Good Practice Guidance
Income Recognition and Accruals

Key Principles: Transparency, Collaboration, Informed

Legacy income is a fundamental source of revenue for most charities and is vital in supporting our charitable causes. Structures and responsibilities vary greatly between charities, so legacy professionals in different organisations will have greater or lesser input into income recognition and accruals systems. However, this section is intended to offer a range of useful information that should be applicable to many organisational set-ups.

A charity will manage and report income in two broad categories – unrestricted (for general purposes) and restricted (where there is a preferred or required use for the funds). Each charity has a legal requirement to ensure restricted legacy income is used as the donor wished or the gift should be declined.

As an important income stream, all legacy teams should have processes in place for managing and reporting income. Whether our legacy administration function sits within fundraising, finance or elsewhere, as a voluntary income stream legacy income and expenses must be reported separately from income generated by other charity activity.

While legacy professionals don't need to know every requirement in detail, by understanding the basic reporting and planning requirements of our charity, we can ensure our processes support the charity's ability to properly report legacy income. Applying the Principles of Informed and Collaboration, building good relationships with key stakeholders in our accounts team and working closely with them to develop good processes will make this task easier. If the systems and processes in legacy administration are right, routine income reconciliation, reporting, forecasting and annual audits should run smoothly.

It may feel at times that legacy professionals and accounts colleagues speak different languages! By having open conversations and employing the Principle of Transparency about why information is needed for either party enables us to assess how best to manage and deliver the information.

Things to think about

- **Reconciliation**

As a major income stream, legacy administration will receive large numbers of payments; some payments will be by cheque and more often now by bank transfers. To assist reconciliation and accurate recording of legacy income, it's worth us considering the following:

- Do we have a system in place to record legacy payments expected by bank transfer? When notified of a transfer, it's helpful to record the sum expected and any reference from the letter to enable us and our accounts team to identify the payment
- Could our accounts team provide a list of bank transfers at regular intervals so that we can confirm receipt of the funds and thank executors in a timely fashion?
- Do we undertake a full reconciliation of all legacy income and expenses with the accounts team at least once a month?

- **Reporting**

Legacy income can form a large portion of a charity's income and it's important to provide our accounts and executive team colleagues with key financial information on legacy income for planning and statutory reporting purposes. Regular reporting is an excellent opportunity to raise the profile of our work, demonstrating Transparency and Collaboration within our organisations. It's worth considering:

- Reporting on income and notification numbers
- Reporting on other financial information, such as estimated values of gifts not yet paid and income accruals
- Identifying and agreeing the key performance indicators, so that we understand what information is required and its use to others. We can then set up processes to capture the correct information in our legacy systems to easily produce reports
- Adding 'narrative to the numbers', to reinforce key messages and balance reminders of the uncertainty of legacy income with success stories to highlight our work

- **Income Recognition**

The Statement of Recommended Practice (SORP) sets out how charities should apply Financial Reporting Standards (FRS), as issued by the Charity Commission and Office of the Scottish Charity Regulator, while for Northern Ireland the Charity Commission for Northern Ireland's guidance is most relevant here (see **Further reading and links** below). Reporting standards are slightly different for small charities and large charities, so while legacy professionals do not need to know all the details, we do need to be informed about, and familiar with, key elements applicable to our charity. Sections 5.29 to 5.37 of FRS102 give more details about how to recognise and accrue legacy income.

To comply with income recognition requirements, we need to estimate the likely income from each gift. Any system for estimating the value of a gift will be audited so we should be consistent in how we manage estimates. Whatever system we implement to ensure compliance, it should not interfere with our core activity, i.e. dealing with gifts in wills efficiently and effectively to bring in funds to carry out our charitable purpose, and ensure every generous donor's final wishes achieve their greatest potential. Below are some points to consider:

- Estimated values should be updated if a change in value is significant, but it’s worth considering whether any changes make a material difference to our expected income
- Can we agree a financial level with our accounts colleagues which is deemed “significant” and requires a change? The financial level will depend on the size of our legacy income, and the impact any change may make on our charity’s ability to deliver its work
- How can we estimate the value of gifts which are uncertain and cannot be estimated? It’s useful to discuss the issue with our charity auditors and agree an approach. For example, we could multiply the number of gifts without estimates by the average value of our legacy gifts. In that case, if our average legacy gifts are worth £10,000, and we have 100 gifts without an estimate, a value of approximately £1,000,000 is unlikely to be far off. However, average values will need to be based on reasonable analysis that can be evidenced and documented

- **Forecasting**

Collaboration with our accounts colleagues and senior staff is key to creating and maintaining a system which provides the information our colleagues require, but doesn’t become an unnecessary burden for legacy professionals. It’s important to explain the uncertainty of knowing how many people will die leaving a gift and when the executors may make payment. Again, points to consider are below:

- We are usually asked to forecast annual income for 3 to 5 years ahead. Maintaining a pipeline of estimated values is helpful as this will be a realistic value of legacy funds due to our charity which will probably be paid over the next 12 to 18 months. We can use changes in this pipeline as evidence to increase or decrease forecasts to reflect fluctuations in notification numbers and asset values (i.e. house prices and share prices)
- It is common to report expected income, or phase income, month on month to support colleagues planning what activity our charity can undertake. It’s key that executive and accounts teams understand that executors control when legacies are paid and there will be fluctuations that legacy professionals can’t control. We can forecast income by phasing expected income from individual legacy gifts, or do a flat forecast (dividing our expected annual income by 12 months)
- There is a danger that estimating when income might be received becomes counterproductive if a disproportionate amount of legacy staff time is invested in detailed forecasting then explaining why funds haven’t been received exactly when expected. To combat this issue, we can set an agreed level of variation that would be acceptable before undertaking a detailed review

Again, being transparent, informed and collaborative in our relationships with key executive and accounts staff will help our conversations and create a better shared understanding of the uncertainties in this income stream.

- **Audit**

In this context, auditors are looking to verify that:

- our processes for handling money are robust
- we are entitled to the payments we have received
- all income received has been credited to the correct legacy
- any restricted income has correct descriptions attached
- all income accrued is correct and estimates are as accurate as possible

Auditors will ask to see documentary evidence such as Wills, letters from executors sending cheques or notifying bank transfers, verification of receipt of bank transfers, and assets and liability schedules to verify any estimated values. By making sure these documents are easy to find, we save time when answering questions from the auditors.

- It's useful to meet with our auditors prior to the start of audit to discuss what they need so we can prepare. This also gives us an opportunity to discuss any changes in process so the auditors can understand the impact of any changes
- At the end of audit, a follow up meeting is useful to discuss any findings
- Working with our accounts team and auditors, we can create a checklist of activities agreed with auditors setting out regular in-year reviews. This will reflect the shared understanding of what is required and allows us to set processes with confidence. While it will take some time to create, it will save time in the long run as regular checks give us an opportunity to find and correct any mistakes at an early stage to avoid misstatements of income (and issues with our auditors)

- **Questions to ask**

Given the above, it's worth us thinking about these questions to continually improve how we recognise and accrue legacy income:

- What systems do we have in place? Do they meet our charity's needs or do we get a significant number of requests for additional information?
- Are checks and reviews complimentary to legacy functions? Capacity needs to be balanced so reviews and reports do not interfere with our ability to generate income. Are our charity's requests for information proportionate? Have we explained the impact on requests on the capacity of our team?
- Do we understand our charity's reporting needs? Do we capture the right information and do reports show what our charity needs? Can our IT systems be used to make reporting easier?
- Do our processes make it easy to find documents and resolve discrepancies?

Further reading and useful links

- Charity Reporting & Accounting: The Essentials
- Charity SORP (England and Wales) – FRS102: Accounting and Reporting by Charities
- OSCR – Charity Accounting
- Charity Commission for Northern Ireland Accounting and reporting essentials

See **Member Toolkit** for an example of working with accounts and audit colleagues on income recognition.