



January 2026

FRS 102 factsheet – Periodic Review 2024 Leases

The Periodic Review 2024 amendments to FRS 102 are applicable for accounting periods beginning on or after 1 January 2026. Early application is permitted, provided that all amendments are applied at the same time.

Note that amendments in respect of supplied finance arrangements published at the same time are applicable from 1 January 2025.

Summary

Changes to lease accounting for lessees will remove the distinction between operating and finance leases for lessees and brings UK GAAP in line with international standards. This will result in leases being brought on balance sheet as a right-of-use asset and replacing a straight-line operating lease expense with depreciation and interest. This represents a fundamental shift that will affect a wide range of businesses, as most entities hold at least one lease (usually premises).

Some exemptions apply for short-term leases and low-value assets and there are practical expedients to ease the transition. There is no option of restating comparatives on transition but rather the cumulative effect of initial application is recognised as an adjustment to the opening balance of retained earnings. This may make the first set of financial statements under the new regime look unusual.

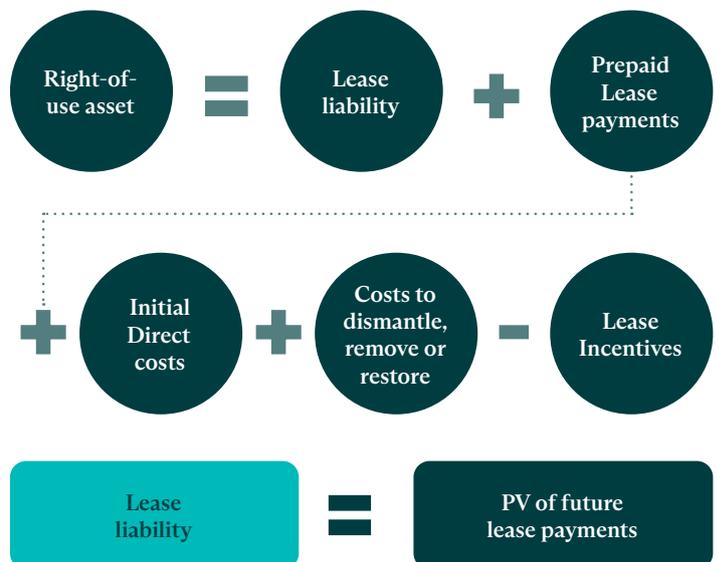
Revised accounting

Under the amendments to FRS 102, the accounting for leases as lessee will follow a right-of-use asset model which requires the following:

- Recognition of a right-of-use asset and a corresponding lease liability at the present value of future lease payments (subject to exemptions for short term leases and low-value assets).
- The right-of-use asset is measured initially based upon the value of the lease liability (plus prepayments and direct costs) and then depreciated over the lease term.
- The lease liability is subsequently increased by interest and reduced by lease payments with interest expense being presented separately from depreciation in the profit and loss account.

- The straight-line operating lease rental charge is therefore replaced by depreciation and interest costs.
- Lessor accounting remains largely unchanged.

The right-of-use asset and the lease liabilities are recognised at the commencement date of the lease.



Upon transition the lease liability is determined based upon the remaining (unpaid) lease payments as at the transition date. Any difference between the right-of-use asset and the lease liability is adjusted directly to opening equity. Restatement of the prior year is not permitted.

Key areas of judgement

Assessment of whether a contract contains a lease

The new lease model under FRS 102 is based upon the principle of control, not of the asset but of the right to control the use of the asset for a period in exchange for consideration. This involves assessing whether there is an identified asset (explicitly or implicitly specified and not subject to substantive substitution rights) and then determining whether the lessee obtains substantially all the economic benefits from using that asset and has the ability to direct its use over the lease term.

Certain contracts such as service or supply arrangements may contain embedded leases if they provide control over specific equipment or other assets. Care should be taken to review outsourcing, IT, transport or other long-term service contracts to determine whether they meet the revised definition of a lease.

Substantive substitution rights matter because if a supplier has a right to substitution there is no identified asset and therefore no lease. A substantive substitution right might allow the supplier (or lessor) to swap equipment at any time without the lessee's approval and benefit from that redeployment. For example, a logistics provider may be able to actively pool or reallocate vehicles in a manner that suits their needs.

Broad terms in contracts such as “any time, for any reason” may suggest substantive substitution rights.

Clauses to be mindful of in supplier contracts which may indicate the presence of a lease include those that:

- a. Require the supplier to use a dedicated, identified asset eg specific servers.
- b. Give the customer the right to decide how and when that asset is used eg specifics over a production line such as when it is used, what products are produced on it.
- c. Reserve substantially all of an asset's output to the supplier eg a turbine generating electricity solely for the customer who determines when it is operational.

Exemption for short-term and low-value leases or taking the portfolio exemption

Short-term leases and leases for which the underlying asset is of low value are permitted to be recognised on a straight-line basis over the lease term. This election is made by class of underlying asset for short-term leases but on a lease-by-lease basis for low-value assets. Both are considered accounting policy choices.

Short-term leases are those with a lease term of 12 months or less at the commencement date. If there is a purchase option, then it cannot be a short-term lease. Cancellation clauses need to be considered. It should be noted that a series of one-year leases to follow sequentially such that the economic effect is a lease for the entire term would not qualify for the short-term exemption.

What constitutes a low-value asset requires judgement. The value of the asset is assessed at the level of the underlying asset not at a portfolio level. So potentially many individually low-value assets could still qualify for the exemption even if they add to a material amount. However, there would need to be a stand-back view taken on whether this would be a faithful representation.

The value of the lease has no bearing on the assessment of whether the underlying asset is of low value, for example, if a number of laptops are leased each laptop may be of low value but the fact that the aggregate value of the assets in the lease is not low does not preclude the use of the low value exemption.

The standard specifically sets out the types of assets that would not be of low value to include property, heavy machinery such as tractors, cranes, forklifts and production line equipment and substantial transport such as cars, trains, boats and aircraft.

Outside of these items preparers have some flexibility in determining what is low value, international standards provide examples of low-value assets to include tablets and personal computers, small items of office furniture and telephones. Specifically, anything that is sublet cannot qualify as a low-value asset so this would exclude headleases.

When these exemptions are taken the accounting remains as before with the expense being recognised on a straight-line basis over the lease term or on another systematic basis representative of the pattern of the lessee's benefit.

Lease term

The lease term is the aggregate of:

- The non-cancellable period of a lease plus,
- Any period covered by an option to extend the lease if the lessee is reasonably certain to exercise that option plus,
- Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

The non-cancellable period is based upon enforceability. A contract is no longer enforceable once both parties can walk away without more than an insignificant penalty. This would involve consideration of whether the lessor can refuse a request from the lessee to extend the lease. Where leases don't specify a particular contractual term but require notice of termination or renewal the broader economics of the arrangement should be considered.

These include all the relevant facts and circumstances that create an economic incentive for the lessee such as significant leasehold improvements having been undertaken for the lessee or requiring removal by the lessee.

The assessment of extension and termination options involves determining whether the exercise is reasonably certain. This involves three judgment tests in practice:

- Is the rent at market rate? If extension rent is below expected market rates (a “bargain”), include the option period; if way above market, exclude it.
- Are the exit costs high? Factor in relocation costs, business disruption, refitting expenses or losing a leasehold improvement (eg expensive shop fit out half way through the lease).
- Is the asset a strategic site? For a head office, flagship store or unique warehouse, the certainty of staying often justifies a longer term despite break clauses. Generally, the importance of the asset to the lessee's operations must be considered.

Month to month deals with high exit barriers often have multi year terms in substance. Conversely, a true 6 month break with low relocation costs likely shortens the term.

Lease payments

Lease payments comprise the following:

- Fixed payments less any lease incentives,
- Variable lease payments that depend on an index or a rate, the index at the transition date should be used,
- The exercise price of a purchase option if the lessee is reasonably certain to exercise that option, and
- Payments of penalties for terminating the lease, if the lease reflects the lessee exercising an option to terminate the lease.

Businesses must judge whether payments described as variable are in substance fixed, for example, minimum volume commitments that are practically certain to be met. This would bring them into the liability at inception rather than treating them as contingent operating expenses.

In addition, variable payments should only be included where the variability truly depends on an external index as opposed to usage, performance or sales.

The assessment of certainty around whether a purchase option would be exercised should consider the same economic incentives eg deep in the money purchase options as used for the lease term.

Additional consideration may be required where there are:

- Minimum volume commitments.
- Usage-linked payments with floors eg a minimum annual charge.
- Performance targets in service contracts such as sale or usage targets.

These could indicate in substance fixed lease payments or need to be distinguished from targets directly linked to an index.

Discount rate

Under the revisions to the FRS 102 lease model, the discount rate is determined using a hierarchy:

Start with the interest rate implicit in the lease

This is the rate of interest that discounts the lease payments to a present value equal to the fair value of the underlying asset plus the lessor's initial direct costs. In practice this rate is difficult to obtain mainly because the lessee has no access to critical lessor-specific figures such as the fair value of the underlying asset, the unguaranteed residual value at the end of the lease and the lessor's initial, direct costs.

If the interest rate implicit in the lease cannot be readily determined use the lessee's incremental borrowing rate

The incremental borrowing rate is the rate of interest that a lessee would have to pay to borrow over a similar term, with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar environment. This is a bespoke, hypothetical rate and involves significant judgement in its determination.

It should be noted that an entity's weighted average cost of capital (WACC) is not a suitable estimate as it takes into account both the cost of equity and debt whereas the incremental borrowing rate is only a cost of debt.

If the rate implicit in the lease cannot be readily determined and the lessee elects not to use their incremental borrowing rate, then use the lessees' obtainable borrowing rate

The obtainable borrowing rate is 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.

This could start with a readily observable rate through existing borrowings and consider adjustments for the term of the lease, the value of the lease payments and changes to borrowing costs since existing borrowing was obtained.

Note that the choice of discount rate can be made on a lease-by-lease basis.

Transition choices

When adopting the revisions to FRS 102 for the first time the method of transition involves measuring the lease liability at the present value of remaining payments using the discount rate at the date. The right-of-use asset is calculated at an amount equal to the liability adjusted for any prepayments or accruals.

Some exemptions/choices may make the transition easier:

- An entity may apply the lease accounting to a portfolio of leases with similar characteristics rather than on a lease-by-lease basis. This applies across the standard such as allowing the use of one discount rate for the portfolio. To qualify for this application, it is important to assess whether the leases share similar assets, remaining terms, payment structures and risk profiles.
- As a practical expedient it is not necessary to revisit whether pre-transition arrangements qualify as leases.
- Any IFRS 16 lease liabilities or right-of-use asset values at the date of initial application of revised FRS 102 (or transition date if switching from legacy UK GAAP) may be used as opening balances. However, this must be applied to all leases consistently. This information might be available, for example, if IFRS 16 values are calculated for the purposes of reporting to an IFRS-reporting parent.
- Hindsight may be applied at transition when determining the lease term and whether options are reasonably certain to be exercised.
- When using the incremental borrowing rate or obtainable borrowing rate this may be determined at transition date.

It should be reiterated that restatement of comparatives is not permitted, this is not optional.

Step-by-step checklist for transitioning to the new lease model under FRS 102

Step	Action Item	Considerations	Done (✓)	Step	Action Item	Considerations	Done (✓)
1	Confirm entity is within scope of revised FRS 102 (not FRS 105).			9	Determine lease payments (fixed, variable on index/rate, purchase options, penalties).	Consider whether there are in substance fixed payments. May be indicated by volume/usage clauses. Only include variable payments linked to index/rate, not usage/sales.	
2	Identify first reporting period affected (eg year ending 31 Dec 2026).			10	Determine discount rate (implicit rate if available, otherwise incremental, or obtainable borrowing rate).	Do not use WACC; document rationale for rate chosen.	
3	Decide on transition elections and practical expedients: <ul style="list-style-type: none"> • Short-term leases. • Low-value leases. • Portfolio application. • IFRS 16 alignment. 	Document all policy choices clearly.		11	Calculate lease liabilities (present value of remaining lease payments at transition date).	Assess integrity of spreadsheets used.	
4	Compile complete inventory of leases and lease-like contracts (property, vehicles, equipment, embedded leases).	Review service, outsourcing, IT, and transport contracts for embedded leases. Pay particular attention to contracts which specify a particular asset and give lessee control over how that asset is used over the period of use, as well as if the asset is highly specialized for the lessee's purposes.		12	Measure right-of-use assets (liability plus prepayments, direct costs, less incentives/restoration costs).		
5	For each lease, extract key data: <ul style="list-style-type: none"> • Commencement date. • Lease term/options. • Fixed/variable payments. • Guarantees. • Direct costs. • Restoration obligations. • Incentives. 			13	Recognise opening balances: right-of-use assets, lease liabilities, de-recognise old balances, adjust opening equity.	Restatement of comparatives is not permitted.	
6	Assess whether contracts contain a lease.	Substantive substitution rights may mean no lease exists.		14	Set up depreciation, interest, and payment schedules for each lease.	Ensure systems can track modifications and reassessments.	
7	Consider exemptions: <ul style="list-style-type: none"> • Short-term leases (≤12 months, no purchase option). • Low-value assets (per asset, not aggregate). 			15	Embed controls for new/modified contracts to be assessed and accounted for under revised model.		
8	Determine lease term (non-cancellable period plus reasonably certain options, minus reasonably certain termination options).	When assessing whether exercising options is certain, consider: <ul style="list-style-type: none"> • Renewal rates. • Leasehold improvements. • Strategic importance. 		16	Prepare new lease disclosures (maturity analysis, reconciliation, policy/judgement disclosures).		
				17	Model impact on key metrics (EBITDA, gearing, covenants, remuneration targets) as well as any taxation impacts.		
				18	Communicate with governance, lenders, and stakeholders ahead of year-end.		

This factsheet is based on regulations and law as of 16 January 2026 and professional advice should always be taken.

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