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FOR ENGLAND AND WALES

The Charity
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OSCR
Scottish Charity Regulator

Charity Commission for England and
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102 Petty France
London
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10 May 2023

**Charities SORP-making body's response to FRED 82 Draft amendments to FRS 102
The Financial Reporting Standard applicable in the UK and Republic of Ireland and
other FRSs – Periodic Review**

Introduction and Background

The Charity Commission for England and Wales, the Charity Commission for Northern Ireland and the Office of the Scottish Charity Regulator act together as the joint SORP-making body for charities in the UK and are advised by the Charities SORP Committee. The current SORP Committee comprises 14 Committee members drawn from the 4 charity law jurisdictions covered by UK-Irish GAAP. The Charities SORP Committee had its inaugural meeting on 12 March 2020.

The joint SORP-making body welcomes the opportunity to respond to FRED 82 Draft amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* and other FRSs – Periodic Review.

In developing this response, the joint SORP-making body has taken advice from the SORP Committee and has been informed by extensive stakeholder feedback gathered during the ongoing SORP development process. Our thanks to all those who have supported us in this process to date.

The needs of the charity sector

The charity sector in the UK and Republic of Ireland is dominated by small organisations – in fact over 99% of registered charities would be classed as ‘small’ in company law terms. The joint SORP-making body reshaped the Charities SORP development process following its governance review in 2018-19 to focus on the needs of users of the SORP, to prepare high quality annual reports and accounts, and those who use that information for a variety of purposes. Our work since then has been focused on the needs of those two groups with a particular focus on how smaller charities preparing accrued accounts can be provided with an accounting framework that is proportionate, appropriate and practical. This in turn would support the preparation of high quality qualitative and quantitative information that is relevant to those who want to receive it.

As part of the new Charities SORP development process, the engagement partners who worked with the joint SORP-making body and SORP committee to identify and examine issues being experienced and areas for improvement, consistently identified problems that smaller charities encounter with preparing accrued accounts. While charity law does provide a simplified basis of accounting for smaller charities that are not companies, there remains a significant number of smaller charitable companies who are struggling to understand the relevant requirements and whose resulting accounts are often unintelligible for many stakeholders who want to use them. This is often due to clutter in the documents coupled with a lack of clarity about what the charity is doing and how it is doing it due to the complex accounting treatments that charities have to apply to their transactions.

Charities should have a reporting framework that is more suitable for their needs in terms of the transactions they commonly have and the needs of those who use their annual report and accounts. The FRC already recognises the former and provides PBE-specific requirements and guidance which has been a marked step forward in the modernisation of accounting standards in the UK and Ireland. However, a more significant shift is urgently required to properly address the issues that smaller charities are experiencing by currently having to fulfil all relevant requirements of FRS102 where they prepare accrued accounts.

Response to FRED 82 – Key Issues

A question-by-question response to the proposals in FRED 82 is provided below.

The joint SORP-making body acknowledges the FRC’s direction of travel with FRS102 and the move to harmonising UK-Irish GAAP with IFRS. However, we are of the view that FRS102 and the amendments in FRED 82 have become more onerous since the standard

was first introduced. Recognising that 99% of the charity sector are small entities we feel that FRS102 is not proportionate to the characteristics of small not-for-profit entities. We would urge the FRC to consider how the financial reporting requirements for charities can be best achieved.

The joint SORP-making body would draw particular attention of the FRC to two aspects of FRED 82 that are likely to require further consideration to ensure financial reporting requirements can be successfully applied by charities.

(1) Section 20 Leases

The joint SORP-making body has concerns about the consistency, practicability and/or likely costs of meeting requirements around:

- establishing the existence of a non-exchange transaction in a lease contract;
- the consistency of treatment of leased assets at a peppercorn rent and donated assets;
- the consistency of measurement of incoming resources from a lease containing a non-exchange transaction between Section 20 *Leases* and Section 34 *Specialised Activities*;
- measurement of the fair value of lease rentals; and
- the interest rate used to discount the lease liability.

The joint SORP-making body would recommend the development of additional guidance on recognition of incoming resources from a lease containing a non-exchange transaction.

(2) Non-exchange transactions

The joint SORP-making body is aware of circumstances commonly faced by charities that may lead to practical difficulties in applying certain proposals in Section 34 *Specialised Activities*. In particular, the joint SORP-making body anticipates issues with:

- the availability of reliable measurements for donated goods and facilities;
- the value of donations to the charity; and
- disclosures for non-exchange transactions.

Throughout this response, references to paragraph numbers are to the paragraphs in FRED 82 unless stated otherwise.

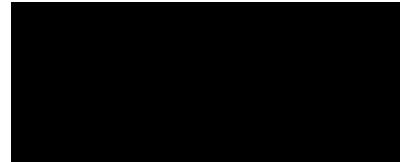
The joint SORP-making body would be pleased to discuss any aspect of this response with the FRC. To arrange this or to discuss any queries relating to this response, please contact Amie Woods in the first instance.

Yours faithfully,



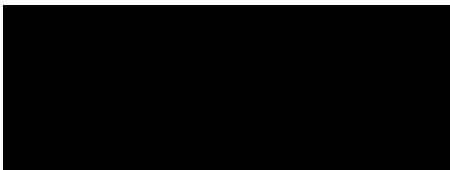
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Question 1: Disclosure

Do you have any comments on the proposed overall level of disclosure required by FRS 102?

Do you believe that users of financial statements prepared under FRS 102 will generally be able to obtain the information they seek? If not, why not?

1.1 General Comments

The joint SORP-making body recognise that the introduction of FRS102 accounting standard represented a major step in terms of aligning for-profit accounting in the UK and Ireland with IFRS whilst accommodating company law requirements and existing traditions in reporting. However, we feel that while the proposed level of disclosure required by FRS 102 may be appropriate for for-profits entities, we are concerned that some of these disclosures are ill-suited to charities and users of charity financial statements - in particular, small charities.

The focus of FRS102 and accounting standards is very much on the interests of the providers of risk capital to for-profit businesses. Charities are established for the public benefit and not as owner managed for-profit businesses and, although welcome and helpful, the PBE paragraphs are proving insufficient in addressing the reporting needs of the users of charity accounts. The joint SORP-making body is of the view that the level of disclosure required is not proportionate for the majority of entities in the charity sector and their user information needs.

As disclosure in the accounts has increased, charities have needed to find extra resource to meet the requirements, this comes at a cost not only from a preparation perspective but also in respect of the external scrutiny. We feel that this extra cost is not proportionate to the benefit. We would highlight that some of the proposed changes in the FRED (for example to leasing that would result in further costs) are potentially not sustainable for charities. In addition, the proposed changes may potentially result in further issues with the availability of independent examiners for charity accounts as increasing complexity results in discouraging individuals from this work.

Our view is that there is inequity between the reporting requirements for small for-profit entities and those for small not-for-profit entities, and we urge the FRC to address this. There is a distinct simpler regime for micro-entities and small companies designed for for-profit entities and we feel that there is a pressing need to have in place a simpler appropriate regime for small not-for-profit entities. To support our response, we have provided data of the number of charities by income band, this is presented at Annex A.

The joint SORP-making body has undertaken significant work with stakeholders since 2019, to seek views on how the SORP can be improved to meet the needs of users and these views helped to inform this response. We are pleased to have gathered stakeholder views as we acknowledge that charities may not engage in FRC consultations, due to lack of available resources, expertise and lack of awareness of the FRC's work.

As outlined in our [first response](#) to the FRC's periodic review in May 2021, our view is that change is needed for smaller charities who prepare accrued accounts. The current simplifications offered by section 1A of FRS102 for entities that operate on a 'for-profit' basis are set in the context of the exemptions from certain accounts filing obligations that those entities enjoy. Charities do not have the same filing options or exemptions as there are different transparency and accountability expectations that the public have of charities. Consequently, the section 1A regime as it currently exists (and would under the FRED proposals) is not suitable for charities. In our submission to the periodic review, we suggested changes to differentiate the application of section 1A. The intention of the proposed changes was to facilitate proportionate disclosures that would be better targeted at both the user and preparer. On reviewing the FRED, we were disappointed that our suggestions had not been incorporated into section 1A.

If FRC are unable to progress on our earlier suggestions for adapting Section 1A for not-for-profit entities, then we would recommend that the FRC considers:

- consulting on developing a UK-Ireland conceptual framework and not-for profit accounting standard as a longer-term solution
- developing a framework whereby FRS105 or a similar framework could be developed for application by the charity sector supported by sector-specific requirements
- how the PBE sections could be enhanced or adapted to meet the needs of small PBE's

We would welcome the opportunity to discuss these recommendations with the FRC.

We feel that it is important to note that the majority of preparers and users of charity accounts will have limited knowledge of IFRS and that this lack of knowledge will create more burden when dealing with the complexities of the revised lease and revenue sections. We would encourage FRC to take this into account in finalising FRS102 and in the development of relevant application guidance.

1.2 Comparative figures

The joint SORP-making body has advocated for change in relation to the requirements for comparative figures for some time. Most recently this was raised in our first submission to the FRC's periodic review in May 2021. The issue that is problematic here is the requirement for comparative figures to be shown, not only for all amounts presented in the current period's financial statements as a result of requirements in FRS102, but also for comparatives to be shown for amounts presented in the current period's financial statements as a result of a requirement of the SORP. This is most acutely demonstrated in relation to fund accounting which is particular to charities where the need for comparatives means that the financial statements become unhelpfully cluttered, potentially preventing users from being able to really understand what is happening to the charity as opposed to enhancing their understanding by providing more information.

As we have consistently explained, the evidence from users and preparers of charity accounts is that the provision of these additional comparatives is not informative or useful in decision making. We continue to seek consideration by the FRC of change in this area so that for SORP specific items, the joint SORP-making body, advised by the SORP Committee and relevant feedback, can set the requirements for comparative figures. In our

view, this would strongly support the FRC's aim, that the joint SORP-making body shares, to provide useful information to users by making the financial statements clearer and easier to read and interpret.

Question 2: Concepts and pervasive principles

Do you agree with the proposal to align FRS 102 and FRS 105 with the 2018 Conceptual Framework? If not, why not?

This FRED, and IASB/ED/2022/1, propose to continue using the extant definition of an asset for the purposes of Section 18 *Intangible Assets other than Goodwill* and the extant definition of a liability for the purposes of Section 21 *Provisions and Contingencies* of FRS 102. This is consistent with the approach taken in IAS 38 *Intangible Assets* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* which use the definitions of an asset and a liability from the IASB's 1989 *Framework for the Preparation and Presentation of Financial Statements*. Do you agree with this approach? If not, why not?

Do you have any other comments on the proposed revised Section 2?

2.1 Overall approach

Subject to the detailed comments made elsewhere in this response, the joint SORP-making body is broadly supportive of the steps taken to align FRS 102 with the IASB's 2018 Conceptual Framework for Financial Reporting to promote consistency with global accounting standards. However, the amendments as drafted mean that Section 2 is substantially longer than the existing standard. It would be helpful to users of the standard, if this section could be made more succinct.

Except for comments relating to leasing included in Section 6 of this response, the joint SORP-making body does not wish to comment on proposals for FRS 105 due to it not being applicable to charities.

2.2 Definition of an economic resource

The joint SORP-making body notes that an economic resource is defined in paragraph 2.37 as "*a right that has the potential to produce economic benefits*". This would appear to be framing economic resources (and therefore both assets and liabilities) solely in terms of economic benefits. This may be problematic for charities where they acquire or create assets for their service potential rather than to solely receive economic benefits from the asset. It is also worth noting that the creation or acquisition of assets for their service potential is a common transaction for charities and fits with their charitable objectives.

For example, a charity might have an objective to educate the public or make services or artefacts in its collection available to the public. The joint SORP-making body is aware that charities with such objectives may meet them by using assets, for example, by building a website or creating an online repository to allow the public to access relevant resources. Such websites have service potential, provide public benefit, and contribute to the achievement of charitable objectives. However, it is questionable whether such websites provide economic benefits in accordance with the definition in the FRED. Where the

definition of an economic resource (and therefore asset) is framed solely in terms of economic benefits, charities may struggle to justify the capitalisation of website development costs or other capitalisation policies.

The joint SORP-making body would note that in 2007 the ASB produced an interpretation of its Statement of Principles for Financial Reporting which stated at paragraph 4.10 that for public benefit entities an asset can embody service potential as well as or instead of cash flows. The joint SORP-making body realises that this is not an extant publication for the FRC, but service potential is currently recognised as being embodied in assets and liabilities in the IPSASB *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*.

The joint SORP-making body considers that the concept of service potential is already included in FRS 102 both in the glossary and in some asset-related sections, specifically Section 13 *Inventories* and Section 27 *Impairment of Assets*.

The joint SORP-making body is therefore of the view that “economic benefits” as they relate to public benefit entities do not solely relate to cash flows. This is supported to an extent by the specifications of paragraph 2.38 of the FRED which indicate that the rights to economic benefits may take many forms.

However, the joint SORP-making body considers that the definition of “economic resource” could be enhanced and the intention of paragraphs 2.37 and 2.38 for public benefits entities clarified if FRS 102 refers to “service potential” in addition to “economic benefits” in the definition of an economic resource. The joint SORP making body considers that this could have separate PBE application, including a separate PBE paragraph. Including service potential in the definition of an economic resource in Section 2 of FRS 102 would provide a conceptual basis for the financial reporting requirements relating to assets held for their service potential throughout the rest of FRS 102 and would clarify how charities should account for assets acquired or created for their service potential.

The joint SORP-making body suggests that an additional paragraph, PBE2.37A, be included in FRS 102 to clarify the meaning of “economic resource” in the context of PBEs. The joint SORP-making body suggests the following wording:

“For public benefit entities an economic resource is a right that has the potential to produce economic benefits, service potential or both.”

2.3 Use of extant definitions of asset and liability

The joint SORP-making body understands that the extant definitions of assets and liabilities are retained in Section 18 *Intangible Assets other than Goodwill* and Section 21 *Provisions and Contingencies* to ensure consistency with IAS 18 *Intangible Assets* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The joint SORP-making body agrees that there are practical difficulties in achieving this consistency in these two parts of FRS 102. However, the joint SORP-making body would support continued work towards the consistent application of definitions of assets and liabilities throughout FRS 102 to ensure consistency in understanding and application of these concepts by both accounts’ preparers and auditors.

The joint SORP-making body anticipates that use of the extant definition of “asset” throughout Section 18 will not allow for the recognition of all of a charity’s assets, reducing the usefulness of the charity’s financial statements. As indicated above, where the definition of “asset” requires charities to expect future economic benefits without reference

to service potential (as in paragraph 18.4), charities may be unable to recognise the outlay on some projects, such as the creation of a website or online repository for the public benefit, as an asset.

Consistent with its recommendation in Section 2.2 above, the joint SORP-making body suggests that amendments are made to Section 18 to allow charities that for instance create websites for their service potential rather than for economic benefit to recognise expenditure on the intangible as an intangible asset. The joint SORP-making body would therefore suggest two amendments to Section 18 of FRS 102 to achieve this:

- An additional paragraph (PBE18.4A, ahead of the proposed paragraph 18.4A which becomes 18.4B) with suggested wording as follows:
“A public benefit entity shall recognise an intangible asset as an asset only if:
(a) it is probable that the asset will generate either expected future economic benefits, service potential or both; and
(b) the cost or value of the asset can be measured reliably.”
- An amendment to paragraph 18.8H(d) such that the first sentence reads:
“How the intangible asset will generate probable future economic benefits (or, for a public benefit entity, future economic benefits, service potential or both).”

Question 3: Fair Value

The proposed Section 2A *Fair Value Measurement* of FRS 102 would align the definition of fair value, and the guidance on fair value measurement, with that in IFRS 13 *Fair Value Measurement*. Do you agree with this proposal? If not, why not?

Do you agree with the proposed consequential amendment to Section 26 *Share-based Payment* of FRS 102 to retain the extant definition of fair value for the purposes of that section? If not, why not?

3.1 Overall approach

The joint SORP-making body is broadly supportive of the steps taken to align FRS 102 with IFRS 13 *Fair Value Measurement* to ensure that there is greater consistency with that standard particularly following its post implementation review. The joint SORP-making body agrees with the approach to the simplifications including the retention of the fair value disclosures in other sections of FRS 102 and the proposal not to centralise the disclosure requirements in section 2A.

The joint SORP-making body notes that establishing the fair value of transactions can be complex in the charity sector in which non-exchange transactions and transactions for service potential, rather than economic benefit, are commonplace. For example, lease rentals might appear to be below market value or at a ‘peppercorn’ amount. However, the lease may contain restrictions or conditions that would not be present for a non-public benefit entity, such as a requirement to use the leased asset for the benefit of the local community. Such restrictions or conditions can be difficult to measure, therefore public benefit entities may face additional complexities in applying Section 2A. The joint SORP-making body would welcome application guidance or similar materials to support public benefit entities in the application of Section 2A.

3.2 Amendment to Section 26 Share-based Payment of FRS 102

The Joint SORP-making body does not wish to offer a comment on the proposed amendment to Section 26 Share-based Payment of FRS 102 to retain the extant definition of fair value for the purposes of that section due to this matter not being regular transaction for charities.

Question 4: Expected Credit Loss Model

The FRC intends to defer its conclusion as to whether to align FRS 102 with the expected credit loss model of financial asset impairment from IFRS 9 *Financial Instruments* pending the issue of the IASB's third edition of the *IFRS for SMEs Accounting Standard*. Any proposals to align with the expected credit loss model will therefore be presented in a later FRED. Do you agree with this approach? If not, why not?

In IASB/ED/2022/1 the IASB proposes to retain the incurred loss model for trade receivables and contract assets, and introduce an expected credit loss model for other financial assets measured at amortised cost. The FRC's preliminary view is that, in the context of FRS 102, it may be appropriate to require certain entities to apply an expected credit loss model to their financial assets measured at amortised cost, but allow other entities to retain the incurred loss model. Do you agree with this view? If not, why not?

Based on stakeholder feedback received to date, the FRC does not intend to use the existing definition of a financial institution to define the scope of which entities should apply an expected credit loss model. The FRC's preliminary view is that it may be appropriate to define the scope based on an entity's activities (such as entering into regulated or unregulated credit agreements as lender, or finance leases as lessor), or on whether the entity meets the definition of a public interest entity. Do you have any comments on which entities should be required to apply an expected credit loss model?

4.1 General comments

The joint SORP-making body agrees with the FRC that its conclusion on alignment with the expected credit loss model of financial asset impairment from IFRS 9 *Financial Instruments* should be deferred, pending the issue of the third edition of the *IFRS for SMEs Accounting Standard*.

Question 5 – Other Financial Instruments Issues

When it has reached its conclusion as to whether to align FRS 102 with the expected credit loss model, the FRC intends to remove the option in paragraphs 11.2(b) and 12.2(b) of FRS 102 to follow the recognition and measurement requirements of IAS 39 *Financial Instruments: Recognition and Measurement*. This intention was communicated in paragraph B11.5 of the Basis of Conclusions to FRS 102 following the Triennial Review 2017. In preparation for the eventual removal of the IAS 39 option, the FRC proposes to prevent an entity from newly adopting this accounting policy. Do you agree with this proposal? If not, why not?

Temporary amendments were made to FRS 102 in December 2019 and December 2020 in relation to interest rate benchmark reform (IBOR reform). The FRC intends to consider, alongside the future consideration of the expected credit loss model, whether these temporary amendments have now served their purpose and could be removed. Do you support the deletion of these temporary amendments? If so, when do you think they should be deleted? If not, why not?

5.1 General comments

The Joint SORP-making body does not wish to offer a comment on the proposed amendment to remove the option in paragraphs 11.2(b) and 12.2(b) of FRS 102 to follow the recognition and measurement requirements of IAS 39 *Financial Instruments: Recognition and Measurement*.

Question 6: Leases

FRED 82 proposes to revise the lease accounting requirements in FRS 102 to reflect the on-balance sheet model from IFRS 16 *Leases*, with largely-optional simplifications aimed at ensuring the lease accounting requirements in FRS 102 remain cost-effective to apply. An entity electing not to take these proposed simplifications will follow requirements closely aligned to those of IFRS 16, which is expected to promote efficiency within groups.

Do you agree with the proposals to revise Section 20 of FRS 102 to reflect the on-balance sheet lease accounting model from IFRS 16, with simplifications? If not, why not?

Have you identified any further simplifications or additional guidance that you consider would be necessary or beneficial?

6.1 Overall approach

The joint SORP-making body acknowledges the conceptual basis for on-balance sheet recognition of right-of-use assets and associated lease liabilities in lessee accounts to ensure that the users of an entity's financial statements have a complete understanding of the obligations an entity faces and the assets under its control.

However, the joint SORP-making body is concerned that the proposed requirements in FRS 102 may result in a disproportionate burden for smaller charities. It is noted that within FRS105, micro-entities are not required to adopt IFRS 16-style lessee accounting with the basis for conclusions B105.5 *stating ' stakeholder feedback suggested that the costs of aligning section 15 Leases of FRS 105 with the on-balance sheet model from IFRS 16 Leases could significantly exceed the benefits, as there was significant concern that the requirements of this model would be too complicated for micro-entities. The FRC has decided to propose not to align FRS 105 with IFRS 16 at this stage'*. Many smaller charities applying FRS102 are likely to be the same size as entities applying FRS105 and it is not clear to the joint SORP-making body why there is a need for charities to apply this style of lessee accounting when 'for-profit' entities of the same size do not. To assist with

consideration of this point, we have provided some figures to illustrate the number of charities that sit under the FRS105 threshold that would potentially be subject to different requirements please refer to Annex A. We would recommend that the FRC considers providing a PBE paragraph to provide small charities with a suitable option on lease accounting.

In addition, we foresee potential issues arising with the preparation of consolidated accounts whereby some members of the group are exempt from the new-style lessee accounting and others are not. It is not uncommon for charities to have subsidiary companies set up to undertake trading activities to support the charitable activities of the parent organisation.

It is our understanding that the IFRS for SMEs does not adopt IFRS 16-style requirements for lessee accounting. This further supports our position that smaller charities be excluded from providing the proposed treatment in FRED 82.

The joint SORP-making body is also concerned that the changes proposed to lessee accounting, may result in more charities being subject to audit as the level of gross assets a charity holds is one of the criteria for audit within charity legislation across the UK jurisdictions.

6.2 Accounting for leases containing a non-exchange transaction

6.2.1 Establishing the existence of a non-exchange transaction

The joint SORP-making body notes paragraph 20.36 which requires public benefit entities to account for the difference between the lease payments and market rents as a contribution to the cost of the right-of-use asset.

The joint SORP-making body anticipates that charities are likely to face practical difficulties in applying this requirement. For example, in some cases, the substance of a peppercorn rent might be that the lessor is effectively donating an asset to a charity and the charity is therefore in receipt of incoming resources from a non-exchange transaction. However, in other cases, where the rent appears to be low, circumstances might mean that the rent reflects market value and the lease does not contain a non-exchange transaction. For example, the rent may reflect the level of investment required by the charity to bring the asset into a usable condition. This might be the case for a lease of old buildings such as schools, town halls, community centres and heritage buildings that have fallen out of use or are costly to maintain.

As noted in Section 3.1 of this response above on fair value measurement, the joint SORP-making body would welcome application guidance or similar materials to support public benefit entities in the application of Section 2A as it relates to paragraph 20.36.

6.2.2 Recognition of incoming resources from a lease containing a non-exchange transaction

Paragraphs 20.36 and 20.50(e) will lead to the recognition of any incoming resources from a non-exchange transaction as a result of a PBE's lease payments being significantly below market rents as a contribution to the cost of the right-of-use asset. While the FRED specifies the treatment for the right-of-use asset, it is not clear how a public benefit entity would recognise the incoming resources of such a transaction in the performance statement. The joint SORP-making body would therefore suggest that paragraph

PBE34.67 sets out how this gain might be recognised in the performance statement (the Statement of Financial Activities (SoFA) in the case of a charity).

The joint SORP-making body anticipates that the intended treatment would be for the PBE to recognise deferred income at the commencement of the lease of equal value to the amount included in the right-of-use asset in accordance with paragraph 20.50(e), which is then released to the performance statement (SoFA in the case of a charity) over the life of the right-of-use asset. The joint SORP-making body is of the view that FRS 102 would be enhanced by a specific reference to recognition of incoming resources from lease payments significantly below market rents in paragraph PBE34.67.

6.2.3 Consistency of treatment – leased assets at a peppercorn rent and donated assets

The joint SORP-making body considers that where charities pay a peppercorn rent for a leased asset and that rent is below market value, the lease is in substance the same transaction as the charity benefitting from the use of donated facilities. The joint SORP-making body would therefore suggest that the FRC reviews paragraph PBE34.73 to make clear that public benefit entities can account for incoming resources from donated facilities and incoming resources from a facility leased at a peppercorn rent consistently. PBE34.73(a) as written applies to *donated* services and facilities only. Should paragraph PBE34.73(a) exclude incoming resources from assets leased at a peppercorn rent, there is the potential for inconsistent treatment of transactions that are, in substance, the same (i.e. incoming resources from donated facilities would be measured at value to the charity while incoming resources from facilities leased a peppercorn rent would follow PBE34.73(b) and be measured at fair value, which may differ from the value to the charity). The joint SORP-making body would therefore recommend that PBE34.73(a) be amended to clarify that it applies to services and facilities that are either donated or in substance donated (with explicit cross reference to section 20).

6.2.4 Consistency of treatment – measurement of incoming resources from a lease containing a non-exchange transaction

Where facilities are leased at a peppercorn rent and the incoming resources are measured at value *to the entity/charity* under paragraph PBE34.73 (as the use of the asset is in substance donated), the joint SORP-making body notes that this may create inconsistencies with the required treatment in paragraph 20.36 (and therefore 20.50(e)). Paragraph 20.36 requires a public benefit entity to account for the difference between the lease payments and *market rents* as a contribution to the cost of the right-of-use asset. However, where the incoming resources from the non-exchange transaction are measured at value *to the entity* per paragraph PBE34.73(a) (which, per paragraph PBE34.73A, may not be the same as the market value), there may be an inconsistency between the measurement of the contribution to the cost of the right-of-use asset and the incoming resources from the non-exchange transaction. The joint SORP-making body therefore recommends that paragraph 20.36 be amended to clarify that the contribution to the cost of the right-of-use asset should be measured in the same way as the incoming resource from the non-exchange transaction.

6.2.5 Practicability of measurement

The joint SORP-making body is of the view that FRS 102 would be enhanced by the inclusion of more guidance for PBEs paying rent below market values particularly if they are unable to reliably measure income from a non-exchange transaction.

The joint SORP-making body anticipates that charities will face practical difficulties in measuring the incoming resources from a lease containing a non-exchange transaction where leased assets are of a unique nature, or in a different (likely worse) condition than other available assets. In such cases it is likely that, market rents for a similar asset cannot be readily observed. Other complications may also exist for charities. For example, the joint SORP-making body is aware of charities that occupy space in the offices of an associated entity (for example where the charity is the charitable arm of a commercial entity) for which they pay rent at rates which would not be available to a third party making it difficult to measure the market value of the rent.

In these cases, the joint SORP-making body suggests that charities are required to make a narrative disclosure of the incoming resources they have benefited from following paragraph PBE34.74(c). The joint SORP-making body suggests that “leases below market value for which the entity has not been able to measure the incoming resource reliably” should be added to the list of examples in paragraph PBE34.74(c) to enhance the guidance available to charities.

Additional comments on assumptions around the reliable measurement of donated assets (and services) are made in Section 9.1 of this response below.

6.3 Interest Rate Used to Discount the Lease Liability

The joint SORP-making body notes that the FRED contains two proposals regarding circumstances where the interest rate implicit in the lease cannot be readily determined. The FRED includes a proposal that the obtainable borrowing rate is used as an alternative to the incremental borrowing rate in IFRS 16 or in exceptional cases the gilt rate. This is an area where there are difficulties for entities across most sectors where an entity is not able to identify interest rates implicit in the lease (because this requires knowledge of the fair value and the residual value of an asset). However, an observable interest rate is likely to under or over-estimate the lease liability and therefore for a proper presentation of the transaction this is an important consideration. Additionally proposed PBE20.53 allows a public benefit entity to choose to replace the lessee’s obtainable borrowing rate with “*the rate of interest otherwise obtainable on their deposits held with financial institutions*”.

The joint SORP-making body understands that the PBE paragraph was provided following public benefit feedback from the sector that borrowing is not a regular transaction for public benefit entities but considers it would be very useful to provide additional guidance to assist public benefit entities with the choices between the three options and under what circumstances that the application of each rate would be appropriate.

The joint SORP-making body agrees that it may be difficult for public benefit entities to refer to an obtainable borrowing rate as this is not a regular transaction. However, where public benefit entities apply a deposit rate, there is a risk that the financial statements of a public benefit entity may not be comparable to those of a non-public benefit entity. There is also a risk that a deposit rate would not properly reflect the transaction.

The joint SORP-making body notes that paragraph 20.52 only permits the use of a gilt rate in exceptional circumstances. The joint SORP-making body is of the view that, where public benefit entities are unable to obtain either the rate implicit in the lease or an obtainable borrowing rate, use of a gilt rate would be preferable to use of a deposit rate as use of a gilt rate would help reduce the level of subjectivity required in preparing financial statements and would better reflect the economic substance of the transaction as a form of borrowing while at the same time ensuring consistency with non-public benefit entities. Under this approach the joint SORP-making body anticipates that use of a gilt rate by

public benefit entities may be more frequent than indicated by paragraph 20.52. The joint SORP-making body therefore recommends that paragraph PBE20.53 be reworded to

- 1) remove reference to use of a deposit rate; and
- 2) clarify that public benefit entities might make more frequent use of a gilt rate to discount lease liabilities than anticipated by paragraph 20.52 due to the difficulties in identifying an obtainable borrowing rate.

However, the joint SORP-making body notes that as gilts are a relatively low-risk investment, a gilt rate is likely to be lower than the incremental borrowing rate on a lease, or an entity's obtainable borrowing rate. Use of a gilt rate to discount the lease liability is therefore likely to overstate the liability and understate the interest recognised on the lease liability. As a result, the joint SORP-making body supports the use of the rate implicit in the lease or the entity's obtainable borrowing rate over the use of a gilt rate to discount a lease liability wherever possible. It would be useful to give some indication in FRS 102 of the circumstances under which the relevant rate should be used (or provide accompanying guidance).

The joint SORP-making body notes that as there is a range of gilt rates available, guidance should be produced to support entities in the selection of an appropriate gilt rate.

Question 7: Revenue

FRED 82 proposes to revise the revenue recognition requirements in FRS 102 and FRS 105 to reflect the revenue recognition model from IFRS 15 *Revenue from Contracts with Customers*. The revised requirements are based on the five-step model for revenue recognition in IFRS 15, with simplifications aimed at ensuring the requirements for revenue in FRS 102 and FRS 105 remain cost-effective to apply. Consequential amendments are also proposed to FRS 103 and its accompanying Implementation Guidance for alignment with the principles of the proposed revised Section 23 of FRS 102.

Do you agree with the proposals to revise Section 23 of FRS 102 and Section 18 of FRS 105 to reflect the revenue recognition model from IFRS 15, with simplifications? If not, why not?

Have you identified any further simplifications or additional guidance that you consider would be necessary or beneficial?

The joint SORP-making body accepts that the overall approach to the recognition of revenue from contracts with customers using the 5-step model is likely to better depict revenue recognition and provides the opportunity to enhance accountability and consistency for those transactions. However, we note that some simplifications are offered for micro-entities and would welcome consideration of whether consideration could be given to simplification for small charities.

The joint SORP-making body particularly welcomes the current simplifications, particularly that regarding the use of the word 'promises' rather than 'performance obligations' as this is simpler language which is likely to be more understandable. The joint SORP-making body is also supportive of the other simplifications i.e.

- accounting policy choice for the cost of obtaining a contract
- no requirement to adjust revenue for the time value of money where income is received in advance
- requirements for contract modifications
- allocation of a discount.

However, the joint SORP-making body notes that IFRS 15 *Revenue from Contracts with Customers* allows the time value of money to be ignored when consideration is received 12 months in arrears, but FRED 82 proposes this to be six months or less. This application is possibly a better reflection of the time value of money than that applied to IFRS 15 and might be particularly relevant to smaller entities but may also be more onerous. The joint SORP-making body suggests aligning FRS 102 to IFRS 15 in this respect to avoid a disproportionate reporting burden particularly for smaller entities.

Question 8: Effective date and transitional provisions

The proposed effective date for the amendments set out in FRED 82 is accounting periods beginning on or after 1 January 2025, with early application permitted provided all amendments are applied at the same time. Do you agree with this proposal? If not, why not?

FRED 82 proposes transitional provisions (see paragraphs 1.35 to 1.60 of FRS 102 and paragraph 1.11 of FRS 105).

In respect of leases, FRED 82 proposes to permit an entity to use, as its opening balances, carrying amounts previously determined in accordance with IFRS 16. This is expected to provide a simplification for entities that have previously reported amounts in accordance with IFRS 16 for consolidation purposes, promoting efficiency within groups. Do you agree with this proposal? If not, why not?

Otherwise, FRED 82 proposes to require the calculation of lease liabilities and right-of-use assets on a modified retrospective basis at the date of initial application. Do you agree with this proposal? If not, why not?

In respect of revenue, FRED 82 proposes to permit an entity to apply the revised Section 23 of FRS 102 on a modified retrospective basis with the cumulative effect of initially applying the revised section recognised in the year of initial application. This is expected to ease the burden of applying the new revenue recognition requirements retrospectively by removing the need to restate comparative period information. Unlike IASB/ED/2022/1, to ensure comparability between current and future reporting periods, FRED 82 does not propose to permit the revised Section 23 of FRS 102 to be applied on a prospective basis. However, FRED 82 proposes to require micro-entities to apply the revised Section 18 of FRS 105 on a prospective basis. Do you agree with these proposals? If not, why not?

Do you have any other comments on the transitional provisions proposed in FRED 82?

Have you identified any additional transitional provisions that you consider would be necessary or beneficial? Please provide details and the reasons why.

The joint SORP-making body recognises that the FRED requires transitional provisions on a modified retrospective basis for leases and permits it for revenue recognition which will ease the reporting burden for charities and agrees that these approaches should be specified. It notes that these are akin to the options included for retrospective restatement in the original full IFRS.

The joint SORP-making body is committed to improvement in terms of how the Charities SORP explains the relevant requirements for preparers of accounts and the resulting information provided for readers of charity annual reports and accounts. The extensive stakeholder engagement undertaken by us since the introduction of the new SORP development process has consistently highlighted needs that require an appropriate response. As we have explained above, our view is that significant change is needed to the framework applicable to smaller charities preparing accrued accounts and all steps that can be taken to support this should be taken without delay, recognising that some of the solutions to this are longer term in nature.

That said implementation of the changes currently proposed by FRED 82 is likely to present significant challenges for some reporting entities to assess how they might be applied. We emphasise this point in relation to the proposed changes relating to leasing and revenue. From our experience and stakeholder feedback we know that many entities in our sector refer to the SORP as the source document when preparing their reports and accounts. Our view is that successful implementation will require collective effort. In preparation for the changes, proactive early engagement from the FRC, the accountancy profession and sector advisory bodies will be necessary.

Information to support this early engagement will be available from the FRC with the publication of the new standard no less than 12 months prior to the effective date. For charities, the process of consulting on the new SORP will provide further understanding of intended specific changes for charities. The opportunities provided as a result of all of this information being in the public domain need to be capitalised on. Based on the current timetable the joint SORP-making body would anticipate publishing an updated SORP in Autumn 2024.

The SORP-making body would recommend that this engagement commences as soon as the standard is issued. It would not be feasible for the joint SORP-making body alone to be responsible for developing guidance, training materials and examples and responding to queries to support correct understanding of the changes in the standard and the resulting reporting requirements. This proactive collective effort would help support successful implementation, getting upstream with necessary preparatory work ahead of the SORP being published. Without this collective effort the sector may not be abreast of the changes ahead of the SORP being published in Autumn 2024 which would present readiness and implementation challenges.

Annex A provides data on the number of charities split by income bands and jurisdiction. This data shows that a minimum of 49,000 charities will be applying FRS102. As 99% of the entities in our sector are small in terms of company reporting thresholds, they may not be familiar with IFRS so the concepts may be new to them, and they will likely require more support to understand and implement the changes than larger entities who may have awareness of IFRS.

The joint SORP-making body would also encourage the FRC to commit to the development of comprehensive application guidance covering areas of significant change to support a transition that is as straightforward as possible and results in consistent application.

Question 9: Other Comments

Do you have any other comments on the proposed amendments set out in FRED 82?

9.1 Availability of reliable measurements for donated good and facilities

The joint SORP-making body welcomes the inclusion of the example of practical difficulties faced by charities that receive donations of a high volume of low value second-hand goods for resale in paragraph PBE34.70 and anticipates that this amendment will assist relevant charities in the production of high-quality financial information. It also notes that paragraph PBE34.69A states that “*Resources that can usually be measured reliably include donations of cash or goods, facilities such as free use of office accommodation or event space, and services usually provided by an individual or an entity as part of their trade or profession for a fee.*” While the joint SORP-making body is of the view that as described these resources appear to be able to be measured reliably, it considers that there are circumstances where this would not be the case. For example:

- facilities provided to charities may not be comparable to those available to other market participants, e.g. the condition is below that that would be acceptable if the facilities were paid for at market rates, or conditions are attached to the use of the facilities that affect the value of the donation.
- donated goods may be of a condition that affects the fair value, e.g. donations of food close to its use-by date, donations of used items of clothing, toys and games. Where these goods are for use in the charity or for onward distribution rather than for resale, the charity will face difficulties measuring the donation reliably.

The joint SORP-making body is also of the view that where donations of goods for onward distribution or use within the charity are received frequently, and/or donations consist of frequent small volumes of goods of various nature (for example, donations of different types or brands of goods such as the wide variety of small donations that are made to food banks, donations of toiletries, toys and games to shelters for use by beneficiaries), there can be difficulty in measuring these such that the benefits of reliable measurement are likely to outweighed by the costs of achieving such measurements. This is particularly the case for small charities.

The joint SORP-making body is therefore concerned that the use of “usually” in paragraph PBE34.69A may lead to application issues for charities where there are difficulties outlined above. The joint SORP-making body is of the view that:

- 1) more guidance, and
- 2) consideration of measurement on a cost benefit basis

should be included in this paragraph.

For example, paragraph PBE34.69A might usefully differentiate between large donations of homogenous goods, such as the donation of several pallets of identical food items to a food bank which likely can be measured reliably, and small donations of various food items to the food bank for which the costs of measurement are likely to exceed the benefits of the information to the users of the financial statements. The joint SORP-making body would be happy to discuss the drafting and application of this paragraph to public benefit entities with the FRC.

9.2 Value to the charity

The joint SORP-making body notes the insertion of paragraphs PBE34.73A and PBE34.73B into section 34 via the FRED. The joint SORP-making body welcomes amendments to clarify the measurement requirements where a charity is in receipt of a premium service but would otherwise have only paid for a standard service or would not have paid for the service. The joint SORP-making body is of the view that that this clarification will support consistency of income measurement across the charities sector and for public benefit entities more widely.

The joint SORP-making body questions why paragraph PBE34.73(a) does not also apply to goods donated to the charity. For example, the joint SORP-making body is aware of a charity that receives donations of tents for use by its beneficiaries. Donations can include premium items. However, if the charity was acquiring item such as the tents, the charity would buy affordable rather than premium versions. Allowing charities to measure donations of services and facilities, but not goods, at value to the charity risks creating inconsistencies in the charity's financial statements where in substance the transaction is the same.

PBE34.73A and PBE34.73B refer to the 'open market'. The joint SORP-making body notes that the term "open market" is not defined in FRS 102 and is only used once in FRS 102 outside the PBE section on incoming resources from non-exchange transactions. While the joint SORP-making body acknowledges that the term "open market" is likely to be understandable to charities and acknowledges that there is a cross-reference to Section 2A *Fair Value Measurement* in paragraph PBE34.73B, the joint SORP-making body is of the view that the paragraphs could be updated to avoid the use of terminology that does not appear elsewhere in FRS 102 and reword them consistently with the definition of fair value. For example, the first two sentences of PBE34.73B could be amended as follows:

"The fair value of resources received, or receivable is usually the price that the entity would have paid ~~on the open market~~ for a similar resource. When there is no direct evidence of ~~an open market~~ the fair value for of a similar resource a value may be derived from sources such as: ..."

9.3 Disclosures for Non-Exchange Transactions

The joint SORP-making body notes the amendment to paragraph PBE34.74(c) i.e. the addition referring to "the indication of other forms of non-exchange transactions from which an entity has benefited, for example, unrecognised volunteer services, or donated goods that have been received but which the entity does not expect to recognise until the goods are sold or distributed".

Although the descriptions of volunteer services which have not been recognised may be useful to the users of the accounts (indeed the joint SORP-making body is already considering a similar disclosure), it would be helpful if FRS 102 is clear that the "indication" of the donated goods that have been received but which the entity does not expect to recognise until the goods are sold or distributed should be a narrative description rather than a quantitative amount to avoid losing the benefit of the practicability test offered by paragraph PBE34.70.

9.4 Income from Legacies

The SMB notes paragraph PBE34.70A with respect to income recognition from legacies. As part of its ongoing work to update the Charities SORP, the SMB and the Charities SORP Committee has conducted engagement activities with a range of stakeholders including technical experts, funders and representatives of charities of a range of sizes. As accounting for income from legacies is a complex area, a key finding from this engagement activity was that requirements for recognising income from legacies in the Charities SORP could be enhanced to ensure the understandability of the requirements.

The SMB would welcome the opportunity to further develop content on legacies for inclusion in FRS 102 with the FRC.

Question 10: Consultation stage impact assessment

Do you have any comments on the consultation stage impact assessment, including those relating to assumptions, sources of relevant data, and the costs and benefits that have been identified and assessed? Please provide evidence to support your views.

In particular, feedback is invited on the assumptions used for quantifying costs under each of the proposed options (Section 3 of the consultation stage impact assessment); any evidence which might help the FRC quantify the benefits identified or any benefit which might arise from the options proposed which the FRC has not identified (Section 4 of the consultation stage impact assessment); and appropriate data sources to use to refine the assumption of the prevalence of leases by entity size (Table 23 of the consultation stage impact assessment).

The joint SORP-making body has outlined its views on the impact of FRS 102 on charities above, in section 1 of this response.

The joint SORP-making body has no further comments to make on the consultation stage impact assessment.

Annexe A: Total number of charities in income bands

	Charity Commission for England and Wales	Office of the Scottish Charity Regulator	The Charity Commission for Northern Ireland *	Charities Regulator for Republic of Ireland	TOTAL	Cumulative % of total charities
Income of £250,000 and under:						
Company	18,437	2,302	N/a	2,538		
Non-company	121,667	18,648	N/a	2,000		
TOTAL	140,104	20,950	5,545	4,538	171,137	87%
Income between £250,001 and £500,000:						
Company	3,770	574	N/a	683		
Non-company	3,866	464	N/a	116		
TOTAL	7,636	1,038	353	799	9,826	92%
Income between £500,001 and £632,000						
Company	1,097	125	N/a	235		
Non-company	793	61	N/a	29		
TOTAL	1,890	186	80	264	2,420	93%
Income between £632,001 and £1,000,000:						
Company	1,951	241	N/a	362		
Non-company	1,071	109	N/a	45		
TOTAL	3,022	350	126	407	3,905	95%
Income between £1,000,001 and £10,200,000:						
Company	5,077	509	N/a	646		
Non-company	1,516	195	N/a	169		
TOTAL	6,593	704	211	815	8,323	99%
Income more than £10,200,000:						
Company	1,027	98	N/a	99		
Non-company	355	31	N/a	88		
TOTAL	1,382	129	30	187	1,728	100%
Total number of charities	160,627	23,357	6,345	7,010	197,339	

* Granular information not available