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CHANGES TO FRS 102: LEASE ACCOUNTING FOR LESSEES

GUIDANCE FOR COMPANIES

AUGUST 2025

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REFERENCES

- ACCA - technical factsheet - Lease accounting under FRS 102
- FRS 102 2024 edition
- FRC Fact sheet 11 – lease accounting for lessees

INTRODUCTION AND OVERVIEW

Following the Financial Reporting Council (FRC)'s periodic review of FRS102 in 2024, Section 20 of FRS102 "Leases" has been effectively rewritten, impacting the way leases are to be accounted for.

The changes are based on the principles of IFRS 16 Leases and is intended to bring the FRS102 standards in line with the international standards.

The new requirements become mandatory for accounting periods commencing on or after 1 January 2026. Early adoption is permissible, provided that all the periodic review amendments are applied at the same time.

The purpose of this document is to act as a guide to assist our clients in understanding and applying the changes as required, where applicable.

This guide will cover the following key areas:

- Who will likely be impacted by the changes.
- The key definitions and characteristics of leases which will be affected by the changes.
- Key considerations impacting the treatment of leases.
- How to account for leases under the new requirements at transition.

While this guide is intended to provide an overview to companies to assist with the accounting for leases under the new FRS102 requirements, we encourage any companies with complex or unusual agreements or matters outside of the norm to reach out to their Duncan & Toplis contact should they wish to discuss further. These matters could include, but are not limited to, rolling leases, contracts with multiple components, intra-group arrangements and lease modifications.

WHO WILL BE IMPACTED?

The recognition, measurement and presentation requirements of the revised Section 20 are applicable to **all entities applying FRS 102, including** those that are in scope of **Section 1A Small Entities**.

Micro-entities preparing financial statements under **FRS 105**, The Financial Reporting Standard applicable to the Micro-entities Regime are **unaffected** by the new lease accounting requirements.

The new changes apply to lessees. Whilst the lessor requirements have also been rewritten, in many cases the accounting under the new requirements will not differ significantly from that under the previous requirements, with the exception of sub leases which should be considered individually in line with FRS102 Para 20.92.

WHAT DEFINES A LEASE?

A lease is defined as “a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration”.

For a contract to be recognised as a lease, there must be an underlying asset.

Under the new recognition and measurement principles, a lessee does not distinguish between a finance lease and an operating lease.

Therefore, there will be minimal (if any) changes in the accounting for finance leases, but significant changes for operating leases.

The revised requirement requires a lessee to recognise all leases on-balance sheet, subject to the following exemptions:

SHORT TERM LEASES

The FRC has included a new definition of a ‘short-term lease’ which is:

“A lease that, at the commencement date* has a lease term of 12 months or less. A lease that contains a purchase option is not a short-term lease.”

This recognition exemption must be applied by class of underlying asset.

LEASES FOR WHICH THE UNDERLYING ASSET IS OF LOW VALUE

FRS102 Section 20 does not specify a particular value threshold. Instead, it provides a list of examples of asset types that are not of low value.

Per FRS102 Para 20.11 The following are examples of underlying assets that **would not be of low value**:

- cars, vans, buses, coaches, trams, trucks and lorries;
- cranes, excavators, loaders and bulldozers;
- telehandlers and forklifts;
- tractors, harvesters and related attachments;
- boats and ships;
- railway rolling stock;
- aircraft and aero engines;
- land and buildings; and
- production line equipment

It should be noted that this is not a comprehensive list, and professional judgement will be needed to assess what is, and what is not, low value. If you are not sure whether an asset should or should not be considered low value, we encourage you to reach out to your Duncan & Toplis contact to discuss further.

Examples of assets which would be considered low value would be:

- Laptop computers
- Desktop computers
- Tablets
- Small items of office furniture
- Mobile telephone

Leases of low-value assets qualify for off-balance sheet recognition regardless of whether those leases are material to the lessee.

In addition, paragraph 20.9 clarifies that the value of lease payments has no bearing on the assessment of whether an underlying asset is of low value.

*Commencement date of a lease is defined by FRS102 as: “The date on which a lessor makes an underlying asset available for use by a lessee.”

ACCOUNTING TREATMENT OF LEASES UNDER FRS102 - TRANSITION

Upon the transition to the new FRS102 requirement, a “cumulative catch-up” approach **must** be taken.

FRS 102, para 1.47 states:

“A lessee shall not restate comparative information. Instead, it shall recognise the cumulative effect of initially applying the Periodic Review 2024 amendments to Section 20 as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application.”

Prior-year adjustments must not be carried out on initial application of the new lease accounting provisions. FRS 102, para 1.51(a) states that the lessee shall recognise a lease liability at the date of initial application at the present value of the remaining lease payments, discounted using:

- (a) the lessee’s incremental borrowing rate or
- (b) the lessee’s obtainable borrowing rate.

The ‘lessee’s incremental borrowing rate’ is defined as:

- 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.

The ‘lessee’s obtainable borrowing rate’ is defined as:

- 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.

Should you have any questions or require further guidance or assistance as to how to discount the net present value of remaining lease payments, we encourage you to reach out to your Duncan & Toplis contact to discuss further.

CONCLUSION

As can be seen, if you currently have a significant number of, or more complex or unusual, operating leases, a significant amount of work will need to be done to ensure that the first set of financial statements following transition to the revised FRS 102 are accurately presented.

Should you require assistance or support to ensure that there is a smooth transition, we encourage you to reach out to your Duncan & Toplis contact to discuss what our Specialist Technical Financial Reporting Team can do to assist with this process.

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