEs had directly drafted the TAR, taking away from the autonomy of trustees and hence reducing their accountability. In any case an auditor or IE is only required to review the TAR for material discrepancies with the accounts²⁴, and it could be argued that narratives of PBR rarely refer to amounts of money and hence their inclusion or omission will rarely lead to discrepancies with the accounts. Moreover, for the smallest charities (under £25K income) where there is no requirement for audit or independent examination, the onus is solely on the trustees.

Nevertheless, in charities which were aware of the PBR requirement, phase 2 of the study found clear instances where PBR had been a positive catalyst for fresh engagement with the charitable objects and clarification of beneficiaries. It was found that many trustees had an intrinsic desire for legal accountability and probity and wanted "to be doing the right thing" on anything that was legally

required – so the fact that PBR was mandatory helped them ensure it was addressed. Furthermore, a small number of “high concern” charities invested great effort in PBR, and the fact that it was mandatory was central to their effort. Without this, it seems very unlikely these charities would have engaged with public benefit issues in their reports and accounts.

7.3 Summary

This study has provided a wide range of quantitative and qualitative data on the practices of charities in respect of public benefit reporting. A follow up study found that for most charities already on the register, PBR was felt to be by far the most practical consequence of the renewed approach to public benefit in the Charities Act 2006 (Baker et al 2012).

In principle, a mandatory system of PBR amounts to a major increase in the accountability demands on charities. Under PBR, public benefit is no longer an abstract concept, but rather a requirement on which every registered charity – small or large – must report every year. Moreover, the study found that those complying reasonably well with PBR generally accepted the value of such reporting: even if in some cases it was a high-concern issue, there was an acceptance that charitable status requires an explanation of how a charity’s work leads to public benefit.

Overall, therefore, it appears that a mandatory system of PBR is achieving higher levels of charity accountability in relation to the central requirement of public benefit – but much more education and enforcement will be needed to make this fully effective.

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TABLES AND FIGURES

Table I: The Charity Commission's Principles and Sub-Principles of the Public Benefit Requirement (*source: Charity Commission 2008*)

- 1 *There must be an identifiable benefit or benefits***
- 1a It must be clear what the benefits are
 1b The benefits must be related to the aims
 1c Benefits must be balanced against any detriment or harm
- 2 *Benefit must be to the public or a section of the public***
- 2a The beneficiaries must be appropriate to the aims
 2b Where benefit is to a section of the public, the opportunity to benefit must not be unreasonably restricted by:
 2b(i) Geographical or other restrictions; or
 2b(ii) Ability to pay any fees charged
 2c People in poverty must not be excluded from the opportunity to benefit
 2d Any private benefits must be incidental.

Table II: Sample Selection Framework

Charity Income Band	Actual number of registered charities in the study within each income band	Charities studied as a percentage of all registered charities in the band
(a) Over £500K	398	4.2%
(b) £100K - £500K	395	2.3%
(c) £25K - £100K	398	1.5%
(d) £5K - £25K	211	0.2%
Totals	1,402	0.9%

Table III: Analysis of TAR Quality by Charity Activity Area			
<i>Activity Area</i>	<i>Number of charities</i>	<i>Mean overall PBR quality score (0-5 scale)</i>	<i>Proportion of charities meeting full requirements (those with scores of 4 or 5)</i>
General Charitable Purposes	122	1.75	3.3%
Education/Training	314	2.11	14.6%
Medical/Health/Sickness	49	2.49	18.3%
Disability	28	2.18	7.1%
Accommodation/Housing	31	2.13	19.4%
Religious Activities	91	2.15	7.7%
Arts/Culture	31	1.81	12.9%
Other	80	2.11	6.3%
All charities with a single field of activity	746	2.08	11.1%

Figure 1: Proportions of charities meeting specified elements of PBR

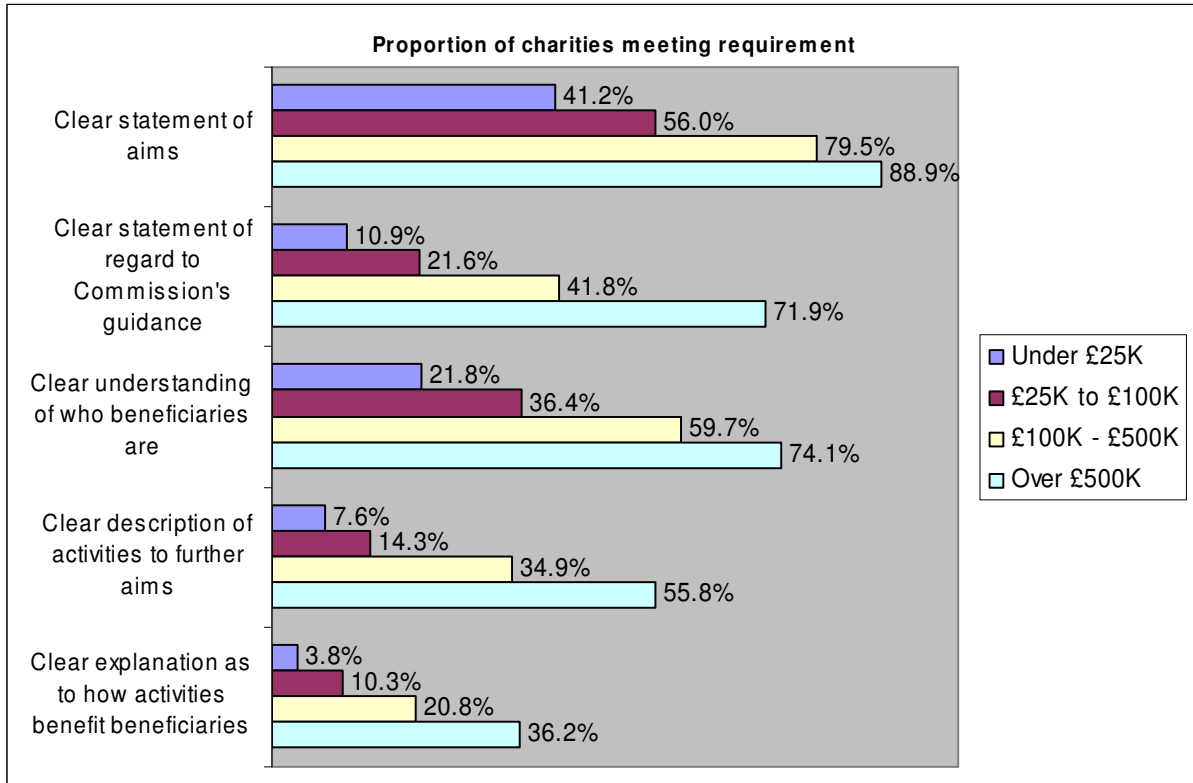


Figure 2: Charities meeting the full requirements for Public Benefit Reporting under the 2008 Regulations

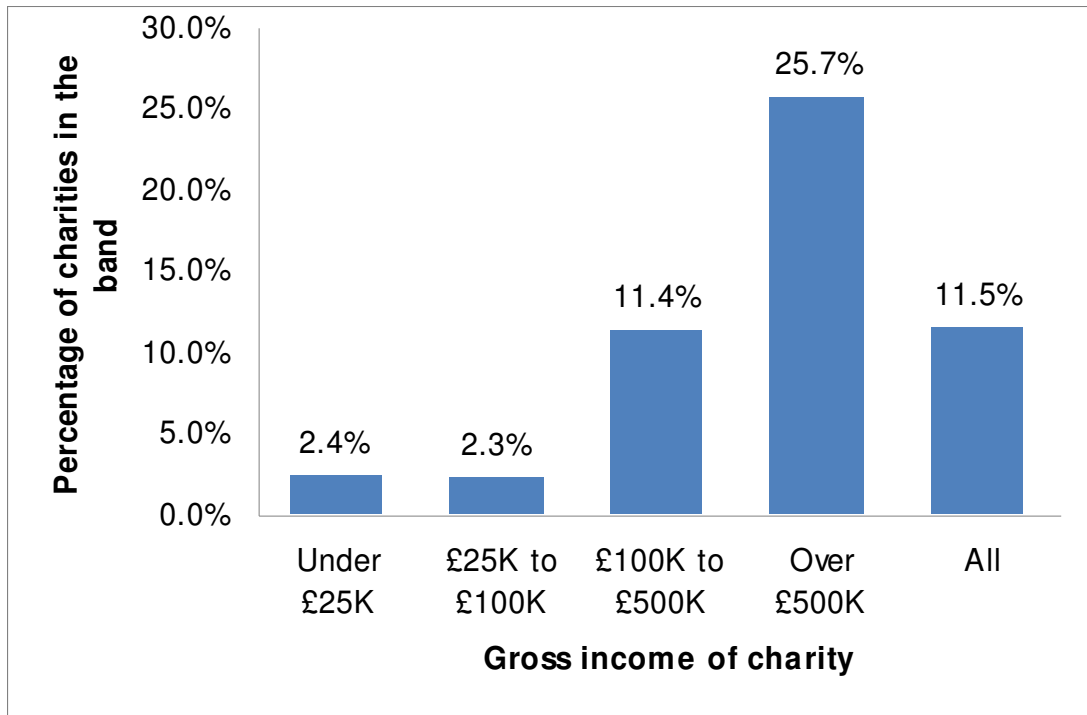
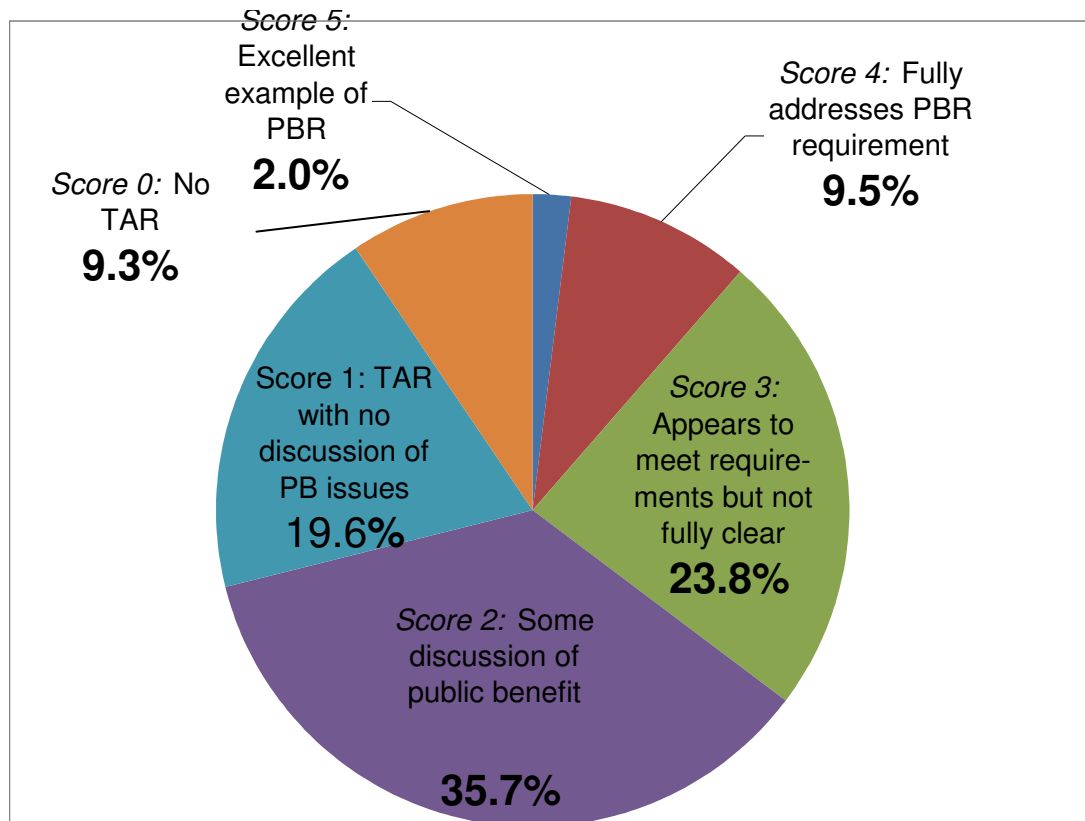


Figure 3: Proportion of charities reaching each level of public benefit reporting (whole sample)



NOTES

¹ The term “charity trustees” is used in UK legislation to refer to those who serve on the board of a charity, whatever the charity’s legal structure (trust, association, company, etc).

² Charities Act 2011, s162 (previously Charities Act 1993, s45).

³ SI 2008/629 – regs 40(2)(b) and 40(2)(c)(ii).

⁴ Charities Act 2006, ss.1-5 (now consolidated in Charities Act 2011 ss.1-6 – so subsequent legal references are given to the 2011 Act).

⁵ The first substantive case was *Jones v Williams* (1769) 2 Am 651.

⁶ Charities Act 2011, s.4(3).

⁷ *Independent Schools Council and Charity Commission and others* [2011] UKUT 421 (TCC) – hereafter “the ISC case” and *HM Attorney General and Charity Commission and others* - Upper Tribunal (Tax and Chancery) case FTC/84/2011.

⁸ Charities Act 2011, s.4(2). Previously it had been widely understood in case law that charitable purposes under the former first three heads (poverty, education, religion) were for the public benefit.

⁹ Charities Act 2011, s.14.

¹⁰ Charities Act 2011, s.17.

¹¹ Charities Act 2011, s.17(5).

¹² Now in Charities Act 2011 s.162.

¹³ The Charities (Accounts and Reports) Regulations 2008 SI 2008/629.

¹⁴ See note 7.

¹⁵ The upper income limit for R&P accounting was later increased to £250,000 – see note 20. The provision is now in Charities Act 2011, s.133.

¹⁶ The requirements – under the Charities (Accounts and Reports) Regulations 1995 – took effect for financial years starting on or after 1 March 1996 – i.e. years ending February 1997 onwards. The law allows 10 months after year end for accounts to be filed with the Charity Commission so the impact was from 1998 onwards.

¹⁷ SSI 2006/218.

¹⁸ At the time of the study the thresholds were in the Charities Act 1993 as amended by the Charities Act 2006 – they are now consolidated in the Charities Act 2011, s.30(2)(d), s.145(1), s.133 & s.144(1)(a).

¹⁹ A higher registration threshold of £100K applies to charities in certain sectors which were formerly exempted from registration: this includes many churches and also armed forces charities.

²⁰ This R&P upper limit was increased from £100K to £250K income for financial years ending April 2009 onwards, but many of the AR&As in this study were for the financial year 1.4.2008 – 31.3.2009 and were thus subject to the earlier limit. So it was felt £100K was a suitable boundary for this study.

²¹ The abbreviation £K denotes multiples of £1,000.

²² The aggregation is only used for illustrative purposes – it is not representative of all registered charities because in the overall sample larger charities were represented proportionately more often than smaller ones. However, as the larger charities show higher levels of compliance, this has the effect of overstating rather than understating the overall compliance.

²³ Evidence of Sam Younger (Chief Executive of the Charity Commission) – House of Commons Public Administration Select Committee, 25 October 2011: answer to Q110 indicates that the Commission had not to date been conducting random reviews of accounts filed.

²⁴ Charities (Accounts and Reports) Regulations 2008, regs 24(g)(iii), 25(h)(iii), 31(j)(iii).