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# CHANGES TO FRS 102: REVENUE FROM CONTRACTS WITH CUSTOMERS

**GUIDANCE FOR COMPANIES**

**AUGUST 2025**

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## REFERENCES

- FRS 102 2024 edition
- FRS 102 amendments – ICAEW revenue recognition
- FRC Fact sheet 10 – Revenue from contracts with customers

## INTRODUCTION AND OVERVIEW

Following the Financial Reporting Council (FRC)'s periodic review of FRS102 in 2024, Section 23 of FRS102 "Revenue from Contracts with Customers" has been effectively rewritten, impacting the way in which revenue from contracts will be accounted for.

The changes are 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:

- What constitutes a contract with a customer.
- The new "five-step process" for recognising revenue from contracts with customers.
- The accounting treatment options at transition.
- Other key considerations when accounting for revenue from contracts for customers.

## WHAT DEFINES A CONTRACT?

Under FRS102, a contract is defined as “An agreement between two or more parties that creates enforceable rights and obligations.”

**Simply put, section 23 applies to all contracts with customers.**

This is subject to a few exceptions, as follows:

- a) Lease contracts – these fall within the scope of Section 20 Leases
- b) Contracts within the scope of FRS 103 Insurance Contracts
- c) Financial instruments and other contractual rights or obligations within the scope of Section 9 Consolidated and Separate Financial Statements, Section 11 Basic Financial Instruments, Section 12 Other Financial Instruments Issues, Section 14 Investments in Associates and Section 15 Joint Arrangements
- d) Non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers
- e) Incoming resources from non-exchange transactions for public benefit entities.

A contract with a customer may be partially within the scope of Section 23 and partially within the scope of other sections (e.g. a lease contract that includes the provision of services).

Should you have any questions in respect of this, please reach out to your Duncan & Toplis contact in the first instance.

# REVENUE: A NEW FIVE-STEP MODEL

## What's changing

FRS 102 will adopt a five-step revenue recognition model, aligned with international standards.

The five steps are as follows:

- 1) Identify the contract with a customer.
- 2) Identify performance obligations.
- 3) Determine the transaction price.
- 4) Allocate the price to performance obligations.
- 5) Revenue is then recognised when (or as) obligations are satisfied.

# STEP ONE – IDENTIFY THE CONTRACTS WITH A CUSTOMER

The first step is to identify contracts that are within the scope of the five-step model. To do so, the entity must ensure that the contract meets the criteria of FRS102 paragraph 23.7, namely:

- a) the parties to the contract have approved the contract and are committed to perform their respective obligations;
- b) the entity can identify each party's rights regarding the goods or services to be transferred.
- c) the entity can identify the payment terms for the goods or services to be transferred.
- d) the contract has commercial substance; and
- e) it is probable that the customer will have the ability and intention to pay the consideration to which the entity will be entitled when it is due.

## Contracts not meeting the criteria

A customer might pay in advance of a contract meeting the criteria set out in paragraph 23.7 (above). If that happens, the entity recognises any consideration received as a liability until those criteria are met.

If a contract never meets the criteria, the entity recognises the consideration received as revenue when the criteria in FRS102 paragraph 23.10 are met. Broadly, these require the contract to be finished or terminated and the amounts received to be non-refundable.

## Combining contracts

Contracts entered into at or near the same time with the same customer (or related parties of the customer) are accounted for as a single contract if:

- a) the contracts are negotiated as a package with a single commercial objective
- b) the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
- c) the goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation.

## Contract modification

Contract modifications can be a complex area to account for. Further worked examples are available within FRS 102 and through further guidance from both the ICAEW and the FRC.

Please reach out to your Duncan & Toplis contact in the first instance should you wish to discuss further.

## STEP TWO – IDENTIFY THE PERFORMANCE OBLIGATIONS IN THE CONTRACT

A performance obligation is a promise to transfer distinct goods or services to the customer.

Many contracts will have a single performance obligation. However, when a contract has more than one performance obligation, the subsequent steps of the revenue recognition model ensure that the revenue associated with each performance obligation is recognised at the appropriate time.

Generally, the contract explicitly states the goods or services that an entity promises to transfer. However, in some circumstances, promises may be implied by an entity's customary business practices, published policies or specific statements.

There are no restrictions on the goods or services that an entity might promise in a contract with a customer.

A performance obligation may be a distinct good or service, a distinct bundle of goods or services, or a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Paragraphs 23.21 to 23.25 of FRS102 set out how an entity determines if a good or service is distinct, which is the case when both the following criteria are met:

- a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e. the good or service is capable of being distinct); and
- b) the entity's promise to transfer the good or service is separate from other promises in the contract.

The assessment is not always straightforward, and we encourage you to reach out to your Duncan & Toplis contact if you wish to discuss further.

If a good or service is not distinct, the entity combines it with other goods or services to identify a distinct bundle of goods or services. In some cases, the distinct bundle contains all the goods or services in a contract (and so the contract contains a single performance obligation).

## STEP THREE – DETERMINE THE TRANSACTION PRICE

The transaction price is the amount that will be recognised as revenue: it is the amount of consideration to which the entity expects to be entitled in exchange for transferring goods or services promised to a customer, excluding amounts collected on behalf of third parties (e.g. some sales taxes).

### Variable consideration

The consideration promised in a contract may include a variable amount (for example, because of some discounts, rebates, refunds, penalties or performance bonuses).

Where this is the case, the entity shall estimate the variable amount in the transaction price and update that estimate at the end of each reporting period.

There are two steps to estimating variable consideration:

- 1) An entity shall first estimate the 'expected value' or 'most likely amount' of variable consideration, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled.
- 2) That estimate shall only be included in the transaction price to the extent that it is highly probable that the entity will be entitled to the cumulative amount of revenue recognised when the uncertainty associated with the variable consideration is subsequently resolved (sometimes referred to as the 'variable consideration constraint').

The estimate is not always straightforward, and we encourage you to reach out to your Duncan & Toplis contact if you wish to discuss further.

## STEP FOUR – ALLOCATE THE TRANSACTION PRICE TO THE PERFORMANCE OBLIGATIONS IN THE CONTRACT

Step four requires the entity to allocate the transaction price determined in step three to the obligations identified in step two.

If a contract contains a single performance obligation, or if all performance obligations in a contract are satisfied at the same point in time; the entity does not usually need to allocate the transaction price, because any allocation would make no difference to the accounting outcome.

### Allocation based on stand-alone selling prices

Allocation is based on the stand-alone selling price of each good or service. The stand-alone selling price is the price at which an entity would sell a good or service promised in a contract separately to a customer.

An entity shall determine the stand-alone selling price at contract inception of the distinct good or service underlying each performance obligation in the contract.

The transaction price is allocated in proportion to those stand-alone selling prices. Any discount or variable consideration is, generally, also allocated to all the performance obligations on a relative stand-alone selling price basis.

### If the stand-alone selling price is not directly observable

If a stand-alone selling price for a good or service is not directly observable, an entity should use a suitable method to estimate it, taking into account all information that is reasonably available to the entity and applying estimation methods consistently in similar circumstances. For example:

- Adjusted market assessment approach – an entity estimates the price that a customer in the market would be willing to pay for the good or service.
- Expected cost plus margin approach – an entity forecasts its expected costs and adds an appropriate margin.
- Residual approach – an entity subtracts the stand-alone selling prices of all the other goods or services from the total transaction price, leaving a balancing figure. This is only permissible when the stand-alone selling price of the good or service is highly variable or uncertain.

Step four also considers several additional considerations:

- a) estimating the stand-alone selling price for a customer's option (material right) to acquire additional goods or services;
- b) allocating a discount or variable consideration when the method described above does not depict the amount of consideration to which the entity expects to be entitled; and
- c) allocating changes in the transaction price, including changes in variable consideration.

Again, these allocations and estimates may not be straightforward, so we encourage you to reach out to your Duncan & Toplis contact if you wish to discuss further.

## STEP FIVE – RECOGNISE REVENUE WHEN (OR AS) THE ENTITY SATISFIES A PERFORMANCE OBLIGATION

At step five, the entity should recognise as revenue the transaction price allocated to each performance obligation at step four when, or as, the entity satisfies that performance obligation.

Performance obligations are satisfied by transferring the promised goods or services to the customer. The approach applied is decided based on how the customer obtains control of that good or service, which occurs either over a period of time or at a point in time. The approach taken for each performance obligation is decided at contract inception.

**This is a vital point to reiterate, that revenue is recognised either at a point in time, or over a period of time.**

### Performance obligations satisfied over time

An entity transfers control of a good or service over time if:

- a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs;
- b) the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
- c) the entity's performance does not create an asset with alternative use to the entity and the entity has an enforceable right to payment for performance completed to date

An entity recognises revenue over time by measuring, at the end of each reporting period, its progress towards complete satisfaction of that performance obligation.

An entity determines an appropriate single method of measuring progress for each performance obligation, such as:

- a) an output method, such as surveys of work completed, or counts of units delivered; or
- b) an input method, such as measures of time elapsed or of costs incurred.

### Performance obligations satisfied at a point in time

Quite simply, if a performance obligation is not satisfied over time, it is satisfied at a point in time.

To determine the point in time at which a customer obtains control of a promised asset, an entity considers indicators of the transfer of control, which include but are not limited to:

- a) the entity has a present right to payment for the asset;
- b) the customer has legal title to the asset;
- c) the customer has physical possession of the asset;
- d) the customer has the significant risks and rewards of ownership of the asset; and
- e) the customer has accepted the asset.

## Licensing

A licence establishes a customer's rights to the intellectual property of an entity. If a promise to grant a licence is a performance obligation, to determine whether that performance obligation is satisfied over time or at a point in time, an entity shall consider whether the nature of the entity's promise in granting the licence provides the customer with:

- a) a right to access the entity's intellectual property as it exists throughout the licence period, in which case the promise to grant the licence is satisfied over time; or
- b) a right to use the entity's intellectual property as it exists at the point in time at which the licence is granted, in which case the promise to grant the licence is satisfied at a point in time

## Other

Section 23 also contains detailed requirements relating to the following situations:

- a) bill and hold arrangements;
- b) consignment arrangements;
- c) customer acceptance clauses; and
- d) repurchase agreements

Should your company be impacted by any of these situations, and you wish to discuss further, please reach out to your Duncan & Toplis contact.

## CONCLUSION

As can be seen from the above transitioning to the revised requirements can prove to be a complex exercise. Therefore, it is recommended you:

- Consider the specific implications for your company at the earliest opportunity.
- Ensure you fully understand the implications.
- Consider speaking to your Duncan & Toplis contact to find out how our Specialist Technical Financial Reporting Team can help if required.

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