

Feedback from Engagement Strands and Working Groups on Legacies

Engagement Strand: Trustees
A. Options Considered by the Engagement Strand
<ul style="list-style-type: none"> • To retain the status quo but increase clarity of the requirements • Tiered reporting • Guidance to accompany the SORP to clarify requirements • Introduce a ‘certainty’ principle for smaller charities • To introduce a mechanism within the SORP for trustees to disclose late legacies (to demonstrate the increase in reserves is not a result of poor financial planning)
B. Advantages/Disadvantages of Options Considered
<p>Trustees have the perspective of both a preparer and the user of accounts and considered the treatment of disclosure from both perspectives making the following observations:</p> <ul style="list-style-type: none"> • Legacies have an impact on reserves but going concern and liquidity issues are also important when considering the disclosure of legacies. • There may be value in adopting the virtually certain principle, though it was argued that the current SORP already provides sufficient flexibility in this regard • Variances can arise from inconsistencies in approach due to the use of judgement. Comparability may be affected by some trustees being more cautious in their approach than others. • Trustees need to manage the additional complexity arising from the use of management accounts which do not reflect the legacy reporting requirements. This will result in different figures being used for financial (and operational) decisions on a regular basis which do not reflect the principles required for annual reports and accounts. • There is often a considerable time lag between charities being informed of a legacy and the money being received. It is reported that this process could take anywhere between nine months and two years. This presents real challenges to trustees in how best to use their judgement to publicly disclose the money expected/received. • The proceeds from some legacies, and in particular when the charity is a residuary legatee, introduces an element of uncertainty as to what will be received. This uncertainty can have a material impact on the decision making of trustees and the actions affecting a charity’s operations and intended beneficiaries. • For small charities receiving a large legacy, there is the additional challenge of having to appoint auditors for a single year because the sum of money involved tips them over the audit threshold. This is more pertinent for charities in Scotland and Northern Ireland because of the lower audit threshold. • The option to consider a contingent asset may be a solution. • A charity’s accounts could be manipulated by a decision when to recognise a legacy. There needs to be clearer principles as to when to report and to reduce the current amount of flexibility available.

C. Conclusions
<p>The following are the recommended options to the committee (options 1,3 and 5).</p> <ul style="list-style-type: none"> • To recommit to the recommendations at the end of the exploration phase: <ul style="list-style-type: none"> ○ The use of plain English ○ Greater use of hyper linking ○ Including of a comprehensive glossary and full indexation ○ Equal consideration to the importance of reporting both financial and non-financial performance in the report and accounts ○ To clarify in the SORP what is a legal requirement and what is recommended and to cite sources ○ To reduce the length and complexity of the financial notes by better use of referencing, signposting, cross- referencing and hyperlinking • To provide clearer guidance to accompany the SORP to clarify reporting requirements. • To introduce a mechanism within the SORP for trustees to disclose late legacies (to demonstrate the increase in reserves in not a result of poor financial planning).
D. Other comments
<p>A fourth option, to introduce a 'certainty' principle over 'probable' could be considered but with a preference that the principle could be extended to all charities.</p> <p>There should be a range of documents, in different styles, to help trustees understand complex accounting concepts, such as accounting for legacies. Text guidance should be accompanied with worked examples, case studies, flow charts and decision trees.</p> <p>The engagement strand also commented that it encouraged the SORP Committee to consider the impact of a one-off legacy pushing a small charity over the audit threshold and whether that is a reasonable outcome.</p>

• Engagement Strand: Large charities
A. Options Considered by Strand
<ul style="list-style-type: none"> • The move from certainty to probable made it harder to value and include legacies as it involved more judgement • Whether there would be a need to request a change to FRS102 in respect of recognition of legacies • More guidance, perhaps an application note, is needed on valuation of legacies which include assets and those with cash • How to manage considerable time lags between the recognition of a legacy in the accounts and when the proceeds may be received

<ul style="list-style-type: none"> • Whether inclusion of a note, demonstrating what had been received and not yet received, would help the reader understand the charity's position
B. Advantages/Disadvantages of Options Considered
<ul style="list-style-type: none"> • There can be a play off between the earlier recognition of income and the impact on other funders. • Any matters requiring judgement inevitably have no "right" answer.
C. Conclusions
<ul style="list-style-type: none"> • There is no consensus that any change to the treatment and recognition of legacy income is required. • Legacies should be in the SORP glossary. • More narrative reporting should be encouraged by the SORP concerning legacies, explaining what has and hasn't been received.
D. Other Comments
<ul style="list-style-type: none"> • Users understanding of the accounts would be enhanced by further disclosure in the notes and additional explanation in the trustees' annual report for significant items.

Engagement Strand: Smaller charities
A. Options Considered by Strand
<ul style="list-style-type: none"> • The change in the recognition decision and timing from 'virtually certain' to 'probable' has created problems for the preparers of charity accounts as it now involves judgement. • There are problems with the reliability of measurement where a legacy involves property as there may be a difference in value between notification and sale.
B. Advantages/Disadvantages of Options Considered
<ul style="list-style-type: none"> • Problems are created for the preparers of accounts when areas of judgement are introduced.
C. Conclusions
<ul style="list-style-type: none"> • Clearer guidance is required and a flowchart or decision tree which address specific points would increase consistency. • The guidance should set out numerical examples of different scenarios.
D. Other Comments
It may be that, given the 'softer' income recognition criteria, it may be difficult to provide clear guidance.

Engagement Strand: Academics, regulators and proxies for the public interest
A. Options Considered by Engagement Strand Member – Proxy for public interest
<ul style="list-style-type: none"> • Whether the use of judgement is consistent with a principles-based approach to standard setting.
B. Advantages/Disadvantages of Options Considered
<ul style="list-style-type: none"> • The introduction of judgement increases risk.
C. Conclusions
<ul style="list-style-type: none"> • The current guidance provides sufficient parameters to mitigate the risk of undue variation in application. • A comprehensive review of the existing guidance is required.
D. Other Comments

Engagement Strand: Academics, regulators and proxies for the public interest
A. Options Considered by Engagement Strand Member – Regulator A
<ul style="list-style-type: none"> • Due to the make up of charities on the register most are small charities, this tends to be a large charity issue.
B. Conclusions
<ul style="list-style-type: none"> • Further guidance around the issues and worked examples would be beneficial • For the majority of small charities in receipt of an occasional legacy the existing guidance is sufficient.

Engagement Strand: Academics, regulators and proxies for the public interest
A. Options Considered by Engagement Strand Member – Regulator B,
<ul style="list-style-type: none"> • Providing additional clarification with guidance and examples • Returning back to 'virtually certain' (or 'expected') from 'probable' • Making provision in the notes to the accounts for clarification in the event when a legacy is recognised before it is received.
B. Advantages/Disadvantages of Options Considered

- Providing additional clarification with the use of guidance and examples
- Conversion back to 'virtually certain', or to new term 'expected' would require a change to FRS102 *The Financial Reporting Standard Applicable in the UK and Republic of Ireland*
- Including information on legacies accrued but not received may have an influence on other funders.

C. Conclusions

- Accounting for legacies should follow the same principles as for other income.
- Further clarity could be introduced through additional guidance, including examples
- The guidance needs to be clear.

D. Other Comments

- The concept 'probable' lacks certainty and precision.
- How often is the option in paragraph 5.32 of the SORP is used for dealing with multiple small legacies?
- Accounting for legacies is rarely an issue for this Regulator, would the views of legacy practitioners be of use to this issue?

Engagement Strand: Professional and technical group A

A. Options Considered by Strand

- To continue with the SORP as it stands

B. Advantages/Disadvantages of Options Considered

- Option of probable over certain allows for greater variance through personal judgement in the accounts
- Early recognition introduces risks due to changes in valuation and measurement
- Support for a consistent approach that removes wide interpretations

C. Conclusions

- The legacies section of the SORP needs to be reviewed for clarity
- Greater clarity required as to what the SORP means by 'probable'
- Consideration of further guidance from FRS102 on contingent assets to be included in the SORP
- Charities that receive low volumes of legacy to defer recognition until the income is received as a clear statement from the personal representative is received
- Lighter touch for smaller charities to relieve them of the burden of complex accounting
- Option for legacies to be recognised upon receipt, this could be through tiered reporting or an option for smaller charities
- Consideration for larger charities to disclose in the trustees' annual report accounting estimates that have been used

D. Other Comments

- More consistent approach would help sector forecasters predict legacy income
- Consistent approach to recognition would allow providers of legacy management software to deliver better products

Engagement Strand: Professional and technical group B

E. Options Considered by Strand

- Income from non-contentious legacies, including recognition after the balance sheet date
- Discounting of legacy income and debtors
- Whether unrestricted legacy income, not yet received, should form part of the charity's "free" reserves

F. Advantages/Disadvantages of Options Considered

- There is a lack of clarity within the SORP about when to recognise legacy income
- Specific requirements of 5.31 of the SORP are problematic as they require the charity to have knowledge of what a third party knows when assessing whether a legacy is due
- Recognition of legacies can introduce volatility in charity accounts
- Funders have been known to withdraw support if they believe a charity is in receipt of a large legacy

G. Conclusions

- There is scope to give charities, particularly small and medium-sized charities, a concession in relation to the timing of recognition of legacy income, for example, on a receipt basis.
- That the SORP Committee engages with a legacy expert to revise the recognition criteria
- Requirements could be developed to disclose information about legacies which do not meet any recognition criteria
- The circumstances described in paragraph 5.33 means there should either be a 'must' requirement to recognise an adjusting event after the balance sheet date or the current 'should' good practice point should be deleted.
- The Charities SORP is amended to make it clear whether legacy debtors and related income must be discounted if the charity believes it is probable that a transfer of assets in the form of cash will not take place for more than a year.
- That the Charities SORP Committee considers whether it should specify the basis for the selection of a discount rate, should the Committee determine that discounting is required.
- On agreeing new requirements for identifying and reporting on 'free' reserves, consideration is given as to whether unrestricted legacy income which has not been received and where the timing of the receipt of cash assets is uncertain should be included within a charity's calculation of its 'free' reserves. The engagement strand was of the view that this should be the case as long as charities are required to recognise income when receipt becomes probable.

H. Other Comments

- The engagement strand did not discuss the presentation of legacy income and related expenditure but have made recommendations previously about the use of natural classifications by charities in its report on tiering.

Charities SORP Working Group (A)

- The treatment is likely to be simple for smaller charities; they are likely to first learn about a legacy when they receive the cheque in the post.
- More difficult for larger charities.
- Tiered reporting approach may therefore be useful.
- The SORP explains the steps to take adequately – clear criteria are already in the SORP. However, this could be presented more clearly. For example, make it clear that all three criteria in paragraph 5.31 are required to meet the ‘probable’ criterion rather than one of them; and perhaps provide a flowchart to walk the preparer through the criteria that need to be met for recognition.
- Accountants/preparers do not deal with the legacy recognition regularly and are likely to need to refer to the SORP every time they are asked about a legacy.
- Broad agreement that a flowchart/decision tree in an Appendix to the SORP would help.
- Perhaps one flowchart for the simplest approach (case by case basis) and another for when the charity has a pipeline and can use a portfolio approach.
- Noted that it will not be possible to change accounting treatment without changing FRS 102.
 - General agreement that the “probable” versus “virtually certain” argument has concluded and there will not be an option to revert to the “virtually certain” recognition point.
- Tiered reporting would provide an opportunity to allow for a more straightforward treatment based on cash flows for smaller charities.
- From a funder point of view, it was noted that there is a time lag between the accounts being prepared and the application for funds. This allows the funder to ask for, and receive, more information about what has happened with the legacy since the year end.

Charities SORP Working Group (B)

- It’s not possible to change the basis of recognition from ‘probable’
- The SORP contains quite a lot of information on accounting for legacies already, therefore perhaps there is scope for further signposting rather than expanding this detail in the SORP
- The group is aware of the distortion in the accounts that receipt of a legacy may have for small charities, however, this is unavoidable as this is a receipt in these charities,