



TRUSTEES' SHORT GUIDE SERIES

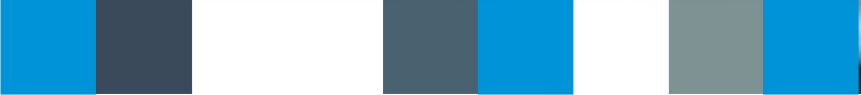
Income recognition SORP 2026 – accounting for exchange transactions.

Basic charity governance
and accounting.

October 2026



pem.



Income may be received either on an exchange or non-exchange basis depending on whether the giver of the income is receiving something of equal value in the arrangement. Where the income is an exchange transaction it must be accounted for under the new five step revenue model introduced by FRS 102 to align UK Accounting Standards with International Standards (IFRS).

The five step model

For exchange agreements, contracts such as service delivery and membership, the five step model is the appropriate approach under FRS 102 and SORP 2026.

Step 1: Identify the presence of a contract with a third party

As discussed in the separate *PEM Guide to Income recognition SORP 2026 – identifying exchange and non-exchange transactions*, identifying whether there is a contract or whether the income comes from a non-exchange transaction is the key starting point.

A contract is an agreement between two or more parties that creates enforceable rights and obligations. This can take many forms, from a verbal undertaking to a documented formal contract.

Where a contract is modified or varied, the changes will either require recognition of a new contract, if the remaining goods and services to be delivered can be considered separate and distinct from what has been recognised previously; or the changes will be recognised as an adjustment to income, the progress towards completion of the contract will be reassessed based on the new terms, such as the length of the contract, price, or number of goods or services to be delivered.

Step 2: Identify the performance obligations in the contract

A performance obligation is the promise to transfer to the customer, member, donor either:

- A distinct good or service (or bundle of goods and services)
- A series of distinct goods and services that are substantially the same and have the same pattern of transfer to the third party (for example regular monthly services).

To be distinct the third party must be able to benefit from the good or service on its own and it must be separate from other promises in the contract. It can be complex to identify the performance obligations and whether they are distinct or combined as a bundle. Options, upfront fees and other elements can require distinct treatment, which is likely to be different from the current approach.

Further the approach to considering whether a party is agent or principal, previous based on the balance of risks and rewards, is now focussed on control.

Step 3: Determine the transaction price

The transaction price is typically straightforward, but may include some variable amounts, such as discounts or performance bonuses. In most cases the variable amount will be accounted for as the most likely amount, all or nothing, however if there are a large number of similar contracts then the expected value is calculated.

Step 4: Allocate the transaction price to the performance obligations

Where a contract includes a number of performance obligations that have separate standalone prices, the calculation is relatively simple. However, where there are no separate standalone prices, the price of the individual performance obligations must be estimated. The SORP identifies three suitable methods:

Adjusted market assessment approach – an estimate of the price a third party would pay in the market.

Expected cost plus a margin approach – expected forecast costs plus an appropriate margin.

Residual approach – this approach is considered to be rarely appropriate and only used where the above two methods are not practicable. In this case the price for the performance obligation which does not have a standalone price/estimated price is based on the total transaction costs less other identified prices.

Any discounts should be spread across all performance obligations unless there is a fairer allocation. Variable payments should also be allocated unless they are specifically related to certain performance obligations.

Step 5: Recognise income at a point in time or over time

As noted above with the agent vs principal decisions, the key factor in the new approach is control. Charities must identify when control of the goods or services is passed to the customer/recipient. A performance obligation is recognised over time where:

- The benefits are consumed as the charity performs; or where the charity's work carried out to date would not need to be reformed if another entity were to complete the remainder of the contract.
- The charity's performance creates or enhances an asset controlled by the third party as the asset is created or enhanced.
- The charity has the right to be compensated for the work carried out to date.



If a contract is not satisfied over time, it will be at a point in time. Indicators of whether control passes include:

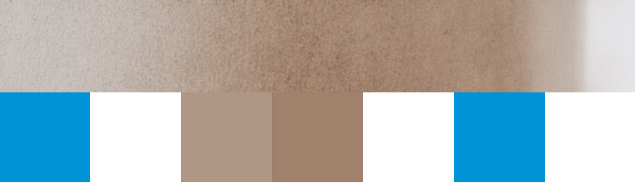
- The charity has right to payment
- The third party has legal title
- The third party has physical possession
- The third party has the significant risks and rewards of ownership
- The third party has accepted the asset.

Where a performance obligation is recognised over time, the amount of the allocated price recognised will be calculated by measuring the progress towards complete satisfaction of that performance obligation. Methods of measuring progress include:

- **Output methods** – based on surveys of work completed, units delivered or time elapsed
- **Input methods** – based on time elapsed, costs incurred or labour hours extended.

The method should be the best representation of the transfer of control. If a charity is at the early stages of a contract and cannot reasonably measure its progress, but expects to be able to recover its costs; it can recognise income to the extent of the costs incurred.

Income received in advance of satisfaction of the performance obligation should be deferred.



Restrictions/Unrestricted

Typically income from exchange contracts is unrestricted. As the funds are earned/not a gift, there are no trust law restrictions. If a contractor requires unused funds to be returned or any surplus to be spent for a particular purpose then the income may be regarded as restricted.

Other exchange transactions

Membership

Membership may be an exchange transaction or akin to a donation and classified as a non-exchange transaction depending on the membership arrangements. Where membership includes an exchange transaction it must be linked to how member benefits are drawn down. The SORP gives the example of an annual member pass for an attraction which may be allocated straight-line for example, where the charity cannot predict how frequently a member will visit.

Royalties

Depending on the terms of the agreement, these may be recognised either at a point or points in time or over time.

Long term contracts

Again depending on the contract, the performance obligations may be satisfied at a point or points in time or over time. The charity will need to establish its method for measuring progress. Any upfront fee payable is normally deferred and recognised on the same basis as the goods and services. Contract costs, which are not recognised as an expense, can be capitalised and recognised on the same basis as the contract. These costs are ones which would not have been incurred by the charity if the contract had not been obtained and are expected to be recovered from the third party.

Practical expedients and transition

Transition from existing practice to FRS 102 and SORP (2026) can be made following two separate methods. Either the modified retrospective approach or the fully retrospective approach. Charities, as with other entities, must refer to FRS 102 for guidance on initial transition.

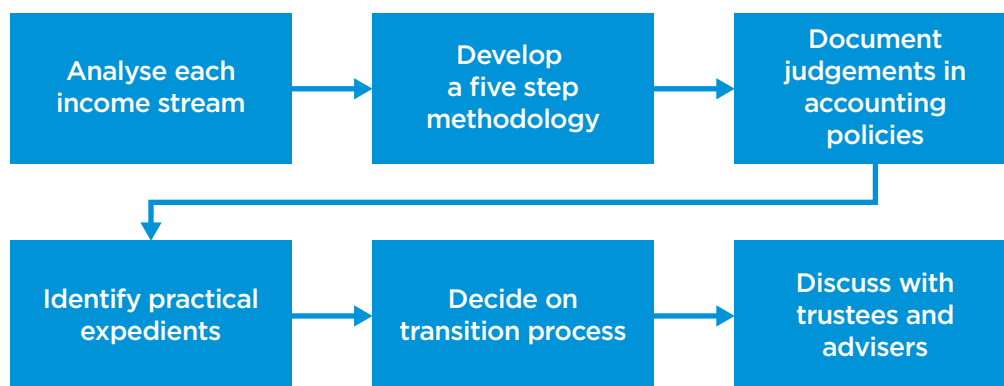
The first transition step is to identify those contracts which require review and recalculation. If a contract was started and completed in the same annual period then it does not require any restatement. For other contracts the timing of the of review will depend on the approach.

The modified retrospective approach means that no adjustment is made to the prior year comparatives and that the impact of all changes is shown as an adjustment to opening balances. In this case, if a contract was completed before initial application, it does not require restatement. For example, for a December year end, this would mean contracts completed before 1 January 2026 do not require restatement. This approach may result in non-comparability between years.

Alternatively, the fully retrospective approach requires the restatement of the prior period as if the standard has always been applied. In this case, if a contract was completed before the start of the earliest period presented, it does not require restatement. For example, for a December year end, this would mean contracts completed before 1 January 2025 would not require restatement. This may mean that considerably more contracts are captured for restatement.

Next steps

The key to applying the correct treatment is understanding the nuances of the charity's arrangements. Trustees and management should start with each separately identified income stream.



During an audit or independent examination, management would be expected to be able to explain and justify their judgments over their income recognition process and for the first year the transition adjustments.

Trustees should consider the implications for accounting and reporting with their advisers or please contact any member of our Charities & Not-for-Profit team.

Further reading

- [Charities SORP 2026](#)
- [FRS 102 \(2024 Edition\)](#)
- [FRS 102 Factsheet 10 Revenue from Contracts with Customers](#)
- [PEM Guide Income recognition SORP 2026 – identifying exchange and non-exchange transactions](#)
- [PEM Guide Reporting requirements by type of charity](#)

Your Charities & Non-profit team

Audit and accounts



Kelly Bretherick
Partner, Audit
e. kbretherick@pem.co.uk



Michael Hewett
Partner, Audit
e. mhewett@pem.co.uk



Nikki Loan
Partner, Audit
e. nloan@pem.co.uk



Grace Quist-Therson
Director, Audit
e. gquist-therson@pem.co.uk



James Rayson
Director, Audit
e. jrayson@pem.co.uk



Gemma Baratte
Senior Manager, Audit
e. gbaratte@pem.co.uk



Andrew Turpin
Partner, VFO
e. aturpin@pem.co.uk



Melissa Guenigault
Manager, VFO
e. mguenigault@pem.co.uk

Tax and VAT



Kate Millard
Director, Employment Tax
e. kmillard@pem.co.uk



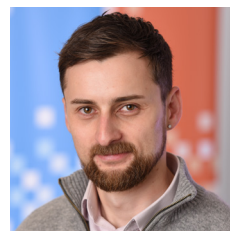
Judith Pederzolli
Director, Business Tax & SDLT
e. jpederzolli@pem.co.uk



Robert Plumbly
Director, VAT
e. rplumbly@pem.co.uk



Michelle Harris
Assistant Director, VAT
e. mharris@pem.co.uk



Edward Spanner
Manager, Accounts
e. espanner@pem.co.uk



David Widdowson
Assistant Manager, Accounts
e. dwiddowson@pem.co.uk

Outsourcing: Virtual Finance Office (VFO)

Independent examination

PEM

Salisbury House

Station Road

Cambridge CB1 2LA

t. 01223 728222

e. pem@pem.co.uk



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