Helpsheet – Step by step guide to accounting for leases as a lessee
Part 3: accounting for a social donation lease

What is a social donation lease?

Lease arrangements where the payments are significantly below market rent but are higher 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. A charity lessee must use the information readily available to it to determine whether it is party to a social donation lease.

When deciding whether the charity has a social donation lease, it will need to consider whether the benefit is being provided at an apparently reduced cost because what the charity is receiving the use of is faulty in some way (e.g. a shop premises that has a damp issue) or it is receiving the benefit because it is a charity and the lessor offers a lower rent as a result of this.

Determining whether or not a lease exists

When considering whether or not the charity has a social donation lease, the first step is to determine whether a lease exists that meets the definition within FRS 102. See Part 1 of this helpsheet for more guidance.

The importance of understanding the nature of non-exchange income

Where a charity has a social donation lease, it will need to consider the nature of the ‘benefit-in-kind’ received by the charity, see Module 6 Donated goods, facilities and services, including volunteers of the SORP. In some cases, the incoming resource may be in effect the donation of an asset. However, in many cases the incoming resource may be in effect the donation of a service or facility.

It is important to consider the nature of the ‘benefit-in-kind’ because whether the charity considers it to be the donation of a service/facility or the donation of an asset will affect the calculations that the charity will need to make.

In particular, donated facilities and services are measured at the value of the donation to the charity, that is, the price the charity estimates it would have paid in the open market for a service or facility of equivalent utility to the charity. In the case of a social donation lease, this could be the cost of leasing a facility of equivalent utility.

Donated assets are measured at fair value. Fair value of a donated asset is generally the price that the charity would have paid on the open market for the asset but where a charity does not have access to such information, an estimation may be used based on relevant evidence such as the cost of the item to the donor who, in the case of a social donation lease, would be the lessor.

When considering such arrangements, it may be helpful to consider the responses to the following questions:

- How would the non-exchange element of the transaction be treated if it were not part of a lease arrangement?
- Does the transaction result in the charity being able to realise the fair value of an asset or is it the receipt of a service or facility?

Further considerations are outlined in paragraphs 10B.77 and 10B.78 of the SORP.

Nominal or peppercorn arrangements

Nominal or peppercorn arrangements are not social donation leases. See Part 1 of the helpsheet for guidance on such arrangements.

Community Asset Transfers

Community Asset Transfer is an established mechanism used to enable the community ownership and/or management of publicly owned land and buildings. It exists in England, Wales, Scotland and Northern Ireland and involves the transfer of land or buildings from a statutory body (e.g. a local authority) to a community organisation at less than its full market value in order to achieve a public benefit.

Community Asset Transfer may take various forms of tenure including freehold transfer, licences, short leases and long leases. The legislation concerning the transfer of community assets allows the transfer to be made at less than market value. Charities involved in Community Asset Transfers will need to consider the accounting treatment for the particular transaction they are involved in and may need to consider obtaining professional advice.

Where a charity is involved in such an arrangement or similar arrangements, it may be helpful to consider responses to the following questions in deciding how it should be accounted for:

- Is the arrangement transferring ownership of an asset to the receiving organisation? For example, if ownership transfers on day 1 of the arrangement, then a lease is unlikely. If ownership transfers at a later date or never transfers, then a lease seems possible.

- Is it a lease-like arrangement allowing use of an asset and transferring management responsibility of the asset to the receiving organisation?
- Does the arrangement meet the definition of a lease under FRS 102? To do so, it must have the six features of a lease as explained in paragraph 10B.23 of the SORP
- Is the arrangement a nominal or peppercorn arrangement?

Social donation leases – what do the figures in the charity's accounts mean?

A charity has a social donation lease where the payments due are significantly below market rent, but more than a nominal amount, because the lessor accepts a lower rent for the philanthropic intention of providing a benefit to the lessee. The charity must recognise that the arrangement provides a benefit or donation 'in-kind' to the charity as a result of the lessor giving the charity reduced lease payments. The 'in-kind' benefit received by the charity is referred to as the 'non-exchange component' of the lease.

In its accounts, the charity will have:

- An asset on its balance sheet that represents the right of use it has over the identified asset in the lease agreement. The 'cost' of the right-of-use asset is a figure that is calculated by including a number of different elements including the value of the non-exchange component.
- A liability on its balance sheet representing the present value of the money due to the lessor over the term of the arrangement. The total payments due over the term of the lease are adjusted to reflect the fact that money due in the future is worth less than money paid today. This is called the time value of money.
- Non-exchange income that represents the benefit or donation in kind that the charity receives from the lessor.

How to account for a social donation lease

This section explains how to find the relevant explanations within module 10B of the SORP for what to do in the first year of recognising a new social donation lease arrangement and in subsequent years. Examples to illustrate how to meet the relevant requirements are also provided.

As it is considered unlikely that a lease arrangement will have performance related conditions, the examples below are based on a lease arrangement that does not contain any performance related conditions. Example 1 explains the first year of

recognising a social donation lease arrangement and Example 2 explains what to do after initial recognition of a social donation lease arrangement.

A performance-related condition (in respect of funding commitments, government grants and other non-exchange transactions) is a condition under which entitlement to resources is conditional on the performance of: (a) a specified activity; or (b) a particular level of service or units of output to be delivered. Clauses of a general nature, for example, requiring the charity to continue its charitable activities for the duration of the arrangement, are not considered to be performance-related conditions.

If you consider that a social donation lease arrangement has performance-related conditions, see 10B.83 of the SORP or seek professional advice.

In the first year of recognising a lease arrangement:

	Paragraphs of module 10B of the SORP to read
When the charity first recognises the lease arrangement in its accounts, it must measure the right-of-use asset and the lease liability.	10B.44 to 10B.56 plus 10B.69 to 10B.74 and 10B.79 to 10B.85
A charity must disclose information in the notes to the accounts about its lease arrangements.	10B.94 to 10B.104

Example 1 - steps to take in the first year of recognising a social donation lease arrangement

A charity enters into an agreement on 01/01/X1 to use one floor of a five-storey office building for three years. The other four floors are occupied by the lessor, a commercial business. The market rent for this floor is £120,000/year.

The lessor states that as part of its corporate social responsibility activities, it will give the charity a 50% discount on the office space, so the charity will pay £60,000/year (paid in arrears). If the arrangement had not been available, the charity would have expected to pay £72,000/year for office space elsewhere.

Where a charity is party to a social donation lease, it must consider the nature of the incoming resources of the non-exchange component as this determines how to measure them. In some cases, the incoming resource may be in effect the donation of an asset. However, in many cases the incoming resource may be in effect the donation of a service or facility.

In this example, the charity determines that it is a facility it has received under this arrangement. Therefore, the non-exchange component is £12,000/year - the

difference between the value to the charity (£72,000) and the payment being made (£60,000).

If, after careful consideration, the charity determines that the value to the charity is the same as the amount being paid, the non-exchange component would be zero and Example 1 within Part 2 of this helpsheet may be followed.

If the charity determined that the non-exchange element was the donation of an asset, the non-exchange component is the difference between the fair value of the asset and the lease liability (see Step 2, below, for calculation of the lease liability).

Step 1 – determine what interest rate to use

To measure the right-of-use asset and the lease liability, the charity needs to use an interest rate.

- If the charity knows the **interest rate implicit in the lease**, then this must be used[1]. In some cases, the lessor may be able to tell the charity the interest rate implicit in the lease.
- Where the interest rate implicit in the lease cannot be readily determined, then the charity can choose either the charity's **incremental borrowing rate** or the charity's **obtainable borrowing rate** for the lease.
- Where a charity is unable to readily determine either the interest rate implicit in the lease, or the charity's incremental or obtainable borrowing rate, the charity must use the rate of interest that it could otherwise obtain on deposits held with financial institutions. This could be the rate of interest the charity receives on deposit accounts with their bank or if this is not relevant, a general deposit rate of interest with a financial institution.

For the purposes of this example, the charity cannot readily determine the interest rate implicit in the lease, so the charity has a choice between using its incremental borrowing rate or its obtainable borrowing rate. It chooses to use its obtainable borrowing rate, which it - taking into account a quote from its bank to borrow £360,000 over a similar term – determines is 6% for this lease.

See Annex 1 for definitions of the rates that are shown in bold within Step 1.

Step 2 - measure the lease liability

The initial measurement of the lease liability involves calculating the present value of the lease payments due after the commencement date using an interest rate.

[1] Except on initial application of the revised Section 20 following the Periodic Review 2024 amendments – refer to Financial Reporting Council's Factsheet 9 – Initial Application of the Periodic Review 2024 amendments.

The table below sets out the undiscounted and discounted cashflows using the interest rate determined in Step 1. For more information about calculating discounted cashflows, refer to Annex 2.

Date	Lease payment	Discount factor	Discounted amount
	£		£
31/12/X1	60,000	1.060	56,604
31/12/X2	60,000	1.1236	53,400
31/12/X3	60,000	1.191016	50,377
	180,000		**160,381**

Therefore, the lease liability is initially recognised at £160,381 at the commencement of the lease and this is one component of the cost of the right-of-use asset.

Step 3 – measure the non-exchange component of the right-of use asset

Where there are no performance related conditions, there is a general requirement to recognise income from a non-exchange transaction when it is received or receivable. As in this example there are no performance related conditions, the non-exchange component of the right-of-use asset is measured when received or receivable, and the charity concludes, in this case, it is receivable on the day the lease commences.

The table below sets out the calculation of the non-exchange component of the right-of use asset at 01/01/X1:

Date	Non-exchange component	Discount factor	Discounted amount
	£		£
31/12/X1	12,000	1.060	11,321
31/12/X2	12,000	1.1236	10,679
31/12/X3	12,000	1.191	10,076
	36,000		**32,076**

The non-exchange component of the right-of use asset at 01/01/X1 is £32,076.

Step 4 – measure the cost of the right-of-use asset

Measuring the right of use involves calculating the cost. The cost comprises several components including the initial measurement of the lease liability, see paragraph 10B.49 of the SORP.

The value of the incoming resources from the non-exchange component is also recognised as part of the cost of the right-of-use asset.

As no lease incentives were offered and, as a simplifying assumption, the charity did not incur any initial direct costs (see paragraph 10B.49 of the SORP), the cost of the right-of-use asset is the lease liability plus the non-exchange component (£160,381 + £32,076) amounting to £192,457.

Although not relevant to this example, the cost of the right-of-use asset may include an allowance for dilapidations or similar costs of making good to return the asset in an agreed condition at the end of the lease term. Refer to paragraphs 10B.49, 10B.87 and 10B.88 of the SORP.

Step 5 – determine how to recognise the non-exchange income

As the charity has recognised a non-exchange component as part of the right-of-use asset, it needs to decide how to deal with the other side of the entry which will be the recognition of non-exchange income at the commencement of the lease.

As no performance-related conditions exist in the arrangement, the charity will recognise the non-exchange income when it is received or receivable. This will usually be at the commencement of the lease but may be over the term of the lease depending on the terms of the arrangement. In this example, it is assumed that no terms of the arrangement require it to be recognised other than at the commencement of the lease. As a result, in the first year of recognising the lease arrangement, non-exchange income of £32,076 is recognised in 'Income from donations and legacies' in the Statement of Financial Activities.'

Statement of Financial Activities (extract)

	31/12/X1	31/12/X2	31/12/X3
	£	£	£
Income and endowments			
Income from donations and legacies	32,076	-	-

After initial recognition of a lease arrangement:

	Paragraphs of module 10B of the SORP to read
After the initial recognition of the lease arrangement, the carrying amounts for the right-of-use asset and the lease liability must be adjusted in the charity's accounts	10B.57 to 10B.62 plus 10B.69 to 10B.74 and 10B.79 to 10B.85
A charity must continue to disclose information in the notes to the accounts about its lease arrangements	10B.94 to 10B.104

In the first year of recognising the lease arrangement in Example 1, the lease liability at 31/12/X1 is £160,381. The liability reflects the payments due over the term of the lease and is not affected by the non-exchange component. Example 2 shows the measurement of the lease liability and the presentation in the accounts after the first year of recognising a lease arrangement.

Example 2 – steps to take after initial recognition of a lease arrangement

Step 1 - subsequent measurement of the right-of-use asset

The initial cost of the right-of-use asset of £192,457 (step 4, Example 1) would typically be depreciated on a straight-line basis over the three-year lease term.

Presentation and disclosure in the accounts

A lessee charity must either present the right-of-use assets separately from other assets in the balance sheet or disclose in the notes. If a lessee does not present right-of-use assets separately in the balance sheet, the lessee must:

(i) include right-of-use assets within the same line item as that within which the corresponding underlying assets would be presented if they were owned; and

(ii) disclose which line items in the balance sheet include those right-of-use assets.

The notes to the accounts must include a reconciliation of the carrying amount of the right-of-use asset at the beginning and end of the reporting period. For the year ended 31/12/X2, this could be disclosed as follows:

Leasehold land and buildings	31/12/X2	31/12/X1
	£	£
Cost		
At the beginning of the year	192,457	
Additions	-	192,457
Disposals	-	
At the end of the year	**192,457**	**192,457**
Depreciation		
At the beginning of the year 01/01/X2	64,152	-
Depreciation charge	64,152	64,152
At the end of the year	**128,304**	**64,152**
Net book value at the beginning of the year	128,304	-
Net book value at the end of the year	64,153	128,304

The depreciation expense must be recognised in the SoFA. For example, for the year ended 31/12/X2, depreciation expense would be £64,152.

Step 2 - subsequent measurement of the lease liability

The interest expense is equal to the interest rate (6%) multiplied by the opening balance for the period because payments are in arrears.

The table below shows how the lease liability reduces to zero over the lease term:

Date	Opening balance	Interest expense	Lease payment	Closing balance
	£	£	£	£
31/12/X1	160,381	9,623	(60,000)	110,004
31/12/X2	110,004	6,600	(60,000)	56,604
31/12/X3	56,604	3,396	(60,000)	0
		19,619	**(180,000)**	

Presentation in the accounts:

The lease liability must be presented separately from other liabilities on the balance sheet (see paragraph 10B.56 of the SORP).

Step 3 – determine how to recognise the non-exchange income

As previously established, in the first year of recognising this lease arrangement, all the non-exchange income of £32,076 is recognised in 'Income from donations and legacies' in the Statement of Financial Activities.'

Step 4 – other accounting entries

The interest expense must be recognised in the SoFA. For example, for the year ended 31/12/X1, interest expense would be £9,623.

The SORP requires the disclosure of certain information on material individual fund balances. If this is relevant to your leasing transactions, see Module 2 Fund accounting of the SORP.

Using spreadsheets for calculations - reproduced from FRS 102 Factsheet 11[2]

Discounting can be done in spreadsheets using a line-by-line approach for each period or one of the inbuilt formulae. There are generally three such formulae – PV, NPV and XNPV. It should be noted that PV assumes that the periodic cashflows are identical and at the end of a period, NPV allows differing cashflows but only allows them to be at the end of a period, and XNPV allows full flexibility over cashflow amounts and timing. Care will be needed to ensure that appropriate formulae are applied to appropriate inputs.

Other considerations

In the lease arrangement that a charity has, there may be specific terms or situations that also need to be considered. Module 10B of the SORP covers a number of these, as set out in the table below. Examples 3 and 4 below, provide an illustration of lines 1 and 3 in the table.

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	Paragraphs of module 10B of the SORP to read
Where the agreement combines a lease with other non-lease element such as cleaning, see Example 3, below.	10B.42 to 10B.43
Changes to the lease after the commencement date.	10B.63 to 10B.66
Where the charity receives an incentive to enter into the lease arrangement from the lessor, see Example 4, below.	10B.86
Where the charity may incur costs in making good the asset it is leasing at the end of the lease term.	10B.87 to 10B.88
If the charity carries out work on the leased asset and the lessor reduces the payments due by the charity as a result of that work.	10B.89
Where the right-of-use asset is used to carry out the charity's activities, the charity may need to exclude it from unrestricted funds when calculating the charity's free reserves.	Module 1 Trustees' Annual Report of the SORP Appendix 1: Glossary of terms of the SORP
Where a charity enters into a rolling lease, meaning there is no specified term or end date.	10B.41
Variable lease payments that depend on an index or a rate.	10B.54, 10B.64 FRS 102 Factsheet 11, Examples 3a, 3b and 3c.

Where a charity is considering how to treat irrecoverable VAT on a lease, FRS 102 and the SORP do not specify an accounting treatment so charities will need to apply judgement and may need to seek professional advice.

Example 3 - where the agreement combines a lease with other non-lease elements such as cleaning

A charity enters into a contract to use two identical floors of an office building with accompanying cleaning services and insurance coverage for a total consideration of £120,000 (£60,000 per floor). As part of its corporate social responsibility activities, the lessor is giving the charity a discount of £120,000 on the total consideration in addition to the £6,000 discount it is receiving as a result of the non-lease elements being included in the arrangement. If the arrangement had not been available, the charity expected to pay £72,000 per floor per year for office space elsewhere.

The standalone selling price of leasing a floor of the building is £118,000; the standalone price of cleaning services (per floor) is £3,000 and of insurance (per floor) is £2,000.

The following table sets out the proportion of the total standalone price that relates to each component, which is applied to the total contract amount of £120,000 to determine the share of the total contract amount that relates to each component.

	Standalone price	**% of standalone price**	**Amount allocated to each component**
	£		**£**
Floor 1	118,000	48%	57,600
Floor 2	118,000	48%	57,600
Non-lease	10,000	4%	4,800
	£246,000		**£120,000**

It may be helpful to also refer to Example 3 within Part 2 of the helpsheet to understand the discount that the charity receives as a result of having a social donation lease in this example.

Lease and non-lease components are accounted for separately unless the lessee applies the practical expedient in paragraph 10B.43 of the SORP, see below.

When calculating the lease liability (if not taking the practical expedient), the charity will use the amounts allocated to the lease component, £57,600 and these will need to be discounted as per Step 2 of Examples 1 and 2 above. The non-exchange component of the lease that is needed to calculate the right-of-use asset is calculated as per Step 3, Example 1, above.

The non-lease element of £4,800 (plus associated non-exchange element) is treated as an expense and is not subject to lease accounting.

In the example above, a charity applying the practical expedient would instead elect, by class of underlying asset, not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component. In the above example, the charity would instead identify two lease components each with £60,000 consideration allocated.

Example 4 - where the charity receives an incentive to enter into the lease arrangement from the lessor (based on Example 3a, FRS 102 Factsheet 11)

A lessee enters into a five-year property lease on 01/01/X1, with annual lease payments of £10,000 (paid in advance), an initial six-month rent-free period, and a cash lease incentive of £3,000 received at the start of the lease (as opposed to receivable in the future). The cash lease incentive of £3,000 is available to anyone who signs up to the lease regardless of whether they are a charity or not.

As part of its corporate social responsibility activities, the lessor is giving the charity a 50% discount on the office space so the market rent for each floor is £20,000/year. If the arrangement had not been available, the charity expected to pay £12,000 per floor per year for office space elsewhere.

The lease payments to be reflected in the calculation of the lease liability are as follows:

Date	**Lease payment**
	£
01/07/X1	5,000
01/01/X2	10,000
01/01/X2	10,000
01/01/X2	10,000
01/01/X2	10,000

The cash lease incentive of £3,000 is not included in the calculation of the lease liability but is deducted from the cost of the right-of-use asset. The benefit of the lease incentive is therefore recognised as reduced depreciation of the right-of-use asset.

The non-exchange component of the lease will need to be calculated in line with Example 2 above and added to the lease liability to determine the cost of the right-of-use asset.

Annex 1 - Definitions

Interest rate implicit in the lease (definition from FRS 102) is the rate of interest that causes the present value of the lease payments and the unguaranteed residual value, to equal the sum of the fair value of the underlying asset and any initial direct costs of the lessor.

Lessee's incremental borrowing rate (definition from FRS 102) is the rate of interest a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.

Lessee's obtainable borrowing rate (definition from FRS 102) is the rate of interest a lessee would have to pay to borrow, over a similar term, an amount similar to the total undiscounted value of lease payments to be included in the measurement of the lease liability.

Annex 2 - Calculating discounted cashflows

Step 1: Identify the cashflows

In Example 2 above, the cashflows are the lease payments of £60,000 for each of the year ends 31/12/X1; 31/12/X2; and 31/12/X3:

Date	Lease payment
	£
31/12/X1	60,000
31/12/X2	60,000
31/12/X3	60,000
	180,000

Step 2: Calculate the discount factor

In xample 2 above, the charity cannot readily determine the interest rate implicit in the lease so it uses its obtainable borrowing rate of 6% instead. A discount factor is needed to convert future cash flows into their present value at 01/01/X1. The following formula can be used to calculate the discount factor: $(1+i)^t$ where i is the discount rate per period as a decimal; and t is the time period.

Date	$(1+i)^t$	Discount factor
31/12/X1	$(1+0.06)^1$	1.060
31/12/X2	$(1+0.06)^2$	1.1236
31/12/X3	$(1+0.06)^3$	1.191016

Step 3: Calculate the present value

The present value at 01/01X1 is calculated by dividing each cashflow by the relevant discount factor.

Date	Lease payment	Present value calculation	Discounted amount
	£		£
31/12/X1	60,000	60,000/1.060	56,604
31/12/X2	60,000	60,000/1.1236	53,400
31/12/X3	60,000	60,000/1.191016	50,377
	180,000		**160,381**