LEGACY Link

# BEST PRACTICE GUIDANCE

SORP 2015 and its implications for accruing legacy income

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## SORP 2015 – What now?

At the ILM Annual Conference two years ago, I spoke very briefly about measures to manage volatile legacy income, particularly highlighting the need for conservative forecasting and accruals policies and the importance of legacy fundraising to bring in a larger number of legacies and so, statistically, less chance of volatility.

Legacy Link has, as you may have noticed, is making efforts to encourage charity Directors and senior Fundraisers to invest in legacies, most recently through the first of a series of breakfast seminars, this one held at the Law Society on 29th May. Interest was high and this first event over-subscribed.

All well and good, and an important part of the jigsaw, but I remain anxious about over-zealous accruing and pipeline-squeezing that, in my view, increases risks for the operational running of charities.

The arrival of SORP 2015 has got many charity legacy professionals wondering what changes may come about in their charities and others in one of these areas - accruals.

Up to now, we have been governed by the provisions of SORP 2005, which, for legacies, defined income recognition on the basis of three criteria:

- Entitlement
- Certainty
- Measurement

Different auditors have differed widely in their interpretations of certainty and measurement, so that we have had a huge range of ways of accruing legacies. From a straw poll amongst Legacy Link client charities, they have varied from (a) accruing all legacies from the point of notification to (z) accruing none unless the money has come through the door. In between, some charities accrue only pecuniary legacies and others only residuary legacies where final Estate Accounts have been approved.

The majority view, however, is toward the latter end: not to accrue residuary legacies unless the Estate Accounts have been approved, and to accrue pecuniaries only where there is certainty of receipt. This broadly follows the advice on the ILM factsheet 'SORP 2005 and accounting for legacy income'.

Does SORP 2015 change the definitions, and how will that affect how we recognise income?

SORP 2015 has, at the least, allowed flexibility of interpretation to continue:

“For accounting purposes, evidence of entitlement to a legacy exists where 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.

“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.

“Receipt of a legacy must be recognised when it is probable that it will be received.

Receipt is normally probable when:

- There has been a 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.”

So SORP 2015 replaces ‘certainty’ with ‘probability’. At first glance, this change, which implies that it is more likely than not that the gift will pass to the charity, implies a loosening of the SORP guidelines. However, before we get carried away, let us consider if the other two defining factors, Entitlement and Measurement, have changed.

Well, I do not believe that they have, and indeed they are subject to just the same concerns as before.
For instance, a major problem with both entitlement and measurement is timing – when is the gift likely to be received? We have no power over the timing of distributions, which in law are at the discretion of the Executors according to whether they believe the estate is safe to make them. And that will depend on whether there are outstanding or newly-discovered liabilities or the possibility of claims. As beneficiaries we are unlikely to know the fine details of what is happening in an estate administration. Sure, we are required to ask for a schedule of assets and liabilities, but a good proportion of estate administrators do not provide them, and so we are unable to estimate accurately both what we may receive and when. Never mind that an estate property, usually the largest asset, may not sell quickly or at the asking price.

So with a fair proportion of residuary legacies, a correct answer to the questions of “how much?” and “when?” - this year or next year - may well be “I can’t know yet”. And for that reason, I believe that it is appropriate to veer towards not counting in where there is any doubt. In other words, because the Entitlement and Measurement criteria have not changed, then in my view that limits the amount of change possible in a proper interpretation of SORP 2015.

However, the change from Certainty to Probability will, I fear, mean that some Finance Directors and some Auditors will feel, regardless of SORP's wording, that they now have justification to accrue to the hilt. This counting-in of everything is part of an increasing trend that fails to recognise the significant variability and volatility of legacies.

Of course we all understand that the overall aim of charity accounts is to give the public a fair view of the charity's finances, including an idea of funds genuinely expected to come in in the near future. But some auditors seem to see wills as contracts - a legal and certain entitlement with no 'ifs' or 'buts'.

Many of us long-standing charity Legacy Managers know that not to be the case. For instance, we are seeing a steady rise in estates that cannot meet the legacies left in the Will. A greater number of individuals nearing end of life are needing funds for nursing care; the funds required are coming from their own wealth or through equity release schemes that claim back significant parts of assets (usually the property) on death. I believe that that proportion of estates diminished like this will be increasing significantly over the next ten years and into the future as life expectancy continues to increase. And don't get me started on the inexorable rise of legacies that find themselves subject to litigation.

I therefore feel firstly that whilst the change in SORP should not of itself cause a great difference to accrual policy, some auditors and Finance Directors will assume that it does; and secondly, that any change in SORP interpretation will continue to be dwarfed by the trend amongst auditors to accrue more and more.

Will this necessarily have a bad effect? I believe that accruing to the hilt increases the operational risks for a charity, particularly in years when, inevitably, legacy income falls significantly short of target. Inevitably? Well, yes. Legacy income is volatile. Even if we take out the 'windfall' legacies, those, say over £200,000 that can produce smiles all round when they arrive unpredicted, there will still be alarming fluctuations for most charities in the numbers of 'normal' legacies coming in, for little apparent reason.

As legacy income accounts for broadly between 25% and 90% of the voluntary income of legacy-earning charities, ANY downward fluctuation for which there is no cushion will have a direct affect on the viability of project work and possibly cause redundancies of project staff. Accruing in line with SORP2015 does at least allow for a cushion of legacy income that is likely to come in but has not yet met the criteria for inclusion.

Mine may be a personal and pessimistic view, and of course I look forward to being proved wrong. What is needed, I feel, is a concerted programme of training for Auditors and Finance Directors new to legacies to help them understand just how variable legacy income can be, and that adherence to a strict interpretation of SORP is actually useful.

Perhaps that should be the subject for another breakfast seminar at the least.

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