Charities SORP 2026: Lease Accounting in Practice



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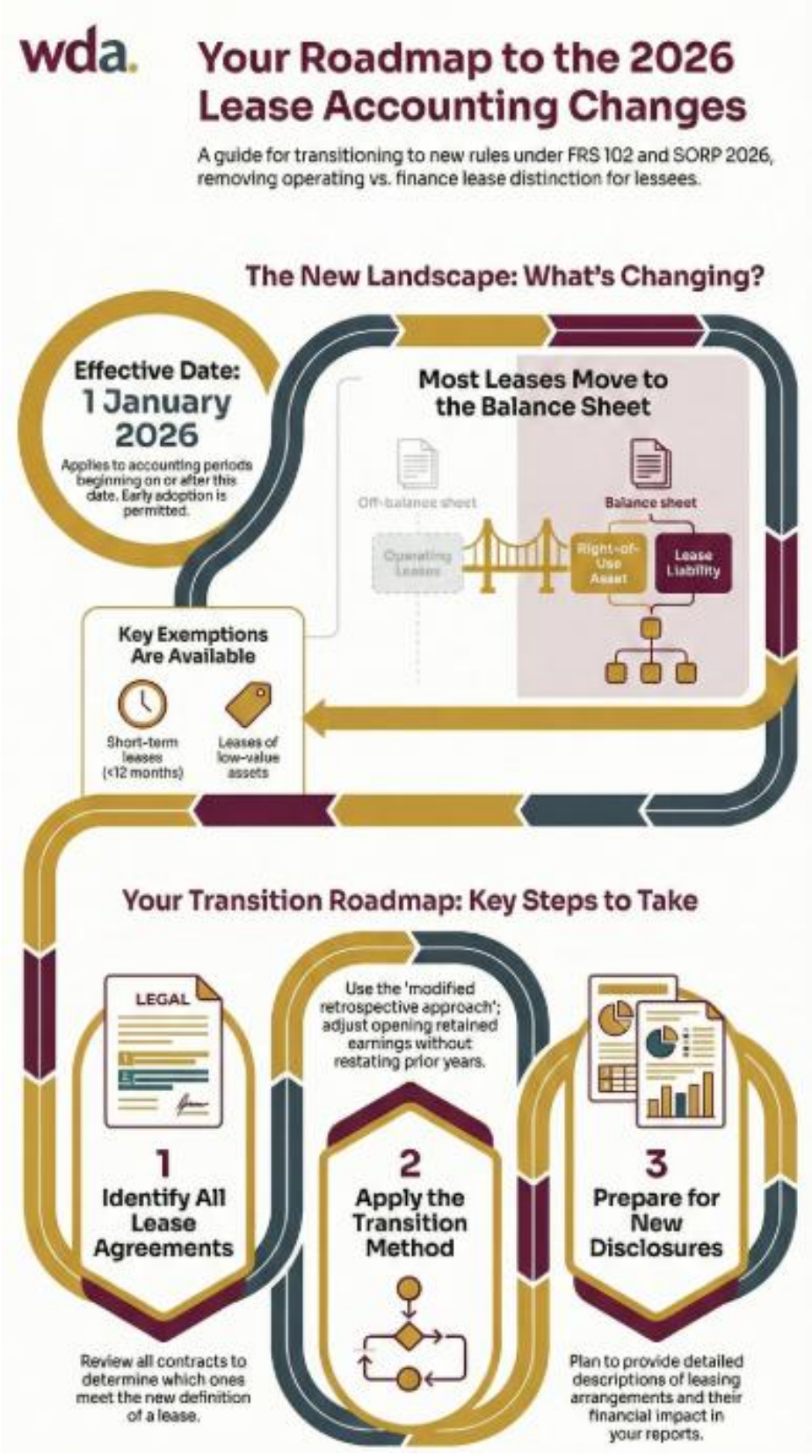
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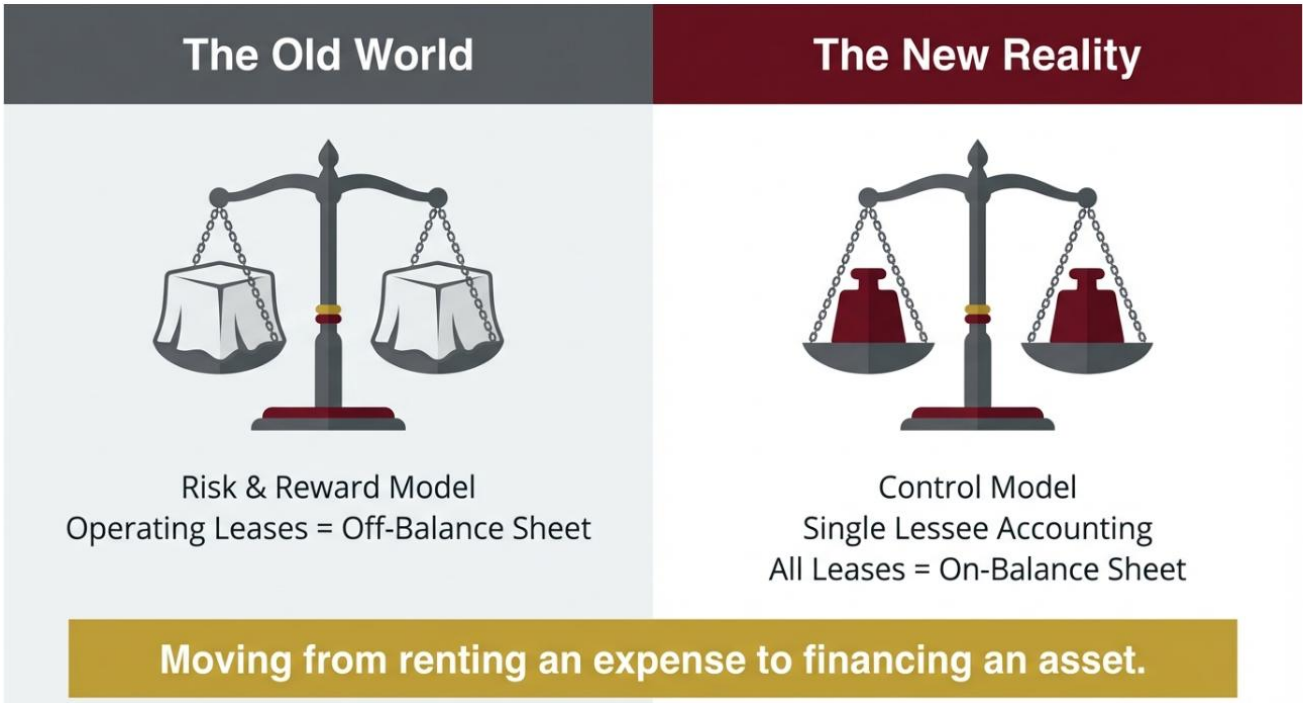
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EXECUTIVE SUMMARY & ROADMAP

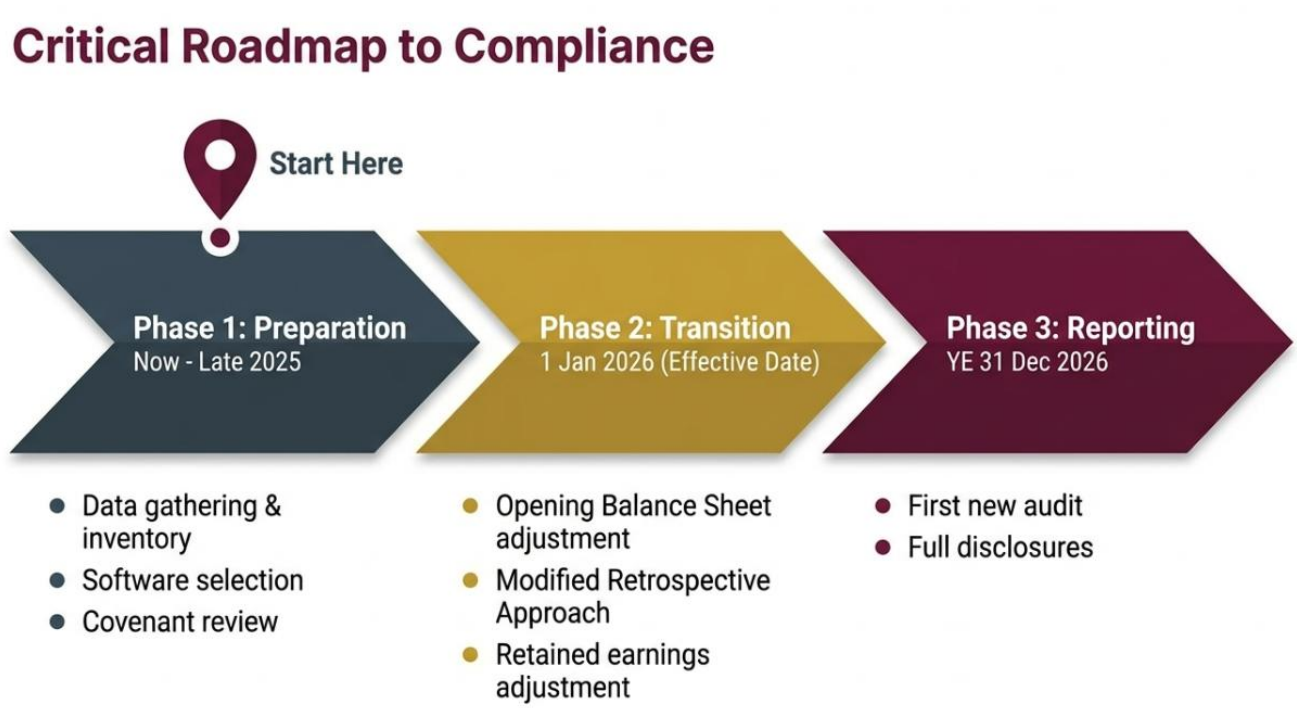


1.0 INTRODUCTION: THE NEW ERA OF CHARITY REPORTING

The amendments to FRS 102, which have been incorporated into the forthcoming Charities SORP 2026, represent a significant evolution in financial reporting for the sector. These changes introduce a new framework for several key areas, with the accounting treatment for leases undergoing the most fundamental transformation. For charity trustees and finance professionals, understanding and preparing for these new requirements is of paramount strategic importance to ensure compliance and maintain transparent financial stewardship.

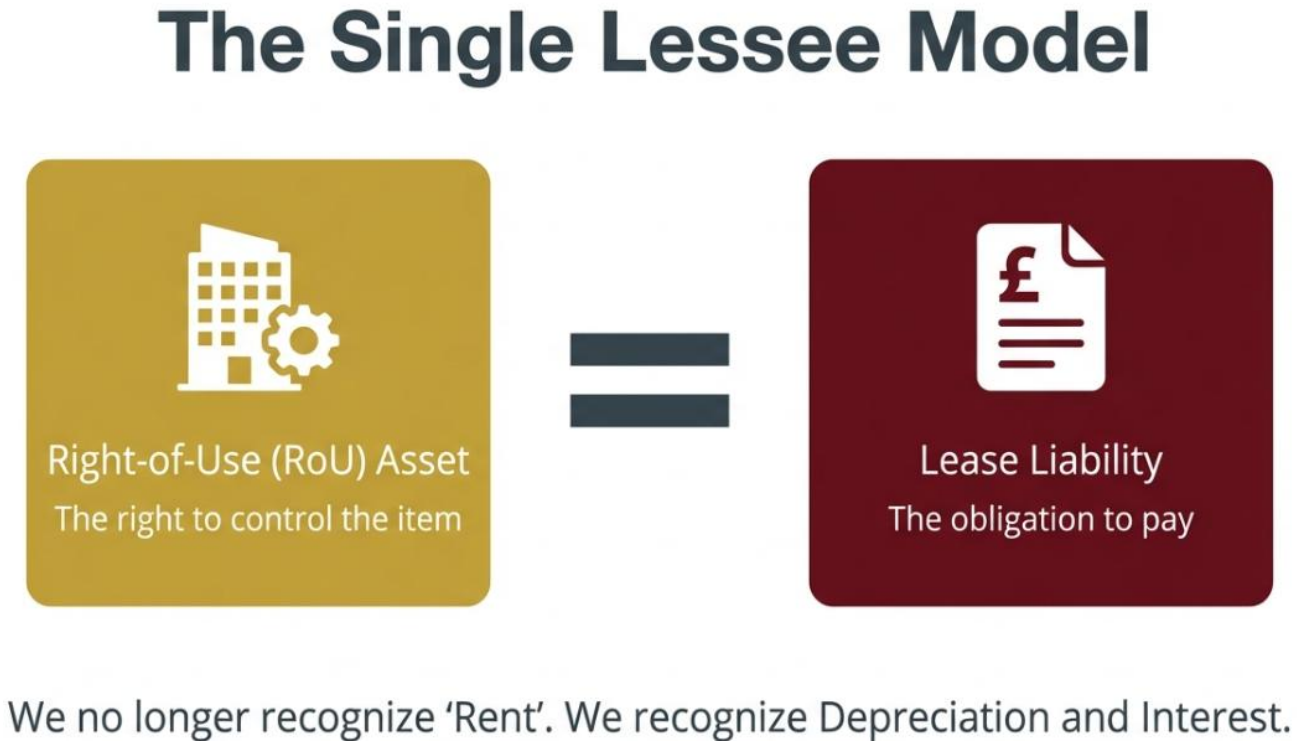


The new rules are mandatory for accounting periods beginning on or after **1 January 2026**. This applies to all charities preparing accruals-based accounts, regardless of size or tier. Consequently, all such charities will need to update their accounting policies to refer to SORP 2026 for these periods. This briefing will focus specifically on the core change in lease accounting, which moves away from the traditional dual model to a new, on-balance sheet approach.



2.0 THE FUNDAMENTAL SHIFT: FROM A DUAL MODEL TO A SINGLE-LESSEE APPROACH

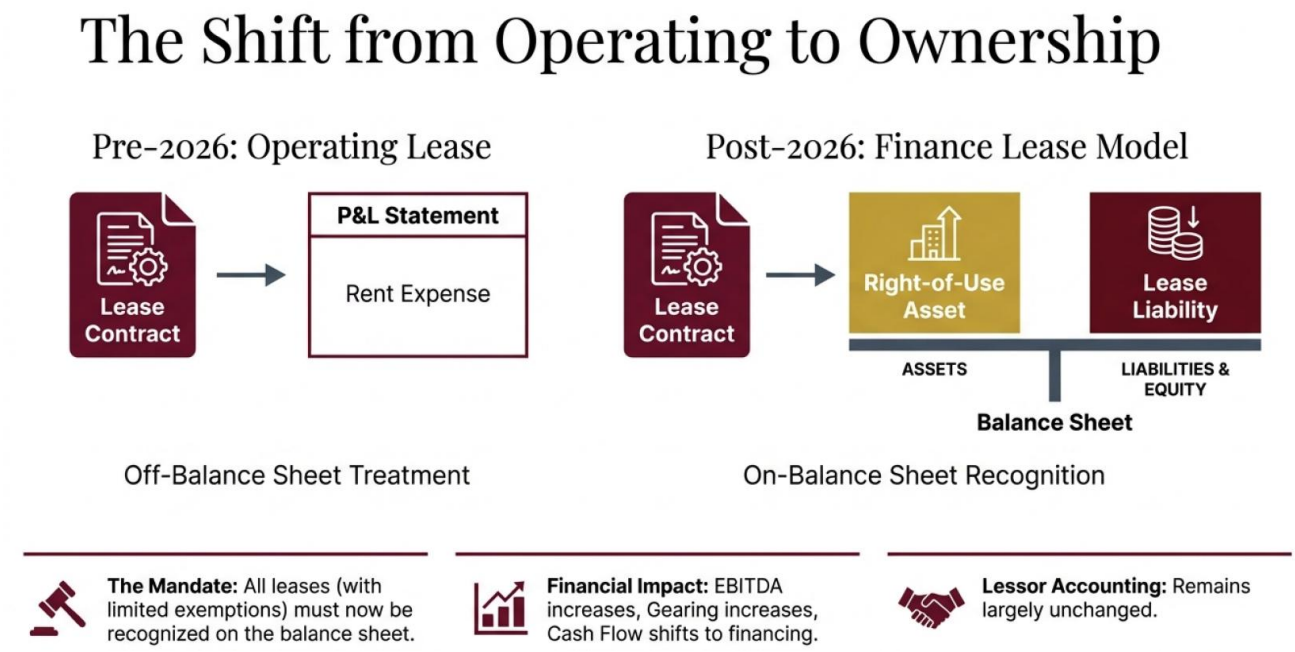
The new standard marks a strategic shift away from the previous lease accounting model, which required a judgment-based classification of leases. For lessees, the long-standing distinction between operating leases and finance leases is being eliminated. This change will fundamentally alter how charities recognise, measure, and report their lease obligations, increasing transparency and providing stakeholders with a more faithful representation of a charity's obligations and the resources it controls to meet them.



Analysis of the Change

- **Old Model:** Previously, leases were classified as either a finance lease or an operating lease. A finance lease was one that transferred substantially all the risks and rewards of ownership to the lessee and was recognised on the balance sheet. An operating lease, which did not transfer these risks and rewards, was typically accounted for off-balance sheet, with lease payments expensed as they were incurred.
- **New Model:** Under the new approach, this distinction is removed for lessees. The standard introduces a single accounting treatment for nearly all leases, requiring them to be recognised on the balance sheet from the commencement of the agreement.

This change means that most leases that were previously classified as operating leases will now be brought onto the charity's balance sheet. This new on-balance sheet approach is built around two new key concepts: the **Right-of-Use Asset** and the **Lease Liability**.



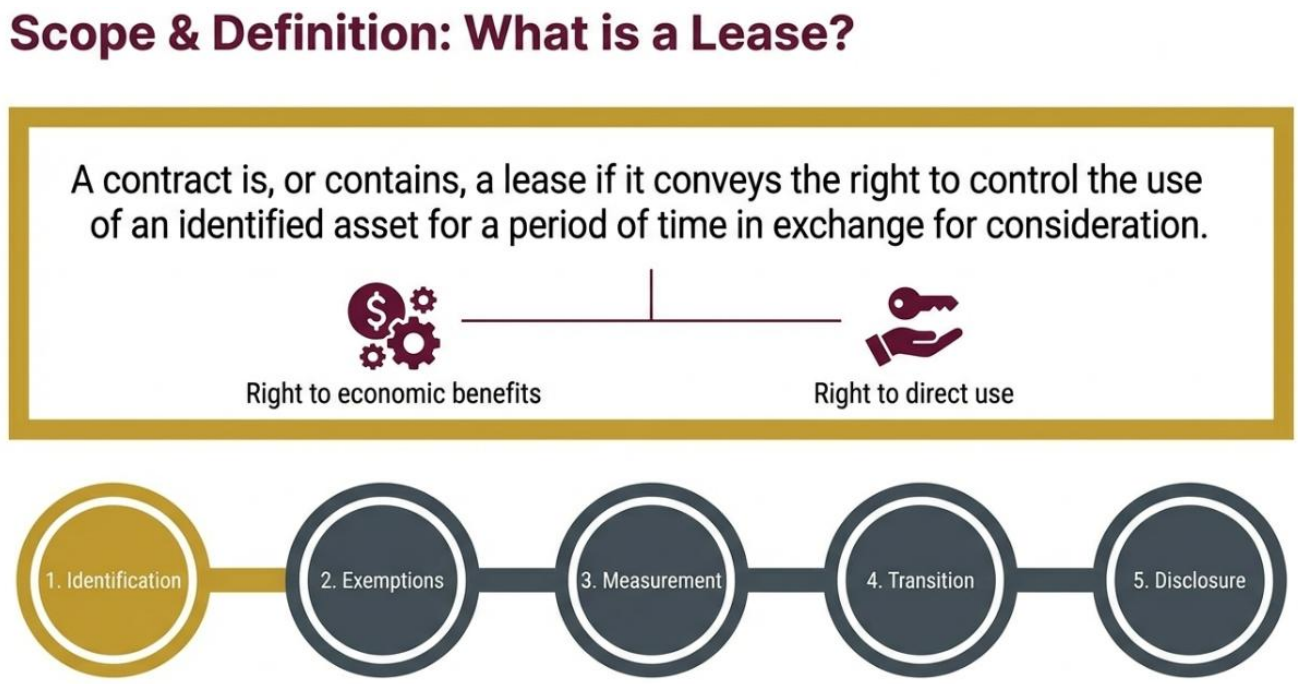
3.0 CORE CONCEPTS: THE RIGHT-OF-USE ASSET AND LEASE LIABILITY

To implement the new single-lessee model, it is essential to master the concepts of the Right-of-Use (ROU) Asset and the Lease Liability. These two elements are now central to reflecting a charity's lease commitments accurately on its balance sheet. They represent the two sides of the same transaction: the charity's right to use an asset and its obligation to pay for that right.

The new key terms are defined as follows:

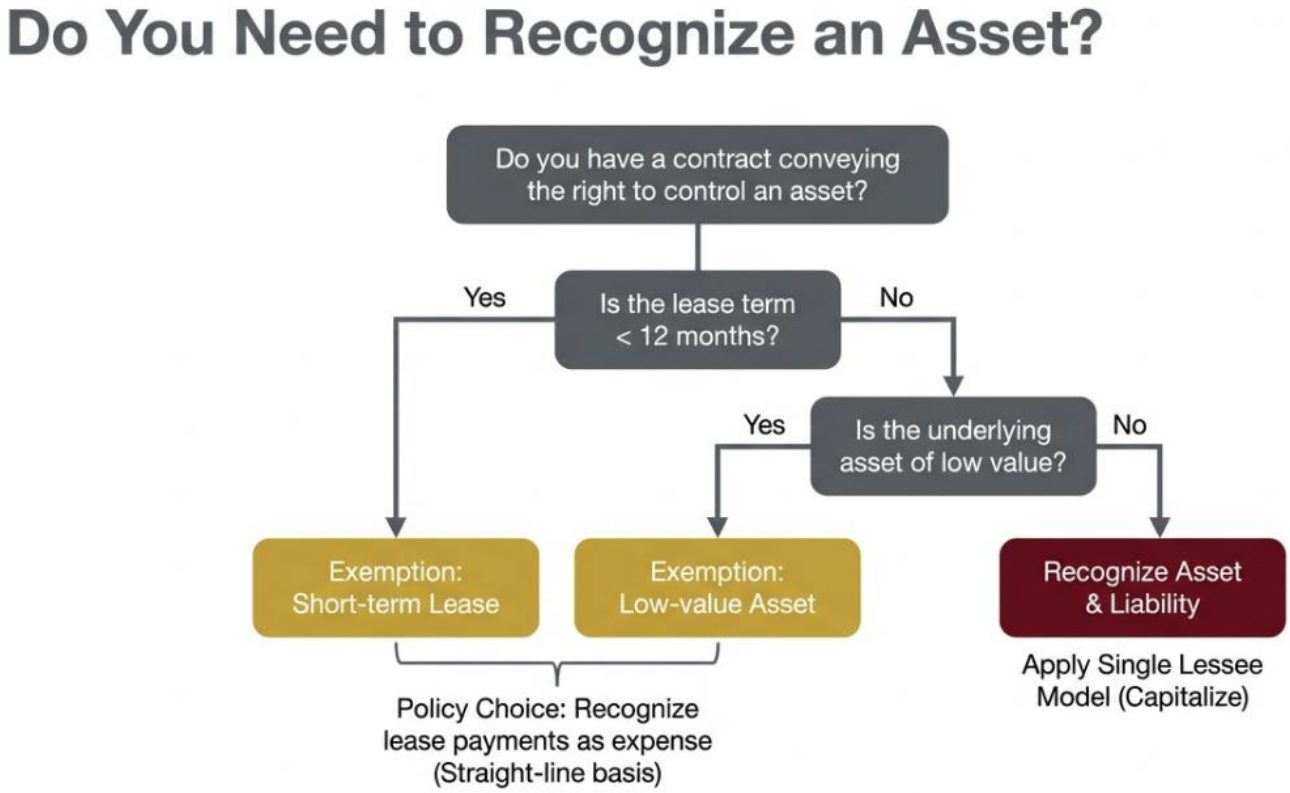
Term	Definition
Right-of-Use Asset	An asset that represents a lessee's right to use an underlying asset for the lease term.
Lease Liability	The liability recognised at the commencement date by a lessee measured at the present value of the lease payments that are not paid at that date discounted using the interest rate applicable to that lease.

The core implication of these new concepts is that at the commencement of a lease, the lessee simultaneously recognises both an asset (the ROU asset) and a corresponding liability on its balance sheet. The following section will detail the practicalities of how these new elements are measured and accounted for over the life of the lease.



4.0 RECOGNITION AND MEASUREMENT: THE ACCOUNTING MECHANICS

Correctly measuring the new lease assets and liabilities is a critical component of the new standard. The accounting treatment involves an initial recognition phase at the start of the lease, followed by a subsequent measurement process for each reporting period. This section details the accounting mechanics required under the new standard.



Initial Recognition and Measurement

At the commencement date of the lease, the following must be recognised:

1. **Right-of-Use Asset:** The ROU asset must be measured at its cost upon initial recognition.
2. **Lease Liability:** The lease liability is measured at the present value of the lease payments that have not yet been paid. These future payments must be discounted using the **interest rate implicit in the lease**.

Subsequent Measurement

After the initial recognition, the ROU asset and lease liability are accounted for as follows:

- **Right-of-Use Asset:** The ROU asset is subsequently measured using the cost model (i.e., cost less accumulated depreciation), unless it meets the definition of investment property or is part of a class of PPE to which the charity applies the revaluation model.
- **Lease Liability:** The carrying amount of the lease liability is adjusted each period. It is increased by the interest charge for the period (unwinding the discount) and reduced by the actual lease payments made.

While this on-balance sheet model applies broadly, the standard provides important practical exemptions that can simplify compliance for certain leases.

Worked Example: The Setup

Fact Card

Entity: WDA Charity Trust

Asset: Specialized Printing Equipment

Lease Term: 5 Years (starts 1 Jan 2026)

Payments: £10,000 per annum (in arrears)

Discount Rate: 5% (Obtainable Borrowing Rate)

The 'Obtainable Borrowing Rate' (OBR) is a simplification allowing you to use the rate you would pay to borrow a similar amount over a similar term.

Step 1: Initial Recognition

The Math

Payment 1: £10k

Payment 2: £10k

Payment 3: £10k

Payment 4: £10k

Payment 5: £10k

Present Value @ 5% = £43,295

The Journal

Dr Right-of-Use Asset	£43,295	
Cr Lease Liability		£43,295

Step 2: Subsequent Measurement (Year 1)



The Asset

Depreciation (Straight Line)

£43,295 ÷ 5 Years = **£8,659 Expense**



The Liability

Amortized Cost (Interest)

£43,295 × 5% = **£2,165 Finance Cost**

Total P&L Charge: £8,659 + £2,165 = **£10,824**

Cash Rent Paid: £10,000

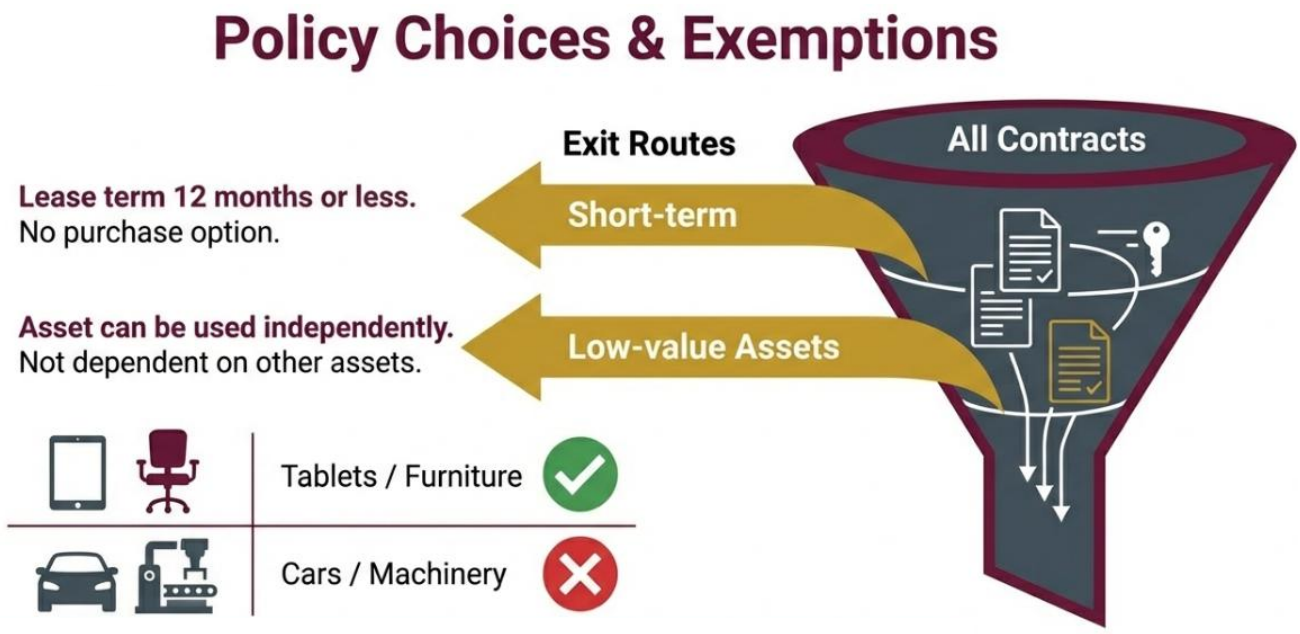
Expense is front-loaded ↵

5.0 PRACTICAL EXEMPTIONS: SIMPLIFYING COMPLIANCE

The new standard includes optional exemptions to reduce the burden of compliance for certain types of leases. Understanding and consistently applying these exemptions is a key strategic decision for charity finance teams. This decision requires balancing the significant reduction in compliance costs and complexity against the loss of granular detail on the balance sheet. A charity can choose whether or not to apply these exemptions.

The primary exemptions available are for:

- **Short-Term Leases:** This exemption applies to leases that have a term of **12 months or less** at the commencement date. It is important to note that a lease containing a purchase option is not eligible for this exemption, regardless of its term.
- **Leases of Low-Value Assets:** This exemption is assessed based on the value of the underlying asset itself when new, on an absolute basis. The assessment is not based on whether the value is material to the lessee charity.



Accounting for Exempted Leases

If a charity opts to take an exemption for an eligible lease, the accounting treatment is simplified. The lease payments are recognised as an expense on a systematic basis over the lease term. This approach is similar to the accounting treatment for operating leases under the previous standard.

Beyond these general exemptions, the SORP provides specific guidance for lease arrangements that are particularly relevant to the charity sector.

Exemption A: Low Value Asset

Definition: Asset is low value on an absolute basis when new (e.g., computers, furniture). Not based on charity materiality.

Scenario: Lease of 10 Laptops (£800 each) for 3 years.

Application: Lease-by-lease basis.



Treatment: Expense on straight-line basis.

Dr IT Expense	£8,000	
Cr Bank		£8,000

Exemption B: Short-Term Lease

Definition: Lease term is 12 months or less at commencement. No purchase option.

Scenario: Pop-up charity shop rental for 9 months.

Application: By class of underlying asset.



Treatment: Expense on straight-line basis.

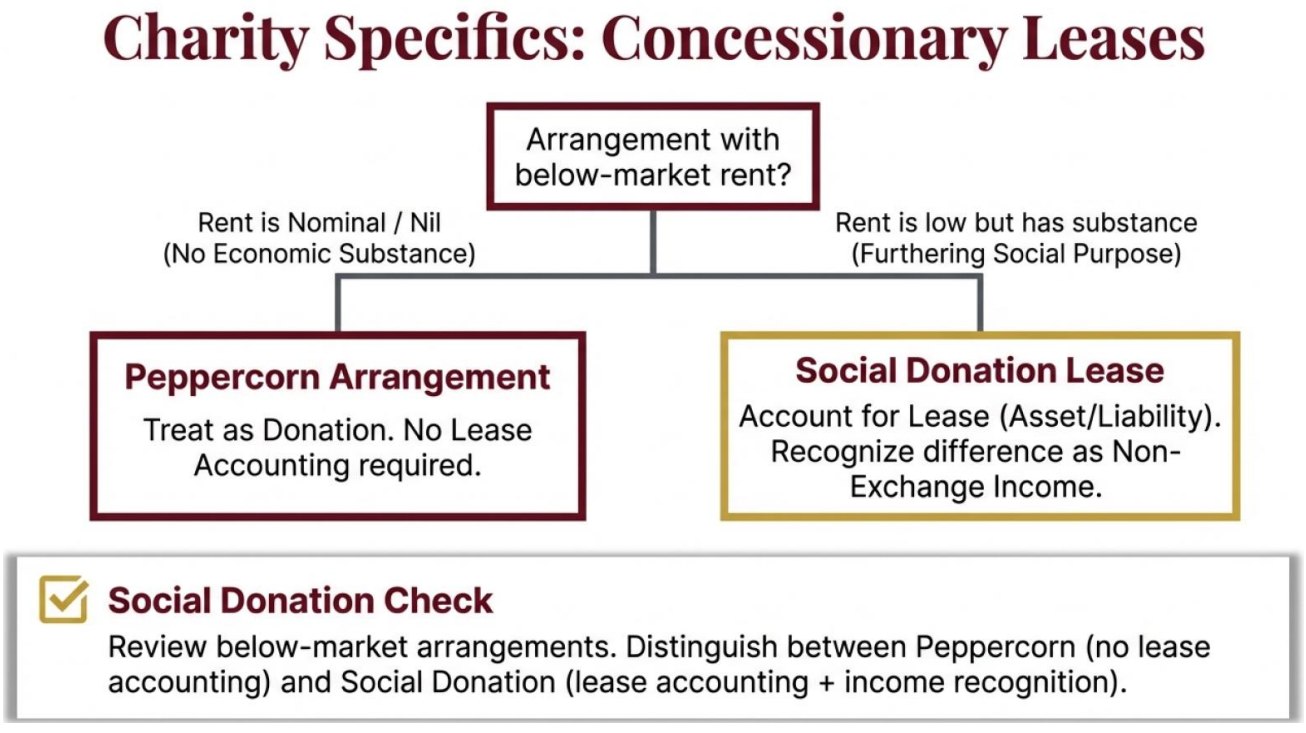
Dr Rent Expense	[Rent Amount]	
Cr Bank		[Rent Amount]

6.0 A SPECIAL CASE FOR CHARITIES: SOCIAL DONATION LEASES

A unique and important consideration within the charity sector is the concept of a 'social donation lease'. These arrangements, which are common in the sector, contain a non-exchange element that requires a specific accounting approach. This treatment is designed to reflect the philanthropic intent of a lessor who provides an asset at a below-market rate to support a charity's objectives.

A **Social Donation Lease** is defined as a lease in which a lessor, with philanthropic intent, charges a public benefit entity consideration that is substantially below market value.



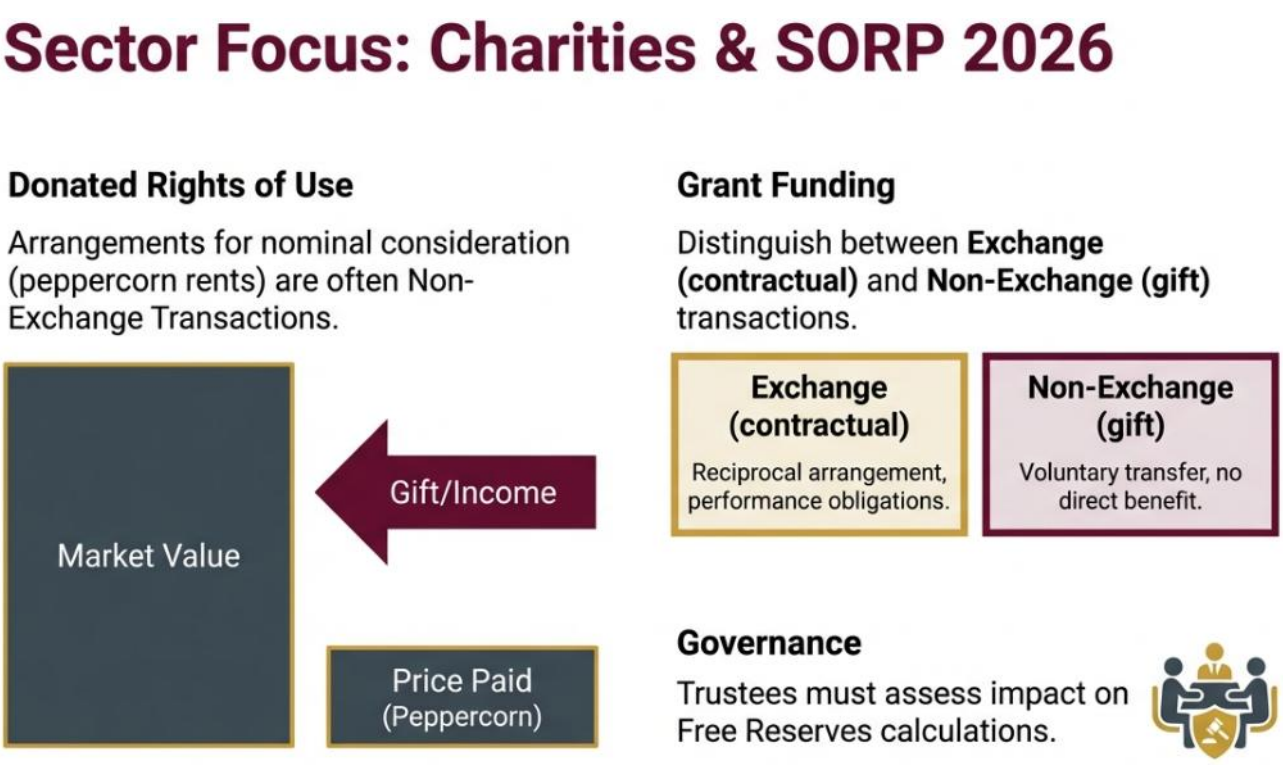


Accounting for the Non-Exchange Component

The accounting treatment for these leases ensures that the value of the 'donated' element is properly recognised:

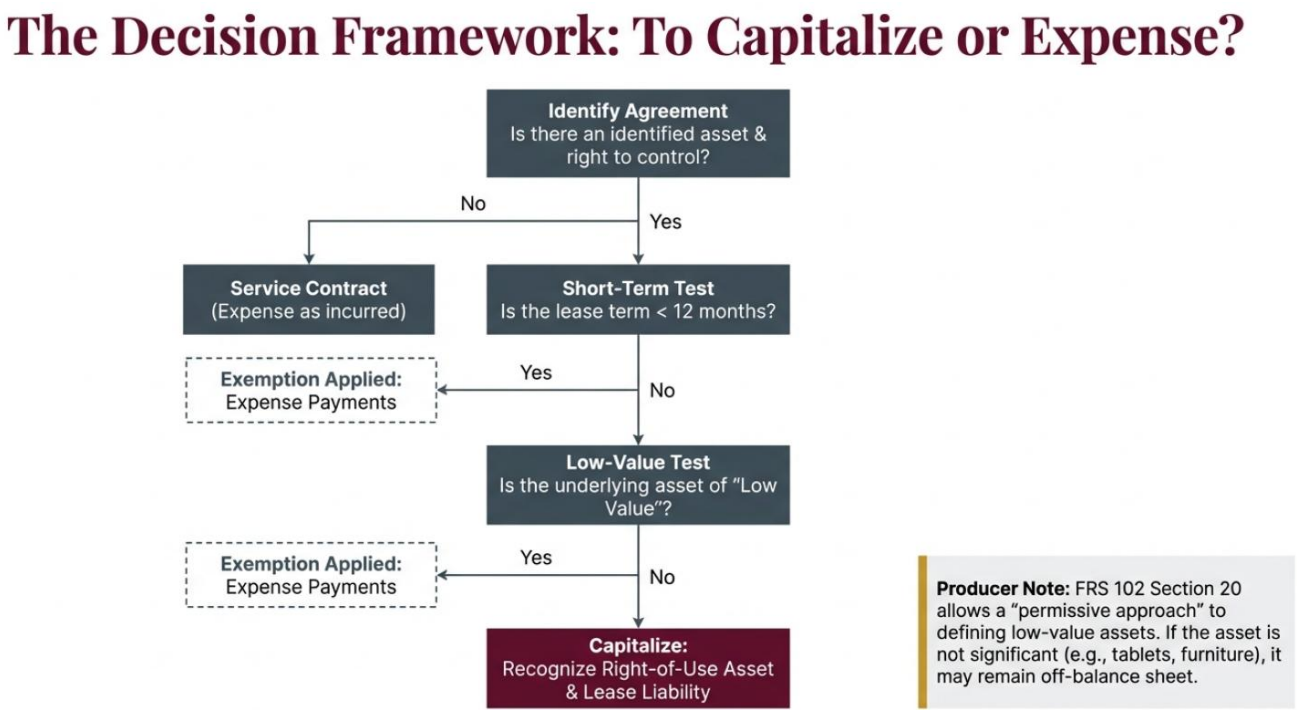
- The value of the incoming resources from this non-exchange component (i.e., the benefit of the reduced rent) is recognised as part of the initial cost of the right-of-use asset.
- This recognition increases the value of the ROU asset recorded on the balance sheet. As a result, the subsequent depreciation charges for the ROU asset will be greater than they would have been otherwise.
- The initial lease liability, which is based on the present value of the actual cash payments, is consequently lower than the initial value of the ROU asset.

These new accounting treatments will have a visible and significant impact on a charity's financial statements, which the next section will explore in detail.



7.0 IMPACT ON FINANCIAL STATEMENTS AND DISCLOSURES

The new lease accounting rules will have a significant impact on a charity's key financial statements and the accompanying notes. Trustees and other stakeholders will see a notable change in the balance sheet, which will now present a fuller picture of a charity's assets and long-term obligations. To ensure transparency, a series of new and updated disclosures are required.



The specific changes to the financial statements and notes include:

- **Balance Sheet:** The most significant impact will be the 'grossing-up' of the balance sheet. The recognition of new ROU assets and corresponding lease liabilities will increase both the total assets and total liabilities reported by the charity.
- **Tangible Fixed Assets Note:** Charities must add a new column for "right-of-use asset" to the tangible fixed assets note to separately track the cost, depreciation, and net book value of these assets.
- **New Required Note:** A new, dedicated note for the "RIGHT OF USE ASSET AND LEASE LIABILITY" is now required. This note must provide detailed workings and reconciliations for the carrying amounts of these new items.
- **Lease Commitments Note:** The disclosures for lease commitments will be amended to align with the new on-balance sheet model.
- **Accounting Policies:** The accounting policy notes must be updated to describe the new treatment for leases under SORP 2026, including the charity's policy on applying the available exemptions.

To ensure readiness for these changes, it is vital to understand the key actions required before the effective date.

Impact on Performance & Cash

Income Statement (SoFA)

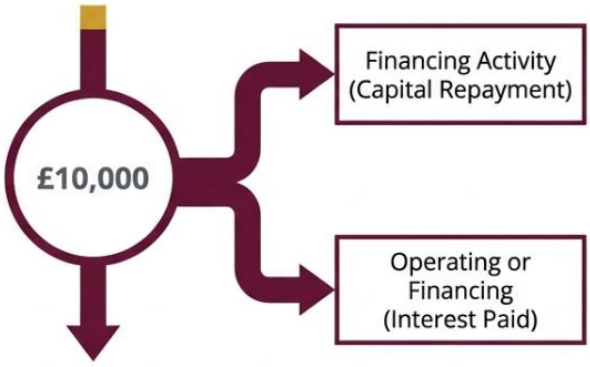
Old	New
Rent Expense	Depreciation (Operating)
	Interest (Financing)

EBITDA

Operating Profit increases because Interest and Depreciation are excluded from that metric.

Cash Flow Statement

Total cash outflow remains £10,000



Initial Recognition: The Balance Sheet Equation

Debit: Right-of-Use Asset

= Initial Lease Liability

+ Payments made at/before commencement

+ Initial direct costs

+ Estimate of restoration costs

- Lease incentives received

Credit: Lease Liability

= Present Value (PV) of future lease payments unpaid at commencement date.

8.0 DIRECTORS & TRUSTEE'S OBLIGATIONS

Under the Charities SORP 2026 and the amendments to FRS 102 (effective 1 January 2026), trustees and directors face specific new legal and reporting obligations regarding lease accounting. These responsibilities require significant judgement and the implementation of new systems to identify and value lease arrangements.

- **Identification and Assessment of Leases**
- **Lessee Obligations: Recognition and Measurement**
- **Application of Exemptions (Policy Choices)**
- **Charity-Specific Obligations: Social Donation and Peppercorn Leases**
- **Lessor Obligations**
- **Disclosure and Reporting**

Identification and Assessment of Leases

Trustees are responsible for ensuring all arrangements that convey the right to control the use of an identified asset for a period of time in exchange for consideration are identified as leases.

- **Assessment of Contracts:** Trustees must assess contracts at inception to determine if they contain a lease. This involves determining if the charity has the right to direct the use of the asset and obtain substantially all economic benefits from it.
- **Systems and Controls:** Because lessees are likely to face challenges finding and identifying leases, trustees must ensure adequate systems are set up to capture this data.

Lessee Obligations: Recognition and Measurement

For charities acting as lessees, the previous distinction between operating and finance leases has been removed. Trustees must now ensure most leases are recognised on the balance sheet.

- **Balance Sheet Recognition:** Trustees must recognise a **Right-of-Use Asset** and a corresponding **Lease Liability** for most leases.
- **Determining the Lease Term:** Trustees must exercise judgement to determine the lease term, which includes the non-cancellable period plus any periods covered by options to extend or terminate the lease if the charity is "reasonably certain" to exercise those options.
- **Selecting Discount Rates:** To calculate the present value of lease liabilities, trustees must select an appropriate discount rate. If the rate implicit in the lease cannot be determined, they must choose between the charity's **Incremental Borrowing Rate (IBR)** or **Obtainable Borrowing Rate (OBR)**. Public benefit entities unable to determine these may use the interest rate obtainable on deposits.

Application of Exemptions (Policy Choices)

Trustees have specific responsibilities regarding optional recognition exemptions provided by the new standard:

- **Short-Term Leases:** Trustees may choose not to apply the on-balance sheet model to leases with a term of 12 months or less (provided there is no purchase option).
- **Low-Value Assets:** Trustees may choose to exempt leases for underlying assets of low value (e.g., tablets, small office furniture) on a lease-by-lease basis. Note that this assessment is based on the value of the asset when new, not the materiality to the charity.
- **Accounting Consequence:** If exemptions are applied, trustees must ensure lease payments are recognised as an expense on a systematic basis (usually straight-line) over the lease term.

Charity-Specific Obligations: Social Donation and Peppercorn Leases

Trustees must identify and account for leases entered into for philanthropic reasons at below-market rates.

- **Social Donation Leases:** If a charity enters a lease where payments are significantly below market rent (a "social donation lease"), trustees must account for the **non-exchange component**.
    - They must measure the Right-of-Use asset at its cost, which includes the value of the non-exchange component (the donation).
    - The difference between the fair value of the asset/service and the lease payments must be recognised as income from donations (unless performance-related conditions exist).
- **Peppercorn Arrangements:** If arrangements involve nil or nominal consideration (lacking commercial substance), trustees should treat these as non-exchange transactions (gifts of facilities) rather than leases under FRS 102.

Lessor Obligations

If the charity acts as a lessor, trustees retain the obligation to classify leases as either **finance** or **operating** leases.

- **Finance Leases:** If the lease transfers substantially all risks and rewards of ownership, trustees must recognise a receivable equal to the net investment in the lease.
- **Operating Leases:** For other leases, trustees must continue to recognise the underlying asset and recognise rental income on a straight-line basis.

Disclosure and Reporting

Trustees must ensure the financial statements provide extensive quantitative and qualitative disclosures to enable users to understand the effect of leases on the charity's financial position.

- **General Description:** A description of significant leasing arrangements.
- **Social Donation Leases:** Specific disclosures regarding the lease term, restrictions, and the charitable purpose effected by granting/receiving such leases.
- **Maturity Analysis:** A maturity analysis of lease liabilities (for lessees) or lease payments receivable (for lessors).
- **Exemptions:** If the charity uses the short-term or low-value exemptions, this fact and the associated expense must be disclosed.

9.0 CONCLUSION: KEY ACTIONS AND TAKEAWAYS

The amendments introduced by FRS 102 and SORP 2026 will profoundly impact lease accounting for all charities. The move to a single on-balance sheet model enhances transparency but requires careful preparation and implementation. For charity finance professionals and trustees, the focus must now shift to proactive planning to ensure a smooth transition.

The most critical action points and takeaways are as follows:

1. **Abolition of Operating Leases:** Recognise that the old operating versus finance lease distinction for lessees is gone. Under the new model, almost all leases will be capitalised on the balance sheet.
2. **Balance Sheet Impact:** Prepare for a significant grossing-up of the balance sheet. This will affect key financial ratios and how the charity's financial position is perceived by funders, lenders, and other stakeholders.
3. **Identify All Leases:** Begin a comprehensive review of all agreements to identify any contracts that contain a lease under the new, broader definitions, which may include service or rental agreements not previously considered leases.
4. **Assess Exemptions:** Make a strategic decision on whether to apply the optional exemptions for short-term leases and leases of low-value assets. This policy should be applied consistently.
5. **Update Systems and Policies:** Take action now to update accounting systems, internal processes, and financial reporting templates in preparation for the mandatory effective date of **1 January 2026**.

Summary of Changes: Old vs. New

Feature	Previous SORP	SORP 2026 (New)
Balance Sheet	Operating leases hidden (Off-Balance Sheet)	All material leases recognized (**Asset** + **Liability**)
Expenses	Single Rent Expense	**Depreciation** + **Interest Expense**
Expense Profile	Straight-line (Flat)	Front-loaded (Higher in early years)
Peppercorn Leases	Note disclosure only	**Asset** at Fair Value; **Income** recognized immediately

WHELAN DOWLING & ASSOCIATES

Ready to Assist

Your Transition Partner for FRS 102 & SORP 2026

The transition is complex, but manageable.
We support identification, calculation, and compliance.

10.0 ABOUT WDA

- We are a mid-tier firm with two offices servicing our client bases in Dublin and Meath.
- WDA specialise in the provision of professional audit and consultancy services including to the Charity & Not for Profit Sector, with over 150 Charity clients across all sectors of the industry.
- Our professional staff comprises of 30 staff: - 4 Partners, 20 professional staff including 2 Audit Managers and 4 support/admin staff.
- Whelan Dowling & Associates has been providing audit and accounting services to the charity sector for over 40 years and are affiliated with the Chartered Accountants Ireland.
- Whelan Dowling & Associates (WDA) are an award-winning firm having achieved the "Best Medium Sized Accountancy Practice in Ireland in **May 2023** and ***again*** in **May 2026,** whilst also being named runner-up as best overall firm in Ireland for both years. We have also won best use of technology and have been shortlisted as a finalist many times over the past 10 years.
- WDA have acted as a Technical Assessor for the Good Governance Awards for several years,
- WDA is listed as a supplier of Audit and Professional services with the Charities Institute of Ireland.

Disclaimer This document, *Charities SORP 2026: Lease Accounting in Practice Management*, is prepared by Whelan Dowling & Associates (WDA) for general guidance purposes only and does not constitute professional accounting, legal, or audit advice. While every effort has been made to ensure the accuracy of the information regarding the FRS102, Companies Act 2014 and the Charities SORP, this guide is not a substitute for independent professional advice tailored to your charity's specific circumstances. As outlined in this guide, the responsibility for assessing reserves is a non-delegable duty of the trustees. Consequently, WDA accepts no liability for any loss or damage occasioned to any person acting or refraining from action as a result of any material in this publication. Trustees should consult with their auditors or professional advisors to ensure compliance with their specific statutory and fiduciary obligations.





11.0 WORKED EXAMPLES & IMPLEMENTATION GUIDE

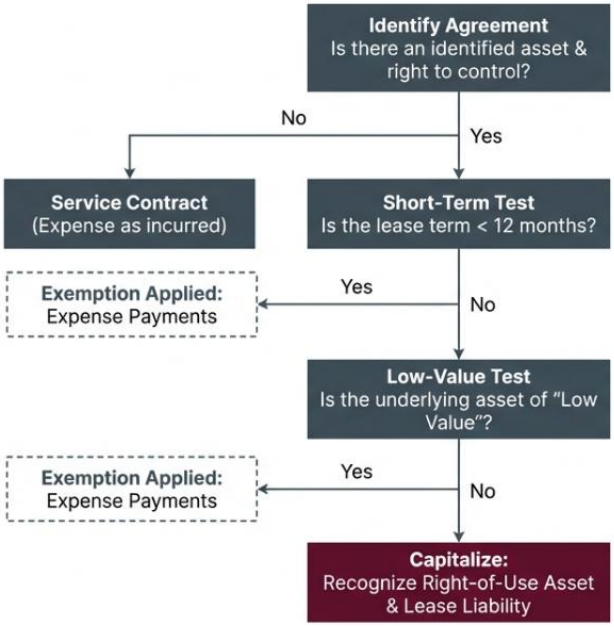
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Charities SORP 2026: Lease Accounting in Practice

Worked Examples & Implementation Guide for FRS 102 Section 20

Prepared for Reporting Accountants & Trustees

The Decision Framework: To Capitalize or Expense?



Producer Note: FRS 102 Section 20 allows a "permissive approach" to defining low-value assets. If the asset is not significant (e.g., tablets, furniture), it may remain off-balance sheet.

Scenario A: Standard Commercial Lease – Initial Recognition

Key Lease Terms

- Asset: Corporate Head Office Floor
- Lease Term: 5 Years
- Annual Rent: £20,000 (payable in arrears)
- Incremental Borrowing Rate: 5%

Lease Liability Calculation (Present Value)

Year	Cash Flow	Discount Factor (5%)	Present Value
1	£20,000	0.9524	£19,048
2	£20,000	0.9070	£18,141
3	£20,000	0.8638	£17,277
4	£20,000	0.8227	£16,454
5	£20,000	0.7835	£15,670
Total Lease Liability			**£86,590**

Initial Right-of-Use Asset is recognized at £86,590 (Liability + Direct Costs of £0).

Scenario A: Subsequent Measurement – Year 1

Lease Liability Roll-forward

Opening Balance (1 Jan): £86,590 → + Interest Expense (5%): **£4,330** → - Rental Payment: (£20,000) = **Closing Balance (31 Dec): £70,920**

Payment Split

Right-of-Use Asset

Cost: £86,590

↓

- Depreciation Charge: (£17,318)

(£86,590 ÷ 5 Years)

↓

= **Net Book Value (31 Dec): £69,272**

Scenario A: Year 1 Journal Entries

Recording the Payment & Interest

Dr Interest Expense: £4,330	
Dr Lease Liability: £15,670	Cr Bank (Cash): £20,000

Recording Depreciation

Dr Depreciation Expense: £17,318	Cr RoU Asset (Accum Dep): £17,318

Note: The total P&L charge is £21,648 (£4,330 Interest + £17,318 Depreciation), which is higher than the cash rent of £20,000 in the early years.

Scenario B: The 'Peppercorn' Lease (Social Investment)

Source: Charities SORP 2026 Example 2

The Scenario

The Facts:

- Charity enters agreement for office space.
- Lessor provides space as part of Corporate Social Responsibility (CSR).
- **Rent Payable:** £10 per annum.
- **Market Value of Rent:** £72,000 per annum.
- **Assessment:** This is a Non-Exchange Transaction (Donation) + Lease.

The Principle



Scenario B: Valuation & Recognition of Donation



WARNING: This creates a significant spike in income in Year 1 without any corresponding cash inflow. Trustees must be aware of this 'paper' income.

Scenario B: Initial Journal Entries (Peppercorn)

Initial Recognition Journal

Debit Side	Credit Side
Dr Right-of-Use Asset **£72,000** (Market Value)	**Cr** Lease Liability £30 (PV of future £10 payments)
	Cr Income from Donations **£71,970** (The 'Gift' portion)

Reference: SORP Module 6 'Donated goods, facilities and services' and Module 10B.125.

Scenario C: Applying Exemptions (Section 20.15)

Scenario	Analysis	Treatment
Vehicle hire for 9 months for a specific project.	Term is < 12 months (Short-Term).	**Expense lease payments as incurred.** (Off Balance Sheet)
Leased laptops and tablets (Value ~£800 each).	Asset is not specialized. FRS 102 allows 'permissive' low-value definition.	**Expense lease payments as incurred.** (Off Balance Sheet)
Leased Minibus (Value £15,000).	Vehicles are NOT considered low value.	**Capitalize.** (On Balance Sheet)

Note: Unlike IFRS 16, FRS 102 does not set a hard monetary threshold (e.g., $5,000) for 'Low Value', but vehicles and buildings are explicitly excluded.

Financial Statement Presentation: Balance Sheet

Statement of Financial Position	
Fixed Assets	
Tangible Assets (PPE)	£XXX
Right-of-Use Assets	**£69,272**
Creditors: Amounts falling due within one year	
Trade Creditors	(£XXX)
Lease Liabilities	**(£16,453)**
Creditors: Amounts falling due after more than one year	
Lease Liabilities	**(£54,467)**

Total Debt: £70,920

Reference: FRS 102 Section 20 and SORP Module 10.

Financial Statement Presentation: SoFA

Statement of Financial Activities

Expenditure on Charitable Activities

Staff Costs	£XXX
Depreciation on RoU Assets	**£17,318**

Other Expenditure / Financing Costs

Interest on Lease Liabilities	**£4,330**

Old SORP vs. New SORP

Old: Rent Expense: £20,000

New: Total Charge: £21,648

Impact: Expenses are front-loaded in earlier years due to interest mechanics.

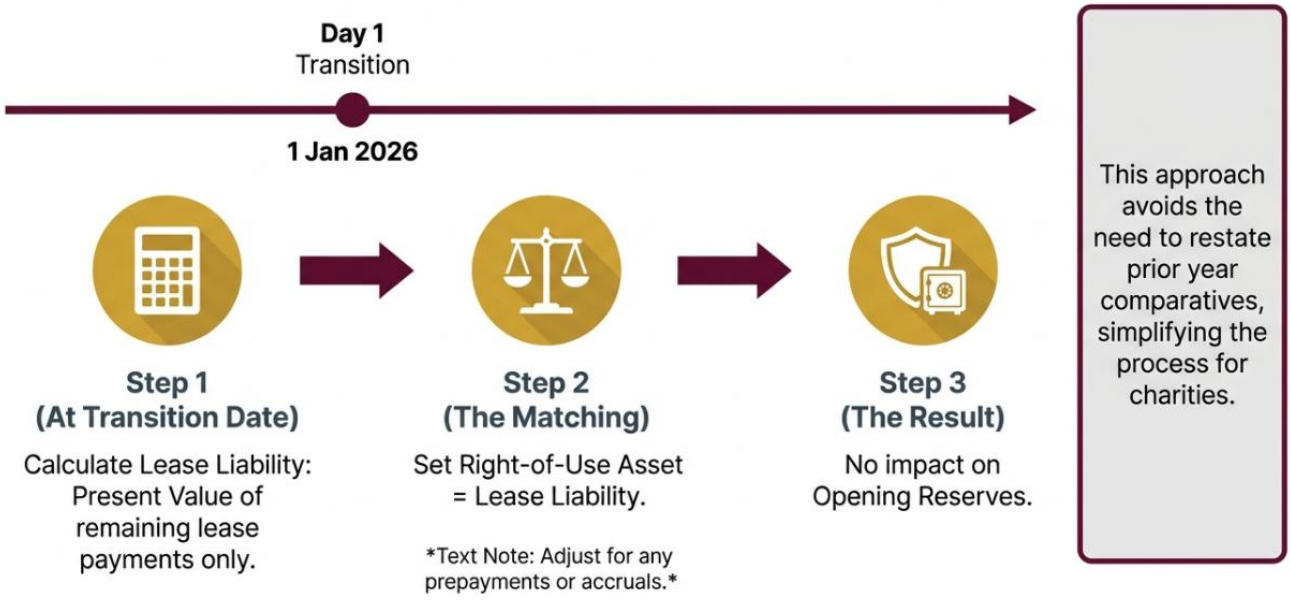
Required Disclosures: The RoU Asset Reconciliation

Per FRS 102 Section 20.81

Movements in Right-of-Use Assets

	Land & Buildings	Plant & Machinery	Total
Cost			
At 1 January 2026	£86,590	£0	**£86,590**
Additions	£0	£0	£0
At 31 December 2026	£86,590	£0	**£86,590**
Depreciation			
At 1 January 2026	£0	£0	£0
Charge for the year	(£17,318)	£0	(£17,318)
At 31 December 2026	(£17,318)	£0	**(£17,318)**
Net Book Value	**£69,272**	**£0**	**£69,272**

Transition: Modified Retrospective Approach



Implementation Checklist: 5 Steps to Compliance

1. **Identify:** Review all contracts. Is there an identified asset and right to control?
2. **Classify:** Filter out Peppercorn leases (Donation element) and Exemptions (Short-term/Low-value).
3. **Calculate:** Determine the Incremental Borrowing Rate and run the Present Value calculation.
4. **Recognize:** Book the initial RoU Asset and Lease Liability. Record 'Donation Income' for Peppercorn leases.
5. **Disclose:** Prepare the Asset Reconciliation note and Maturity Analysis for the accounts.