Legacies

Legacies are a form of donation or gift and in FRS 102 are defined as income from a non-exchange transaction. The essential feature of income from a non-exchange transaction is that the charity receives value from the donor without providing equal value in exchange.

All income should be recognised in the financial period if the transaction satisfies all three criteria:
- entitlement
- probability
- measurement

Generally, an entity is entitled to income when the risks and rewards of ownership have been passed over. **Entitlement** is achieved if all pre-conditions have been met and the control of the resources passes into the charity's hands. The donor can specify how they wish the funds to be spent and this will mean that the recipient charity must treat those funds as restricted funds. However, this does not prevent recognition as income in the period in which entitlement is achieved, providing the other two criteria are satisfied.

Probability has been introduced by FRS 102 and replaces 'certainty' which had been the criterion in previous UK GAAP. The receipt of income has to be probable for it to be included in the financial statements.

Measurement of the amount due should be based on the fair value – so the amount that can be realised if there are assets which have to be sold. You have to be able to measure the amount reliably and income has to be excluded from the accounts if it cannot be measured reliably.

When is a charity entitled to a legacy?

There can be questions over entitlement if the will does not clearly name the charity, for example, getting the name slightly wrong. Problems can also arise if there is more than one possible recipient for the funds, or if the will is contested. In straightforward cases, probate will establish entitlement. 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.

How should a charity assess probability?

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
- any conditions attached to the legacy are either within the control of the charity or have been met

Simply knowing that probate has been granted will be insufficient – there may be assets to be sold in order for the executor to know whether the estate has sufficient funds to pay all legacies. 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.

How should a charity measure a legacy reliably?

Legacy income should only be recognised when it can be measured or estimated with sufficient reliability. 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. This will depend on the complexity of the estate and whether the donor has left a pecuniary legacy or a residuary legacy to the charity – the latter is settled after all other amounts and so the uncertainty over the amount is greater. 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.

New in SORP 2015 – estimating the value from a portfolio

Charities which regularly receive a significant number of legacies will have detailed historical information on the trends and patterns for the settlement of legacies. Such charities may apply an estimation technique in measuring the value of legacies that are recognised as income. For example, 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.

Conclusions

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.

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.

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.

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.