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FRS 102 Lease Accounting Changes

Under the revised FRS 102, accounting periods beginning on or after 1 January 2026, leases move to a predominantly on-balance sheet model, bringing many leases on to the balance sheet as a right-of-use asset with a corresponding lease liability.

What's changing?

The Financial Reporting Council has introduced significant changes to lease accounting under FRS 102.

For leases, the distinction between operating leases and finance leases is largely removed. Instead, most leases will be recognised on the balance sheet through:

- A Right-of-Use (RoU) Asset
- A corresponding Lease Liability

This brings FRS 102 closer to IFRS 16, although important simplifications remain.

Why does it matter?

Many organisations currently expense operating lease payments as they arise.

Under the new model, lease commitments will generally appear on the balance sheet, resulting in:

- Increased assets
- Increased liabilities
- Increased EBITDA
- Increased reported debt

Potential impacts include banking covenants, performance measures, bonus arrangements and stakeholder reporting.

Step 1 - Identify a lease

A contract contains a lease when it:

- Relates to an identified asset
- Gives the customer control over its use
- Provides substantially all economic benefits from that asset

Common examples include property, vehicle and equipment leases.

Step 2 - Determine the lease term

The lease term includes:

- The non-cancellable period
- Extension periods reasonably certain to be exercised
- Periods where termination options are reasonably certain not to be exercised

Step 3 - Consider available exemptions

Short-term leases:

- Lease term of 12 months or less
- No purchase option

Low-value assets may include:

- Laptops
- Tablets
- Mobile phones
- Small office furniture

Buildings, vehicles and production equipment are unlikely to qualify.

How is the accounting calculated?

Lease Liability

Initially measured as the present value of future lease payments including fixed payments, indexed payments, residual value guarantees and certain purchase options.

Right-of-Use Asset

Initially measured as:

- Lease liability
- Plus initial direct costs
- Plus restoration obligations
- Less lease incentives

The asset is subsequently depreciated over the lease term.

Transition to the new standard

A modified retrospective approach is required:

- Comparatives are not restated
- Existing leases are assessed on transition
- Opening reserves are adjusted on adoption

Practical actions before year-end

- Compile a complete lease register
- Identify contracts containing leases
- Assess impact on EBITDA, net debt and covenants
- Review systems and processes
- Brief management, lenders and investors

Early preparation will help ensure a smooth transition.

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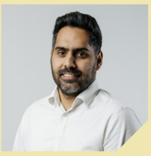

Ranvir Cheema
Director
T +44 20 7396 4348
E rcheema@haysmac.com

10 Queen Street Place
London EC4R 1AG

T 020 7969 5500
E marketing@haysmac.com

haysmac.com