FRS 102:

Get ready for UK accounting changes

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Hosts

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Key takeaways from today

- **Technical accounting:** New lease and revenue rules. New company thresholds
- **Timing:** Changes are mandatory from 1 January 2026 (early adoption is possible)
- **Wider impacts:** Impacts of EBITDA, profit, net debt, performance-based schemes, dividend policies and reserves may be affected
- **Action needed:** Assess impact now to avoid unnecessary disruption
    - **Systems & controls:** Impact finance systems and controls should also be considered
- **Opportunities:** Assess strategic opportunities

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Key takeaways from today

TECHNICAL ACCOUNTING

TIMING

WIDER IMPACTS

ACTION NEEDED:
SYSTEMS & CONTROLS

OPPORTUNITIES
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Summary of key technical accounting changes

- **Leases:** Most leases move *on balance sheet* — expect higher assets, liabilities, and EBITDA (see later)
- **Revenue:** Timing may shift — earlier or later recognition depending on contract structure
- **Disclosures:** More transparency required, even for small companies
- **Change in company size thresholds:** +50% on monetary thresholds (revenue; gross assets) for periods commencing on or after 5 April 2025. Employee threshold untouched

Timing: assume a company reporting basis of 12 months

2025 | 2026 | 2027

5 APRIL 2025:

Change to company size thresholds for periods after this date

The 2-year rule is complicated here. We advise consultation if you are hovering around the threshold levels (new and old)

1 JAN 2026:

Periods **commencing** after this date must apply the new FRS 102. Early adoption is possible

Where companies desire management and statutory reporting to align, changes need to be implemented from this date in financial reporting processes

31 DEC 2026:

Likely year end for the first reporting period under the new standard, assuming a 12-month reporting period

2027:

Preparation of statutory accounts, tax and audit of first period reporting under the new standard

30 SEPT 2027:

Filing deadline at Companies House for 31 December year ends

N.B. Other CH changes for small companies likely to be in force

Lease accounting

Leases: What’s changing?

- **Current approach**
  - Distinction between **finance leases** and ‘off balance sheet’ **operating leases**
  - Rental expense on operating leases recognised in P&L
- **New approach**
  - All leases will be reflected on balance sheet (Right-of-use (“ROU”) asset & lease liability)
  - Rent expense on operating leases **replaced** with **finance cost** and **depreciation**
  - The lease liability is calculated at present value by discounting future cash flows at the incremental or obtainable borrowing rate
  - The rate applied is the rate the borrower would pay to borrow funds over a similar term, with similar security, to obtain an asset of similar value.

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Leases

OPERATING LEASE

Off balance sheet
Disclosure of commitment

FINANCE LEASE

On balance sheet (asset and liability)
Depreciation and Interest

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Spotting impact: leases

- **Who's affected**: Almost all businesses renting property, vehicles, IT equipment or machinery.

Examples:

  - Retail chains with shop leases
  - Professional firms with office leases
  - SMEs with company car fleets or photocopier contracts

Watch for service contracts with embedded leases (e.g. 'exclusive right to use a server' in IT contracts)

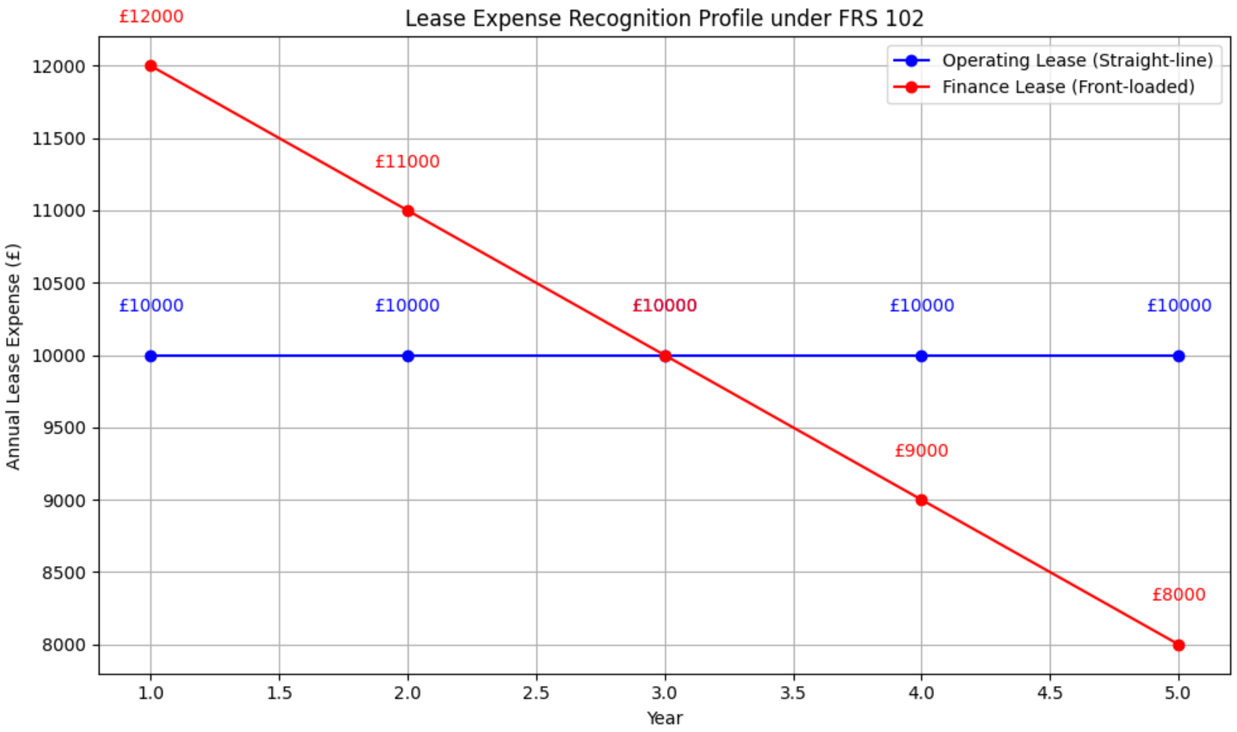
Transition

- Comparatives are NOT restated (leases only)
- Cumulative catchup to retained earnings on date of transition
- Important practical expedients for **short-term** and **low value** leases

Leases: example

- Five-year property lease, £10k p.a., 5% discount rate
- **Old FRS 102**
  - £10k expensed annually (flat profile)
- **New FRS 102**
  - Recognise liability (~£45k NPV) and matching ROU asset
  - Depreciation ~£9k p.a. + interest charge (starting ~£2k, falling over time)
  - Total annual expense **front-loaded** (e.g. £12k in Y1, <£8k by Y5)
- **Key takeaway:** accounting profile changes, cashflows unchanged

Leases: example



Metric	Old Approach	New Approach
EBITDA	EBITDA reduced by £10,000 each year	No EBITDA impact — lease costs are below EBITDA
Gearing	No lease liability → gearing remains unaffected	Lease liability of £43,295 recognised each year → increases gearing

Leases: how might this affect financials?

- **Gross assets** ↑ – may push companies over audit/size thresholds
- **EBITDA** ↑ – rent expense removed, replaced by depreciation + interest
- **Depreciation expense** ↑ – ROU asset depreciated over lease term
- **Finance costs** ↑ – front-loaded profile (higher early years, lower later)
- **Balance sheet gearing** ↑ – lease liability increases reported debt
- **Ratios impacted:** gearing, net current assets
- **Covenant implications:** need lender discussions

Leases: tax impact

- **Accounting recap:** New asset and liability recognition changes the timing of expenses ('**depreciation + interest' instead of 'rent'**)
- **Tax impact**
  - HMRC will continue to allow depreciation and interest as deductible items
  - Initial accounting adjustment to reserves is spread for tax over the remaining lease term
  - No change in overall tax payable
- **Other tax considerations**
  - Gross assets test (may affect eligibility for certain schemes e.g. Enterprise Investment Scheme
  - Retain old lease records for tax reconciliation
  - Deferred tax will capture timing differences

Company size thresholds

- Company size thresholds increased by 50% effective from April 2025
- However, **bringing leases onto the balance sheet increases gross assets**
  - Example: a company with £4m assets today could jump to £8m once property leases are capitalised
- Some businesses may move down a size category, but lease changes may offset this relief by inflating gross assets

Audit requirements

- Management may think the new thresholds exempt them from audit
- Be aware the new lease accounting requirements impact this

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Revenue

Revenue: what’s changing?

- **Existing approach:** often recognises revenue when invoiced or earned overall
- **New approach:** requires further contract analysis to match revenue to delivery
- For most straightforward sales, little will change
- For contracts which are multi-year, bundle goods and services, or contain variable pricing, revenue timing may shift forward or back
- New **five-step model**

Revenue: five-step model

1. Identify the contract with a customer
2. Identify distinct performance obligations
3. Determine the transaction price
4. Allocate the transaction price to performance obligations
5. Recognise revenue when (or as) obligations are satisfied

Revenue: example – financial services

- FinServe signs a three-year agreement to provide services to a PE fund
    - Onboarding/setup fee (paid at start) – £30,000
    - Ongoing administration and compliance – £10,000 per quarter
    - Performance fee if certain Net Asset Value (NAV) thresholds are met – £20,000

- Under old FRS 102, many firms recognised fees when invoiced or when the work was performed overall (often all upfront for the setup)

Revenue: five-step model – financial services

Step	Application
1. Identify contract	Legally enforceable services agreement – multi-year contract with three distinct component deliverables
2. Identify performance obligations	(1) Onboarding / setup (2) Quarterly fund administration (3) Performance reporting / NAV test
3. Determine transaction price	£30,000 + £120,000 [fixed] + £14,000 [variable]* = £164,000 *FinServe estimates 70% likelihood of achieving performance target
4. Allocate the price	(1) Onboarding / setup – £30k (2) Quarterly fund administration – £120k (3) Performance reporting/NAV test – £14k
5. Recognise revenue	(1) Onboarding / set up – £30k – recognise over onboarding period (not on day 1) (2) Quarterly fund administration – £120k – recognise quarterly (3) Performance reporting/NAV test – £14k – when performance is satisfied

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Revenue: practical considerations

- **Harder to detect impact** than leases – sits in contract detail
- **High risk sectors**
  - Construction (over-time revenue)
  - SaaS/software (bundled licence + support)
  - Manufacturing (warranties, rebates, variable consideration)
- **Audit focus**
  - Judgments on over-time vs point-in-time
  - Allocation of transaction price to different deliverables
- **Key message:** revenue timing may accelerate or defer vs old standard

Other changes: beyond revenue & leases

- **Supplier finance arrangements** – new disclosures from 2025 (reverse factoring)
- **Financial instruments** – closer alignment with IFRS 9 principles
- **Share-based payments** – more disclosure detail (arrangements, expense recognition)
- **Disclosure expansions** – judgements, estimates, sensitivities
- **Key message** – leases & revenue dominate, but **businesses will be caught by other areas too**

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Other changes: Section 1A (small companies)

- **Effective from 1 January 2026** – applies to small companies using Section 1A
- **Disclosures expanded significantly**
    - Related parties: Previous exemptions no longer available
    - Leases: ROU assets, lease expenses, commitments
    - Revenue: performance obligations, payment terms
    - Share-based payments: option details, expenses
    - Provisions & contingencies: reconciliations, uncertainties, guarantees
    - Dividends: declared/paid/payable must be disclosed
    - Assumption of going concern basis no longer applies
- **Implication:** Section 1A FS will look much closer to full FRS 102

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Wrap-up & Q&A

- What’s changing: leases, revenue, disclosures, thresholds
- **Who’s affected**: most businesses but particularly those with leases or complex revenue arrangements
- How we support: templates, example bank, escalation process
- **Call to action**: start conversations with advisors and stakeholders early
- If in doubt, consult!

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Get in touch

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Thank you

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