



## Need to know

### Amendments to FRS 102 – Periodic review 2024 – revised Section 20 *Leases*

#### Contents

##### Background

##### Scope and other general principles

##### Recognition exemptions

##### Definition of a lease

##### Accounting for leases in the financial statements of lessees

##### Accounting for leases in the financial statements of lessors

##### Sale and leaseback transactions

##### Effective date and transition

##### Implementing the amended requirements

For more information please see the following websites:

[www.ukaccountingplus.co.uk](http://www.ukaccountingplus.co.uk)  
[www.deloitte.co.uk](http://www.deloitte.co.uk)

This Need to know outlines the changes to the accounting for leases as a consequence of the amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, published by the Financial Reporting Council (FRC) in March 2024 as part of its periodic review of the UK financial reporting framework (the 2024 periodic review).

- Prior to the 2024 periodic review, Section 20 *Leases* of FRS 102 was based on IAS 17 *Leases* and differentiated between an operating lease and finance lease for both lessees and lessors. For lessees, the revised Section 20 is based on the “on-balance sheet” model of IFRS 16 *Leases*, which superseded IAS 17.
- The new requirements provide a comprehensive model for the identification of lease arrangements and their treatment in the financial statements of both lessees and lessors:
  - a control model is applied to the identification of leases, distinguishing between leases and service contracts on the basis of whether there is an identified asset controlled by the customer for a period of time.
  - for lessees, there are significant changes to lease accounting, with assets and liabilities recognised in respect of all leases (subject to limited exceptions for short-term leases and leases of low value assets).
  - for lessors, there are limited changes to the lease accounting requirements.
- The revised requirements are effective for periods beginning on or after 1 January 2026, with early adoption permitted provided all of the periodic review amendments are adopted at the same time (for an overview of all the amendments made to FRS 102 as a result of the periodic review see [Need to Know - Amendments to FRS 102 - Periodic review 2024](#) ).
- Transitional reliefs are introduced to assist companies with adoption.

## Background

When it first issued FRSs 100-105, the FRC committed to a periodic review of the UK financial reporting framework to ensure it continues to function as intended and to meet its overriding objective of high-quality, understandable financial reporting that is proportionate to the size and complexity of the entity and users' information needs through the application of an IFRS-based solution unless there is a clearly better alternative.

In line with this objective, in December 2022 the FRC issued FRED 82 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and other FRSs – Periodic Review*, an exposure draft proposing changes to FRS 102 with related amendments to the other FRSs. After the completion of its second periodic review, the FRC published 'Amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland and other FRSs*' in March 2024. These included a revised Section 20 of FRS 102, which sets out the accounting requirements for both lessees and lessors in respect of their leases.

The previous Section 20 of FRS 102 was based on IAS 17. The International Accounting Standards Board (IASB) replaced IAS 17 with IFRS 16 *Leases* effective for periods commencing on or after 1 January 2019. The revised Section 20 of FRS 102 is based on the principles of IFRS 16, with appropriate simplifications. The consequence of these changes is that, for **lessees**, the distinction between an operating lease and a finance lease is removed and leases are instead recognised 'on balance sheet' with a right-of-use asset and corresponding lease liability. For **lessors**, there are limited changes to the lease accounting requirements.

The revised FRS 102 is effective for periods commencing on or after 1 January 2026, with early adoption permitted provided all amendments are adopted at the same time. A number of **transitional reliefs** are introduced to assist companies with adoption.

## Scope and other general principles

### Scope

The revised Section 20 applies to all leases, including subleases, with the exception of specific items covered by other standards, namely:

- leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources;
- service concession arrangements within the scope of Section 34 *Specialised Activities*;
- for lessors, licences of intellectual property within the scope of Section 23 *Revenue from Contracts with Customers*;
- for lessees, leases of biological assets within the scope of Section 34, and rights held under licensing agreements within the scope of Section 18 *Intangible Assets other than Goodwill* for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights;
- leases that could lead to a loss to the lessor or the lessee as a result of non-typical contractual terms.

Lessees are permitted, but not required, to apply Section 20 to leases of other intangible assets. An entity is required to apply Section 34 to a heritage asset held under a lease.

### Portfolio application

The revised Section 20 generally applies to an individual lease. However, an entity may apply the accounting requirements to a portfolio of leases with similar characteristics, such as a similar lease term for a similar class of underlying asset in a similar economic environment.

### Separating components of a contract

The revised Section 20 generally requires an entity to account for each lease component within a contract separately from any non-lease components within that contract. However, by class of underlying asset, a lessee can elect to not separate non-lease components from lease components as a practical expedient. Instead, a lessee may account for each lease component and any associated non-lease components as a single lease component.

For example, for a lease of a property and an associated service charge set out in the same contract, a lessee can elect not to separate the service charge (non-lease component) from the property lease (lease component) and instead to account for both components as a single lease component, resulting in the fixed elements of both the lease and non-lease components being recognised as a lease liability with a corresponding right of use asset. However, such an election would need to be applied consistently to all leases of the same class of underlying asset.

## Recognition exemptions

The revised Section 20 includes recognition exemptions that permit a lessee to account for short-term leases and leases of low value assets by simply recognising an expense, typically straight-line, over the lease term (i.e., in a manner consistent with the previous accounting for operating leases).

### Short-term leases

A 'short term lease' is defined as a lease that does not include a purchase option and has a lease term at commencement date of 12 months or less. Lessees must apply, or not apply, the exemption for short-term leases consistently for each class of underlying asset.

The 'lease term' is defined as the aggregate of the non-cancellable period of the lease, periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option and periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option. If only the lessor has the right to terminate the lease, the non-cancellable period of the lease includes the period covered by the lessor's option to terminate the lease.

An entity is required to revise the lease term if there is a change in the non-cancellable period of a lease or following a **reassessment** as to whether or not it is reasonably certain to exercise an extension option or to not exercise a termination option in the lease.

### Leases of low value assets

A 'low value lease' is not defined explicitly in Section 20, nor does Section 20 provide a monetary threshold. Instead, Section 20 provides examples of underlying assets that would not be of low value, namely:

- 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;
- production line equipment.

The 'low value' exemption also applies in absolute terms rather than by reference to the size of the reporting entity. In other words, it is not a measure of materiality. It should also be noted that the 'low value' exception only applies to leased assets that are not highly dependent on, or highly interrelated with, other assets.

The exemption for leases of low value assets can be applied on a lease-by-lease basis (i.e., it is available even where an entity has a significant number of leases of low value assets that may be considered to be material in aggregate).

#### Observation

Unlike IFRS 16, which provides examples of underlying assets that would be considered to be of low value, Section 20 focuses on highlighting examples of assets which are not of low value. The FRC took this approach in order to make the on-balance sheet model proportionate for FRS 102 preparers. As a result of this, the FRC expects that FRS 102 preparers will be able to apply the on-balance sheet lease accounting model to a smaller proportion of their leases, substantively reducing the impact of applying this new model.

### Definition of a lease

Section 20 aims to distinguish a lease from a service contract on the basis of whether a customer is able to control the asset being leased for a period of time. FRS 102 defines a lease 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".

#### Observation

As a consequence of the 2024 periodic review, the definition of a lease is revised in a way that is closely aligned to IFRS 16. In many cases, identifying a lease will be the same under both definitions.

An entity is required to identify whether a contract is, or contains, a lease at inception and it will only reassess whether the contract is or contains a lease in case of a modification to the terms and conditions of the contract. The inception of a lease is the earlier of the date of a lease agreement and the date of commitment by the parties to the principal terms and conditions of the lease.

The revised Section 20 includes guidance to determine whether these conditions are met. Significant judgement will be required to make this assessment in some cases. A summary of the detailed guidance is provided below.

### Observation

Similar to IFRS 16, whether a contract is, or contains, a lease is determined by whether that contract conveys the right to use an identified asset for a period of time in exchange for consideration. Under this model, a lessee is required to have not only the right to obtain substantially all of the economic benefits from use of an asset throughout the period of use (a ‘benefits’ element), but also the ability to direct the use of that asset (a ‘power’ element). This is consistent with the concept of control introduced in the revised Section 23 Revenue from Contracts with Customers (for further information about the revised Section 23, see [Need to know — Amendments to FRS 102 Section 23 Revenue from Contracts with Customers - Periodic review 2024](#) ).

Concept	Definition	Observation
<b>Use of an identified asset</b>	An identified asset may be specified explicitly in a contract or implicitly at the time it is made available for use by the customer. However, if the supplier has <b>substantive rights to substitute the asset</b> throughout the period of use, then the asset is not considered to be ‘identified’.	<p>An entity does not need to be able to identify the particular asset (for example, a specific serial number). Instead, an entity needs to determine whether an identified asset is needed to fulfil the contract.</p> <p>One area that may involve significant judgement will be the distinction between a lease and a capacity contract. The requirements clarify that a capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building). This concept can be illustrated by contrasting a contract for substantially all the capacity of a fibre optic cable with a contract for a portion of the capacity – concluding that the former contract includes the right to use an identified asset, but the latter does not.</p>
<b>Substantive rights to substitute the asset</b>	A supplier’s right to substitute an asset is substantive only if both: (a) the supplier has the practical ability to substitute alternative assets throughout the period of use; and (b) the supplier would benefit economically from doing so.	<p>If a supplier has a substantive right to substitute the asset throughout the period of use, then it is the supplier who controls the use of the asset and not the customer.</p> <p>If an entity cannot readily determine whether the supplier has a substantive substitution right, it should presume the supplier does not have one.</p>
<b>Right to obtain economic benefits from use of the identified asset</b>	To control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use. The economic benefits from use of an asset include its primary output and by-products, and other economic benefits from using the asset that could be realised from a commercial transaction with a third party.	This assessment is made within the boundaries of the scope of the contract. For example, in a lease of a motor vehicle which includes a limit for mileage use, that limit is the scope of the contract and the customer will assess the economic benefits it has the right to obtain within this limit.

Concept	Definition	Observation
<b>Right to direct the use of the identified asset</b>	A customer has the right to direct the use of an identified asset throughout the period of use only if either: (a) the customer has the right to direct how and for what purpose the asset is used throughout the period of use; or (b) the relevant decisions about how and for what purpose the asset is used are predetermined and: (i) the customer has the right to operate the asset throughout the period of use; or (ii) the customer designed the asset in a way that predetermines how and for what purpose the asset will be used.	The relevant decision rights to be considered are those that affect the economic benefits derived from the use of the asset. Some examples of customer's rights that meet the definition are: (i) rights to change the type of output produced by the asset; (ii) rights to change when the output is produced; or (iii) rights to change where the output is produced. On the other hand, rights that are limited to maintaining or operating the asset do not grant on its own a right to direct how and for what purpose the asset is used.

## Accounting for leases in the financial statements of lessees

### Recognition and measurement

A lessee will recognise at lease commencement a **right-of-use asset** and a **lease liability**. The commencement date of a lease is defined in Section 20 as the date on which a lessor makes an underlying asset available for use by a lessee.

#### Observation

Similar to IFRS 16, the revised Section 20 requires that lessees account for leases under a single accounting model, under which a lease is recognised "on balance sheet" unless any of the **recognition exemptions** apply.

A lessee's right to use an underlying asset subject to a lease meets the definition of an asset in Section 2 *Concepts and Pervasive Principles* because:

- the lessee controls the right to use the underlying asset throughout the lease term;
- the lessee has the ability to determine how to use the underlying asset and, thus, how it generates future economic benefits from that right of use;
- the right to control and use the asset exists even when a lessee's right to use an asset includes some restrictions on its use;
- the lessee's control of the right of use arises from past events – not only the commitment to the lease contract but also the underlying asset being made available for use by the lessee for the duration of the non-cancellable period of the lease.

#### *Right-of-use asset*

At initial recognition, a lessee measures a right-of-use asset at cost, which comprises:

- the amount of the initial measurement of the **lease liability**;
- any lease payments made to the lessor at or before the commencement date, less any lease incentives;
- any initial direct costs incurred by the lessee;
- any amounts recognised at the commencement date for restoration costs in accordance with Section 21 *Provisions and Contingencies*;
- any amount recognised at the commencement date when a lease component contains a government grant or, for a public benefit entity, a non-exchange transaction.

### Observation

A lessee entering into a lease contract may assume obligations to be performed at the end of the lease term or throughout the lease to maintain the condition of the leased asset (“restoration obligations”).

An obligating event may arise solely by entering into a lease, for example, for obligations to carry out a final restoration of the leased asset, regardless of its condition, or to dismantle and remove the actual underlying asset for return to the lessor. Alternatively, an obligating event may arise subsequently as a result of making alterations to the leased asset, such as an obligation to remove the lessee’s installations or repair wear and tear. These obligating events may occur in full at a point in time (either at the commencement date or subsequently) or increase over time through use or other actions.

If an obligating event has already occurred at initial recognition of the lease, the estimated liability for the related restoration costs is recognised as a provision under Section 21, not as part of the lease liability.

Careful evaluation of all the terms and conditions of a restoration obligation, including the nature of the obligating event and the point in time it arises, is necessary to determine when a provision should be recognised and whether it gives rise to either an addition to a recognised asset, or an expense in profit or loss.

Subsequently, a lessee will measure the right-of-use asset using the cost model, measuring the right-of-use asset at cost less any accumulated depreciation and any accumulated impairment losses and adjusted for any remeasurement of the **lease liability**, except for right-of-use assets meeting the definition of investment property where the fair value model is applied or relating to a class of property, plant and equipment to which the revaluation model is applied.

### Observation

A lessee applies the fair value model in Section 16 *Investment Property* to right-of-use assets that meet the definition of investment property unless it applies the exemption available in Section 16 for property rented to another group entity.

A right-of-use asset that is subleased under an operating lease will meet the definition of investment property and will be accounted for in accordance with Section 16.

For right-of-use assets related to a class of property, plant and equipment to which the revaluation model in Section 17 *Property, Plant and Equipment* is applied, the lessee may elect to apply that revaluation model to all of the right-of-use assets that relate to that class of property, plant and equipment.

### Lease liability

An entity will measure the lease liability at the present value of ‘lease payments’. Lease payments should include:

- fixed payments (including in-substance fixed payments), less any lease incentives receivable from the lessor;

### Observation

Lease payments should include fixed payments regardless of the form in which they are structured in the contract. Therefore, they include ‘in-substance fixed payments’, which is intended to capture payments that could, according to the contract, be variable but are in reality unavoidable. Examples of these types of payments include where payments must be made only if an asset is proven to be capable of operating during the lease, or only if an event occurs that has no genuine possibility of not occurring.

- variable lease payments that depend on an index or a rate (such as the Consumer Price Index (CPI), Retail Price Index (RPI) or a benchmark interest rate), using the index or rate as at the commencement date;

### Observation

A lease may include variable payments related to future performance. The revised Section 20 requires that any variable lease payment not related to an index or a rate to be recognised in profit or loss as incurred.

Where a lease requires payments to be revised periodically in line with the movement in an index such as RPI or CPI, the measurement of the lease payments at lease commencement will be based on the index or rate at that date and no changes to those indices are estimated, i.e. the future payments are not uplifted (or reduced) for the anticipated effects of inflation. The liability will only be **remeasured** when the revisions to the lease payments take effect.

- amounts expected to be payable by the lessee under residual value guarantees;

- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option;
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

Lease payments are discounted using the interest rate implicit in the lease if that rate can be readily determined. If an entity is unable to estimate the rate implicit in the lease, then the lessee should choose, on a lease-by-lease basis, to use either its incremental borrowing rate or its obtainable borrowing rate. A public benefit entity must use the rate of interest otherwise obtainable on its deposits held with financial institutions if it is unable to readily determine either the interest rate implicit in the lease, or the lessee's incremental or obtainable borrowing rate.

#### Observation

The 'interest rate implicit in the lease' is defined as the rate of interest that causes the present value of lease payments and the residual value of the asset at the end of the lease term to equal the sum of the fair value of the underlying asset and any initial direct costs of the lessor. In practice, lessees may not have sufficient insight into those amounts to be able to readily determine the rate implicit in the lease.

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. On this basis, the interest rate implicit in the lease is likely to be similar to the lessee's incremental borrowing rate in many cases because both rates take into account the credit standing of the lessee, the length of the lease, the nature and quality of the collateral provided and the economic environment in which the transaction occurs.

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. The FRC notes that, although this is a broadly similar concept to the incremental borrowing rate, it is expected to be simpler to determine and therefore represents a proportionate simplification to IFRS 16.

Subsequently, a lessee will increase the lease liability to reflect interest accrued and recognised in profit or loss using a constant rate of return method, deduct lease payments made from the liability and remeasure the carrying amount to reflect any reassessment, lease modifications not accounted for as a separate lease, or revisions to in-substance fixed payments.

#### Observation

The different accounting for the right-of-use asset (with depreciation typically recognised on a straight-line basis) and the lease liability (with interest expense recognised using a constant rate of return method) results in probably the most significant impact of the new requirements on a lessee's net profit as the total expense recognised will be weighted towards the earlier parts of the lease term (due to the higher interest cost arising at that time). In contrast, under the previous requirements, the cost of an operating lease was usually recognised on a straight-line basis across the lease term. These changes will also increase EBITDA for most leases.

#### *Reassessment of the lease liability*

A lessee is required to remeasure the lease liability in the following circumstances:

- a change in the amount expected to be payable under a residual value guarantee;
- a change in future lease payments to reflect a change in an index or rate used to determine those payments (including, for example, a market rent review);
- a change in the lease term resulting from a change in the non-cancellable period of the lease (for example, the lessee exercising an option not previously included in the determination of the lease term, or not exercising an option previously included in the determination of the lease term) or resulting from reassessment of the lease term following the occurrence of either a significant event or a significant change in circumstances that is within the control of the lessee and affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term
- a change in the assessment of an option to purchase the underlying asset.

#### Observation

A reassessment of the lease liability differs from a lease modification. A reassessment of the lease liability relates to revised expectations or assessments of terms and conditions in the original lease (such as revised payments after a rent review, or the reassessment of an extension or termination option), whereas a lease modification results from a change in the scope of a lease, or the consideration for a lease, that was not part of its original terms and conditions.



Changes to the lease liability resulting from revisions to residual value guarantees and changes in an index or rate are calculated using the discount rate determined at commencement of the lease (unless the change in lease payments results from a change in floating interest rates, in which case the lessee is required to use a revised discount rate reflecting the change in the interest rate). Changes to the lease term or in the assessment of a purchase option require the calculation of a revised discount rate at the date of the change.

A lessee recognises the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset unless the carrying amount of the **right-of-use asset** is reduced to zero. In this case, a lessee will recognise any remaining amount in profit or loss.

## Presentation

The main presentation requirements are summarised below:

Statement of financial position	Statement of comprehensive income and income statement	Statement of cash flows
Presentation of right-of-use assets and lease liabilities – distinguished from other assets and liabilities either by separate presentation in the statement of financial position or by disclosure of the line item in which they are included.	<p>Presentation of depreciation charge from the right-of-use asset and interest expense on the lease liability (a component of finance costs).</p> <p>Variable lease payments not based on an index or rate are expensed when an event occurs that triggers payment and recognised in profit or loss.</p>	<p>Presentation of cash payments for the principal portion of the lease liability within financing activities and cash payments for the interest portion of the lease liability presented consistently with other interest payments.</p> <p>Presentation of short-term lease payments, payments for leases of low-value assets and variable lease payments not included in the measurement of the lease liability within operating activities.</p> <p>The initial recognition of the lease liability and the corresponding component of the cost of the right-of-use asset (i.e. exclusive of transactions that could be cash flows, such as lease payments made at or before the commencement date or initial direct costs incurred by the lessee) is a non-cash transaction.</p>

## Disclosure

A lessee should disclose, for its right-of-use assets and by class of underlying asset:

- the gross carrying amount and the accumulated depreciation at the beginning and end of the reporting period;
- a reconciliation of the carrying amount at the beginning and end of the reporting period showing separately:
  - additions;
  - disposals;
  - acquisitions through business combinations;
  - revaluations;
  - impairment losses recognised or reversed in profit or loss in accordance with Section 27 *Impairment of Assets*;
  - depreciation;
  - other changes.

This reconciliation is not required for prior periods.

The revised Section 20 also requires a lessee to disclose the following amounts for the reporting period:

- interest expense on lease liabilities;
- the expense relating to short-term leases or leases of low value assets to which the lessee has applied the available **recognition exemptions**;
- the expense relating to variable lease payments not included in the **measurement of lease liabilities**;
- income from subleasing right-of-use assets;



- total cash outflow for leases;
- gains or losses arising from **sale and leaseback transactions**.

A lessee that has right-of-use assets meeting the definition of investment property or heritage assets shall instead apply the relevant disclosure requirements of Section 16 *Investment Property* or Section 34 *Specialised Activities*, respectively.

A lessee should also provide a general description of its leasing arrangements. In particular, a lessee should disclose as a minimum, where relevant:

- information about future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of lease liabilities, including variable lease payments, extension options and termination options, residual value guarantees and leases not yet commenced to which the lessee is committed;
- information about restrictions or covenants imposed by leases;
- the types of discount rate (interest rate implicit in the lease, lessee's incremental borrowing rate or lessee's obtainable borrowing rate) used in calculating lease liabilities and the proportion of the total lease liability calculated using each of those types of discount rate;
- information about sale and leaseback transactions, including:
  - the lessee's reasons for sale and leaseback transactions and the prevalence of those transactions;
  - key terms and conditions of individual sale and leaseback transactions;
  - payments not included in the measurement of lease liabilities;
  - the cash flow effect of sale and leaseback transactions in the reporting period;
  - when relevant, that the entity has made the accounting policy choice to measure the right-of-use asset calculated in accordance with the requirements for measurement of a right-of-use asset at initial recognition when the transfer of the asset in a sale and leaseback transaction is a sale (see **sale and leaseback transactions**).

#### Observation

Consistent with IFRS 16, the revised Section 20 also requires a lessee to disclose additional qualitative and quantitative information if necessary for a user to understand its leasing arrangements.

The revised requirements indicate the information provided must be relevant for the users of the entity's financial statements and should help users to understand the most relevant implications derived from its leases. This could include for example, the flexibility provided by leases, restrictions imposed by leases, sensitivity on key variables, exposure to additional risks and deviations from industry practices.

A lessee that measures right-of-use assets at revalued amounts applying Section 17 *Property, Plant and Equipment* is also required to provide the relevant disclosures required by Section 17 for those right of use assets.

A lessee applying the available **recognition exemptions** for short-term leases or leases of low value assets is required to state that fact and disclose separately the amount of lease commitments for short-term leases and leases of low value assets at the end of the reporting period for each of the following periods:

- not later than one year;
- later than one year and not later than five years;
- later than five years.

A lessee is also required to disclose whether it has applied either or both of the practical expedients:

- to apply Section 20 to a **portfolio of leases**;
- not to **separate non-lease components from lease components**.

#### Accounting for leases in the financial statements of lessors

The lessor accounting requirements in the revised Section 20 are substantially the same as under the previous Section 20. Lessors are still required to classify a lease as either an operating lease or a finance lease.

### Classification of leases

A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership. A lease that is not a finance lease is an operating lease.

#### Observation

When an intermediate lessor classifies a sublease, it should do so by assessing whether it has transferred substantially all the risks and rewards associated with the right-of-use asset in the head lease, rather than by reference to the underlying asset being leased.

As a result, an intermediate lessor will classify more subleases as finance leases than it would have done if those same subleases were classified by reference to the underlying asset.

### Finance leases

A lessor is required to recognise assets held under a finance lease in its statement of financial position at the commencement date and present them as a receivable at an amount equal to the net investment in the lease. The net investment in the lease will be measured as the sum of:

- the lease receivable measured at the present value of the lease payments;
- the residual asset, measured at the present value of any residual value accruing to the lessor.

For a lessor, the lease payments included in the measurement of the net investment in the lease are consistent with those included in the measurement of the **lease liability**.

The present value shall be determined using the rate implicit in the lease. Subsequently, a lessor is required to recognise finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the lease.

### Operating leases

A lessor is required to recognise lease payments from operating leases as income on a straight-line basis over the lease term, unless another systematic basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished or the lease payments are structured to increase in line with expected general inflation.

#### Observation

The requirement to depart from recognising operating lease income on a straight-line basis when lease payments are structured to increase in line with expected general inflation preserves an existing difference between Section 20 and IFRS 16, which does not permit such a departure for lessors.

A lessor is required to present underlying assets subject to operating leases in its statement of financial position according to the nature of the underlying asset, but **disclose** information about assets subject to operating leases and assets not subject to operating leases separately.

### Disclosure

A lessor shall disclose the following amounts for the reporting period:

- for finance leases – selling profit or loss, finance income on the net investment in the lease, and income relating to variable lease payments not included in the measurement of the net investment in the lease;
- for operating leases – lease income, disclosing separately income relating to variable lease payments that do not depend on an index or rate.

For finance leases, a lessor shall disclose:

- a qualitative and quantitative explanation of the significant changes during the reporting period in the carrying amount of the net investment in finance leases;
- a maturity analysis of the lease payments receivable, showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years, reconciling the undiscounted lease payments to the net investment in the lease and identifying the unearned finance income relating to the lease payments receivable and any discounted unguaranteed residual value;
- the accumulated allowance for uncollectible lease payments receivable.

For operating leases, a lessor is required to apply the disclosure requirements of Section 16, Section 17, Section 18, Section 27 and Section 34, where applicable, to assets subject to operating leases. In applying the disclosure requirements in Section 17, a lessor is required to disaggregate assets in each class of property, plant and equipment into assets subject to operating leases and assets not subject to operating leases.

A lessor is also required to disclose a maturity analysis of lease payments receivable, showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years.

### Sale and leaseback transactions

The revised Section 20 includes guidance on sale and leaseback transactions applicable to both the seller-lessee and the buyer-lessor. The treatment of such transactions depends on whether the transfer of the asset in question meets the criteria of the revised Section 23 *Revenue from Contracts with Customers* for recognition as a sale.

If the transfer of the asset is a sale under Section 23:

- the seller-lessee is required to make an accounting policy choice to be applied consistently to either:
  - recognise a right-of-use asset calculated as the proportion of the asset's previous carrying amount relating to the right-of-use it has retained (as a result, a gain or loss on disposal is recognised only to the extent that rights of use have transferred to the buyer-lessor);
  - recognise a right-of-use asset calculated in accordance with the requirements for **measurement of a right-of-use asset at initial recognition**, with any excess of sale proceeds over the previous carrying amount deferred and amortised over the lease term
- the buyer-lessor accounts for the purchase of the underlying asset under applicable requirements in FRS 102 (for example, Section 17 for a purchase of property, plant and equipment) and for the lease under the lessor accounting model in Section 20.

#### Observation

The accounting policy choice permitted by the revised Section 20 is in contrast to IFRS 16, which only permits measurement of the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount relating to the rights retained.

The FRC notes that the introduction of this choice is an optional simplification intended to make an IFRS 16-style model proportionate for FRS 102 preparers.

This alternative approach is similar to the accounting requirements under the previous Section 20 for a sale and leaseback transaction that results in a finance lease.

If the sale proceeds do not reflect the fair value of the asset, or if the lease payments are not at a market rate, adjustments are made to reflect a prepayment of lease payments or additional financing provided by the buyer-lessor.

If the transfer of the asset is not a sale under Section 23:

- the seller-lessee continues to recognise the underlying asset and recognises a financial liability in respect of the sales proceeds received;
- the buyer-lessor recognises a financial asset in respect of the payment made.

Both parties then account for the financial instrument in accordance with the accounting policy choice made for its financial instruments in accordance with paragraph 2 of Section 11 Basic Financial Instruments and paragraph 2 of Section 12 *Other Financial Instruments Issues*.

### Effective date and transition

The revised FRS 102 is effective for periods commencing on or after 1 January 2026, with early adoption permitted provided all amendments from the 2024 periodic review of FRS 102 are adopted at the same time.

The revised Section 20 includes specific transitional provisions, including:

- retrospective application of the revised Section 20 for lessees, with the cumulative effect of initially applying the revised Section 20, if any, being recognised as an adjustment to the opening balance of an appropriate component of equity; restatement of comparatives is prohibited
- a practical expedient permitting a lessee to recognise lease liabilities and right-of-use assets at the date of initial application of revised Section 20 at the carrying amounts calculated under IFRS 16 for the purposes of consolidation of the lessee into financial statements prepared in accordance with IFRS Accounting Standards;
- a prohibition on reassessing whether a previous sale and leaseback transaction met the criteria for recognition as a sale in accordance with the revised Section 23.

### Observation

Subject to certain practical expedients, the principal requirements for lessees on transition are similar to one of the “modified retrospective” approaches permitted on transition to IFRS 16. Applying this approach, a lessee recognises at the date of initial application:

- for leases previously classified as operating leases:
  - a lease liability measured at the present value of the remaining lease payments, discounted using the lessee’s incremental borrowing rate or lessee’s obtainable borrowing rate at the date of initial application;
  - a right-of-use asset measured at an amount equal to the lease liability and adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application;
- for leases previously classified as finance leases, a right-of-use asset and a lease liability at the carrying amount of the leased asset and finance lease liability immediately before the date of initial application.

A lessee is required to explain any of the transitional provisions it has applied.

### Implementing the amended requirements

The effective date of the revised FRS 102 is 1 January 2026. This time allows entities to consider the effects of the new requirements, including whether:

- changes are needed to systems and processes to perform necessary calculations;
- the necessary time, resources and software are available to obtain, cleanse and process the required underlying data about its leasing arrangements;
- judgements are required, particularly in relation to the definition of a lease, determining an appropriate discount rate and the assessment of the lease term;
- key metrics, debt covenants and management compensation are impacted by the changes;
- any additional information is required to make the required disclosures;
- tax is impacted if the treatment of a lease for tax purposes is based on its treatment in financial statements.

### Observation

In determining the tax impacts under UK tax law, the following areas will require careful consideration:

- **depreciation expense:** an analysis of the depreciation expense will be required to determine the extent to which the depreciation expense will be deductible for tax purposes;
- **interest expense:** there are specific UK tax rules regarding the interaction of any interest expense recognised on lease liabilities (for leases that exist on transition and new leases entered into after transition) and the corporate interest restriction, which limits the amount of interest a company can deduct from its taxable income;
- **transitional adjustment:** UK tax law requires the amount recognised in opening equity on transition for the cumulative effect of applying the revised Section 20 to be spread over the weighted average term remaining on the leases, based on a mechanical calculation;
- **timing of tax deductions:** the profile and timing of tax deductions will change as a result of applying the revised Section 20;
- **capital allowances:** in certain circumstances, a lease may meet the conditions to be treated as a ‘long funding lease’, which may change the availability of capital allowances for the right-of-use asset.

The Deloitte Accounting Research Tool (DART) is a comprehensive online library of accounting and financial disclosures literature.

**GAAP in the UK on DART** allows access to the full IFRS Accounting Standards, IFRS Sustainability Disclosure Standards, EU sustainability reporting requirements and UK accounting standards, linking to and from:

- Deloitte's authoritative, up-to-date manuals which provide guidance for reporting under UK GAAP (including UK legal and regulatory requirements), IFRS Accounting Standards, IFRS Sustainability Disclosure Standards and EU sustainability reporting requirements
- illustrative financial statements for entities reporting under IFRS Standards and UK GAAP.

In addition, our **sustainability reporting** volume of GAAP in the UK provides guidance on disclosure requirements and recommendations which businesses must consider in light of the broader environmental, social and governance matters which can significantly drive the value of an entity.

To apply for a subscription to GAAP in the UK on DART, click **here** to start the application process and select the GAAP in the UK package. For more information about GAAP in the UK on DART, including pricing of the subscription packages, click **here**.



This publication has been written in general terms and we recommend that you obtain professional advice before acting or refraining from action on any of the contents of this publication. Deloitte LLP accepts no liability for any loss occasioned to any person acting or refraining from action as a result of any material in this publication.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 1 New Street Square, London EC4A 3HQ, United Kingdom.

Deloitte LLP is the United Kingdom affiliate of Deloitte NSE LLP, a member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"). DTTL and each of its member firms are legally separate and independent entities. DTTL and Deloitte NSE LLP do not provide services to clients. Please click [here](#) to learn more about our global network of member firms.

© 2025 Deloitte LLP. All rights reserved.

Designed by Deloitte CoRe Creative Services. RITM2077086