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# Legacies and the Charities SORP - Discussion Briefing

# Prepared by: CIPFA and Reviewed by the Charities SORP-making body, June 2021

## Purpose of the briefing paper

To assist the engagement strands and Charities SORP Committee in their reflections on the current approach to legacies within the SORP and to undertake a problem-solving exercise to identify:

- the change desired in FRS102 to permit the desired accounting method and the option(s) for changing what the SORP specifies about the reporting of legacies, if any and if so,
- a preferred option with a recommendation as to what the change to the SORP should be, if any.

## Reflection - what does the SORP say about legacies?

Within the Module 4, Section A on the Statement of Financial Activities (SOFA), the current Charities SORP (FRS 102) provides the following recognition and disclosure requirements for all charities:

***A Income and receipt of endowment***

*4.31 Donations and legacies include all income received by the charity that is, in substance, a gift made to it on a voluntary basis. A donation or legacy may be for any purpose of the charity (unrestricted funds or for a particular purpose of the charity (restricted income funds or endowment funds).*

*4.32 Donations and charities do not provide any significant benefit to the donor in return for their payment other than the knowledge that the charity must use the gift to further its purposes. Income from donations and legacies includes:*

- *donations and gifts made by individuals and corporations, including any related tax refund or Gift Aid claimed on gifts made by individuals but excluding goods donated for resale;*
- *legacies receivable by the charity;*
- *grants of a general nature provided by government and charitable foundations which are not conditional on delivering certain levels or volumes of a service or supply of charitable goods;*

- *membership subscriptions and sponsorships where these are, in substance, donations rather than payment for goods or services; and*

- *donated goods for the charity's own use or distribution* and donated services and facilities.

The remaining direct provisions of the SORP relating to legacies are set out in module 5 paragraphs 5.29 to 5.37 and are included in Appendix 1 to this Briefing.

The Charities SORP follows the provisions of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* for the recognition of incoming resources from non-exchange transactions (see below) and provides detailed guidance for initial recognition (and the conditions for recognition), measurement, subsequent measurement and disclosure including portfolio treatment for individually immaterial transactions. It also provides provisions for the recognition of expenditure on raising funds, where relevant.

In particular, Appendix B to Section 34 Specialised Activities of FRS102 provides that:

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| PBE34B.5 | Donations in the form of legacies are recognised when it is probable that the legacy will be received and its value can be measured reliably. These criteria will normally be met following probate once the executor(s) of the estate has established that there are sufficient assets in the estate, after settling liabilities, to pay the legacy. |
| PBE34B.6 | Evidence that the executor(s) has determined that a payment can be made, may arise on the agreement of the estate's accounts or notification that payment will be made. Where notification is received after the year-end but it is clear that the executor(s) has agreed prior to the year-end that the legacy can be paid, the legacy is accrued in the financial statements. The certainty and measurability of the receipt may be affected by subsequent events such as valuations and disputes. |
| PBE34.B7 | Entities that are in receipt of numerous immaterial legacies for which individual identification would be burdensome may take a portfolio approach. |

The effect of the wording that 'evidence that the Executor(s) has determined that a payment can be made, may arise on the agreement of the estate's accounts or notification that payment will be made' allows a great degree of latitude in the timing of recognition of legacies.

There is currently no glossary definition for legacies, although the term has a specific legal meaning.

## What is the reporting difference between 'all' and 'larger' charities?

There are no specific requirements additional requirements for larger charities when reporting legacies within the current SORP.

## FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and the Scope for Changing the SORP to Possible Accommodation of a Different Approach to Legacies

See preceding section but also consideration will need to be given to the requirements for recognising entitlements to legacies within Section 34 of FRS 102, “Incoming Resources from Non-Exchange Transactions”.

FRS 102 paragraph PBE 34.66 states that “Non-exchange transactions include, but are not limited to, donations (of cash, goods, and services) and legacies.”

Regarding recognition and measurement paragraph PBE34.67 states:

An entity shall recognise receipts of resources from non-exchange transactions as follows:

a) Transactions that do not impose specified future performance-related conditions on the recipient are recognised in income when the resources are received or receivable.

b) Transactions that do impose specified future performance-related conditions on the recipient are recognised in income only when the performance-related conditions are met.

c) Where resources are received before the revenue recognition criteria are satisfied, a liability is recognised.

# Engagement strand feedback during the exploration stage

## Income recognition

**Larger Charities Engagement Strand Perspective**

The Larger Charities engagement strand made the following comments:

- Although there are finite categories of income recognition and some issues on interpretation and application of multi-annual funding and legacies, for larger charities it is felt that the present SORP is okay and mostly needs more guidance and more education for preparers of accounts, understanding many of these preparers are independent professionals.

- More clarity on income recognition [is needed] especially for [the] smaller end of [the] large charities range. [This] would help consistency of interpretation and application i.e. [it would provide] less choice on approaches.

- In particular on multi-annual funding where, depending on clarity of performance specified by the funder, the funding is recognised immediately where expenditure may take place over multiple years – [this] needs clarity – the principle of ‘matching’ would seem to be more likely to give a ‘true and fair view’ as applies to other entities.

The CIPFA Secretariat would note that the principle of ‘matching’ is no longer a concept in financial reporting rather the accruals concept would require that income is recognised in accordance with the principles in paragraph PBE3.67 of FRS 102 above and should be a faithful representation of the transaction. Specifically, FRS 102 comments

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| 2.45 | Generally this FRS does not allow the recognition of items in the statement of financial position that do not meet the definition of assets or of liabilities regardless of whether they result from applying the notion commonly referred to as the ‘matching concept’ for measuring profit or loss. |

## Legacies

**Professional and Technical Engagement Strand (A) perspective**

Professional and Technical engagement strand (A) raised the following points:

- The general point raised by the strand was that there was a need for more clarity on the accounting treatment to be adopted. Under the current SORP, trustees need to exercise judgment when deciding when to recognise a legacy in their accounts e.g., when is the receipt probable? Should flexibility be maintained in SORP? Alternatively, would it be preferable to mandate a specific treatment?

- “Would it be possible to adopt one method and provide an explanation in the Notes to the accounts?”

**Major Funders and Donors and Government and Public Bodies perspective**

Major Funders and Donors and Government and Public Bodies raised the following points:

- “We debated whether the current rules for disclosing legacies is better than the old regime – [where legacy income was] only disclosed upon receipt. [There was a] Good debate but not necessarily a consensus.”

- It was recognised that the guidance in the SORP is based on FRS 102, paragraph PBE34B.5 so this would need to be taken into consideration of that standard.

## Observations from the SORP Committee:

At the December 2020 meeting when SORP Committee members were invited to share their key conclusions on topics that had arisen during the exploration stage and that should inform the reflection stage, legacies reporting was noted as an item that is frequently raised and requiring review.

Two SORP Committee meetings were held during February 2021 which considered the feedback from the engagement strands in relation to the user of the accounts and the user of the SORP.

The discussion from the user of the SORP perspective agreed that legacies was a technical topic that should be taken forward from that perspective.

### Relevant SORP research findings

The 2016 SORP research exercise identified that greater guidance and clarification needed as there is divergence in practice. (As noted previously FRS102 as currently worded allows latitude in the timing of recognition of legacies.)

The research provided by the Journal of Accounting & Organizational Change (noted to be published January 2021) *Legitimating accounting change in charities: When values count more than regulation* Ciaran Connolly, Noel Hyndman* and Mariannunziata Liguori Queen's Management School, Queen's University Belfast, Northern Ireland, United Kingdom included the following commentary:

*'Many of the interviewees were particularly critical of the change in the income recognition criterion (from certain to probable, meaning that, for example, legacies, a major source of income for many large charities, would be recorded earlier),…'*

## What needs to be done now?

### Step 1- Making the case for change - a 'basis for conclusions'

There is a need to consider the reporting requirements for legacies as this has had some explicit support from two of the engagement strands and SORP Committee discussions to date.

At this stage, there is a need to decide whether there needs to be any changes to the recognition and measurement requirements specified in both FRS102 and in the Charities SORP and what those changes might be to either improve the understanding of the users of the accounts or to assist accounts preparers with the decisions and judgements required to recognise and measure legacies held by charities. Without a case for change, no change will be considered because its rationale cannot be explained to those affected.

### Step 2 - Advising the change required to the SORP

Having made the case for change, the detailed changes required to FRS102 and the SORP need to be specified. Consideration should be given in as much detail as possible for the reporting requirements for legacies – for example, initial recognition and measurement. If no detail is given, the conclusion drawn is that the detail is left wholly to the discretion of the SORP Committee and SORP-making body.

**Undertaking an assessment of the impact (savings or costs on the preparer and benefits or disadvantages to the reader)**

The FRC will require an impact assessment but until the implications of change are worked through the SORP framework, the impact is unlikely to be clear and so this will be considered at the drafting stage of the process.

## Step 3 - Recommendation

The case made by each engagement strand or combination of strands will inform the deliberations of the SORP Committee and so there needs to be a clear recommendation from the engagement strands and the SORP Committee.

Following evidence provided by the engagement strands the SORP Committee will have its own discussion about what needs to be done and taking the evidence and views from the process, the Committee will settle on a recommended approach for drafting the SORP based on the evidence presented.

**_APPENDIX 1_**

***Analysis of income in the notes to the accounts***

*4.42 Unless analysed on the face of the SoFA, this SORP requires that the notes to the accounts must provide an analysis of the material components of income included within each analysis heading of the SoFA. Amounts for similar activities should be aggregated so as to provide an analysis of:*

- *donations and legacies, distinguishing between the types of gift receivable, for example the amount of donations, grants of a general nature and legacies;*

*B Expenditure*
*B1: Expenditure on raising funds*

*4.44 Expenditure on raising funds includes all expenditure incurred by the charity to raise funds for its charitable purposes. It includes the costs of all fundraising activities, events, non-charitable trading activities, and the sale of donated goods. However, any costs incurred in providing goods or services as a charitable activity must not be included in this heading, even if a charge is made for their provision.*

*4.45 Expenditure on raising funds includes those costs incurred in:*

- *seeking donations, grants and legacies;*

*5.2 Charities should refer to sections 23, 24 and 34 of FRS 102 for more information. This module applies to all charities and sets out:*

- ***recognising income from legacies;***

*Recognising income from legacies*

*5.29. For accounting purposes, entitlement to a legacy cannot arise without the charity knowing of both the existence of a valid will and the death of the benefactor. Those charities with databases of current donors may well have information about an individual donor’s intention or decision to leave a gift to them in their will and charities may also employ agents or carry out their own research to review publicly available information on recent deaths including the granting of probate. Charities having such information should use this information when developing their accounting policy for recognising income from legacies. For accounting purposes,* *evidence of entitlement to a legacy exists when the charity has sufficient evidence that a gift has been left to them and the executor is satisfied that the property in question will not be required to satisfy claims in the estate.*

*5.30. Of itself, establishing entitlement is insufficient to recognise legacy income. The recognition of the gift is also affected by the probability of receipt and the ability to estimate with sufficient accuracy the amount receivable.*

*5.31. Receipt of a legacy must be recognised when it is probable that it will be received. Receipt is normally probable when:*

- *there has been grant of probate;*
- *the executors have established that there are sufficient assets in the estate, after settling any liabilities, to pay the legacy; and*
- *any conditions attached to the legacy are either within the control of the charity or have been met.*

*5.32. Charities which receive a significant number of legacies in a reporting period and have detailed historical information on the settlement of legacies may apply an estimation technique in measuring the value of legacies that are recognised to allow for potential variation in settlement values and the risk of a will being contested. For example, where a charity has numerous immaterial legacies, by using a portfolio approach, the charity may estimate the monetary value of the income that may be received from legacies to which they are entitled by applying a formula or mathematical model. However a portfolio approach is unsuitable for material legacies or when a charity only receives legacies infrequently, as these should be considered individually. When a portfolio approach is not adopted charities must recognise a legacy when the executors have determined that a payment can be made following the agreement of the estate's accounts, or on notification by the executors that payment will be made.*

*5.33. Where a payment is received from an estate or is notified as receivable by the executors after the reporting date and before the accounts are authorised for issue but it is clear that the payment had been agreed by* *the executors prior to the end of the reporting period, then it should be treated as an adjusting event and accrued as income if receipt is probable.*

*5.34. In some cases, a charity may have entitlement to a legacy but there is uncertainty as to the amount of the payment. For example, the legacy may be subject to challenge or the charity's interest may be a residual one. If the interest of the charity in a pecuniary or residuary legacy cannot be measured reliably, details of the legacy should be disclosed as a contingent asset until the criteria for income recognition are met. Where a legacy is subject to the interest of a life tenant, the legacy would not be recognised as income until the death of the life tenant.*

*5.35. Charities should measure or estimate the fair value of the legacy income receivable based on the information available. The fair value receivable will generally be the expected cash amount to be distributed to the charity from the estate. Legacy income must only be recognised when it can be measured or estimated with sufficient reliability. Legacy income classified as receivable within one year should not be discounted by the time value of money.*

*5.36. If the distribution is to be deferred for more than 12 months and an estimate can be made of the likely date of distribution, the legacy, if material, may be discounted by the interest rate the charity anticipates it would earn on a comparable deposit over a similar time frame using the effective interest method set out in section 11 of FRS 102. The unwinding of the discount should be reported as an adjustment to legacy income and not as interest receivable.*

*5.37. If a legacy debtor is impaired because it is doubtful that full settlement will be received, then an adjustment is made to reduce the amount of the legacy debtor and legacy income rather than charging the adjustment as expenditure in the SoFA.*