Helpsheet – Step by step guide to accounting for leases as a lessee
Part 1: Introduction and how to use module 10B of the SORP

Caveat statement

This helpsheet has been prepared by the Charities SORP-making body with input from the SORP Committee to assist charity trustees, preparers and practitioners in understanding and applying the lease accounting requirements of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* and the Charities SORP.

It is intended to explain and illustrate relevant considerations when accounting for leases, but it does not form part of the Charities SORP, does not supersede any requirement of the SORP or FRS 102, does not introduce any additional or mandatory requirements and has not been formally reviewed by the Financial Reporting Council.

The helpsheet should not be relied upon as a definitive statement of the applicable accounting requirements. It does not carry the authority of the SORP, nor is it a substitute for reading the full text of the Charities SORP and relevant parts of FRS 102.

This helpsheet does not provide full guidance on the disclosures required by Section 20 of FRS 102 or module 10B of the SORP. Charities remain responsible for determining the appropriate accounting treatment for their own circumstances and should discuss significant judgements or changes in accounting policy with their auditors or independent examiners as appropriate.

Introduction

This is Part 1 of the helpsheet that aims to support understanding of the requirements for lease accounting set out in *FRS 102, The Financial Reporting Standard applicable in the UK and Republic of Ireland*, as it applies to charities.

All users of the helpsheet should read Part 1 as this will help to explain whether Part 2 and/or Part 3 is also needed.

Part 1 explains in simple terms how preparers of charity accounts should use Module 10B: Lease accounting of the SORP and provides a guide to how to determine if a lease (as defined in FRS 102) exists or not.

How to use module 10B of the SORP to understand what you need to do

The flowchart shown at paragraph 10B.11 of the SORP will help charities understand how module 10B of the SORP applies to their lease arrangements. It explains:

- Where the module does not apply at all
- Where limited requirements apply to nominal or peppercorn arrangements
- Where the charity has a lease that the module applies to
- Where a recognition exemption might apply
- Where a charity may have a social donation lease meaning there are special factors that need to be understood in accounting for the arrangement.

Paragraphs 10B.12 to 10B.14 of the SORP then explain the steps that need to be worked through to understand the requirements applicable to the arrangements the charity has.

Determining whether or not a lease exists

It is important for all charities with a lease-like arrangement, to determine whether the arrangement meets the definition of a lease within FRS 102. In some situations, the legal form of the arrangement may be a lease, but the economic substance is not a lease as defined in FRS 102. That would mean module 10B of the SORP would not apply to that arrangement. Conversely, the charity may enter into an arrangement that isn't referred to as a lease but does meet the definition in FRS 102 and therefore module 10B of the SORP would apply to it. There are 6 features of an arrangement that **have to all be present** for it to meet the definition of a lease within FRS 102. These are set out in paragraph 10B.23 of the SORP and are further explained in paragraphs 10B.25 to 10B.41 of the SORP.

The arrangement that a charity has should be carefully considered in relation to each of the 6 features to determine if the feature is present. For example, one of the features is that the arrangement must be for an identified asset. If a charity entered into an arrangement for the use of a retail unit in a shopping centre where the lessor could move the charity to a different unit at any time to accommodate commercial tenants, this might indicate that the lessor has a substantive right to substitute the asset throughout the period of use. The existence of such a right would mean that there was no identified asset, and therefore that the arrangement would not meet the definition of a lease within FRS 102 and the requirements of module 10B would not apply.

FRS 102 offers a practical expedient for arrangements that exist at the date of initial application[1]. This means that a charity is not required to reassess whether an arrangement is, or contains, a lease. Instead, it is allowed to apply the requirements to arrangements that were previously identified as containing a lease and not to apply the requirements to arrangements not previously identified as containing a lease. If a charity chooses this practical expedient, it shall disclose that fact and shall apply the practical expedient to all of its arrangements. The examples in Part 2 and Part 3 of this helpsheet provide guidance to charities taking on new leases. Where a charity has existing operating leases, it should refer to Section 1 of FRS 102 and Section 3 of FRS 102 Factsheet 9.

Nominal or peppercorn arrangements

If a charity has an arrangement that may have the legal form of a lease, but where it is not paying anything or is paying only a nominal amount, it should read paragraphs 10B.75 to 10B.78 of the SORP to understand how module 10B of the SORP applies to those arrangements. In particular, there are a number of questions that a charity could consider to determine the nature of the benefit being received under the arrangement – that is, whether it is the donation of an asset or of a facility/service. These are outlined in paragraphs 10B.77 and 10B.78 of the SORP.

Example 1 - how to account for a peppercorn arrangement

A charity enters into an arrangement for the use of a shop unit for 5 years. The unit is within a small shopping precinct where there are other shop units available to lease. All the units, including the one the charity uses, are of a similar size and all are in a good state of repair.

The market rent that would have been charged to a commercial business for the premises would have been £1,000 per month but the charity only pays £10 per month as a result of being a charity. The charity concludes that the arrangement does not meet the definition of a lease within FRS 102 because the payments being made by the charity are so low compared to market rents that they lack economic substance.

The lease payments are treated by the charity as an expense and will be included in the appropriate category within the Statement of Financial Activities.

The charity must also consider the benefit it is receiving from the arrangement and exercise its judgement in determining the nature of the benefit it is receiving. In this example, the charity concludes that the use of the shop unit is the donation of a facility. The incoming resources relating to this donation will be recognised in the charity's accounts and will be measured at the value to the charity. For example, if

[1] The date of initial application is the beginning of the reporting period in which a charity first applies the periodic review 2024 amendments, effective January 2026

the charity would have been willing to pay £500 per month for the use of a similar shop, the value to the charity might be £490 per month (that is £500 less the £10 nominal rent). An amount equivalent to the income is recognised as an expense under the appropriate heading in the statement of financial activities in line with paragraph 6.17 of the SORP.

Recognition exemptions

There are exemptions available for short-term leases and leases that involve low-value assets. These exemptions mean that the lease payments are recognised as an expense on a basis that reflects the pattern of benefit the charity receives from the use it obtains from what it is leasing. For example, if the benefit is evenly received over the period of the arrangement, the lease payments would be recognised on a straight-line basis.

More information is provided about the recognition exemptions in paragraphs 10B.15 to 10B.20 of the SORP.

How to account for a lease

Once the charity has established that its arrangement meets the definition of a lease within FRS 102, it can then proceed to understand how to account for it. Parts 2 and 3 of the helpsheet explain how to account for a lease.

Part 2 covers how to account for a lease where the charity pays a market rent to the lessor.

Part 3 explains how to account for a lease where the charity pays significantly below market rents but greater than a nominal amount as a result of the lessor choosing to accept a lower rent for the philanthropic intention of providing a benefit to the lessee are social donation leases.