

Changes to UK GAAP: Lease Accounting

On 27 March 2024, significant changes were announced to lease accounting under UK GAAP as part of a periodic review by the Financial Reporting Council (FRC). The primary updates affect FRS 102, with an effective date for accounting periods beginning on or after 1 January 2026. Early adoption is permitted.

Although this date might feel quite distant right now, it is important to be prepared for the impact on:

- Your accounting systems
- Your finance team – ensuring they are trained and prepared for the transition
- Amendments to your chart of accounts
- Bank covenants and your profit and loss account
- The timing and amount of corporation tax payments
- Remuneration planning

What are the key changes?

Elimination of Operating and Finance Lease Distinction:

Lessees must now recognise almost all leases on the balance sheet, bringing the treatment in line with the IFRS 16 model.

The accounting by lessors has not been significantly changed.

Let's consider the impact on your financial statements

Asset:

The asset will be recorded on the balance sheet as a right-of-use asset. This will be depreciated over the term of the lease. This will typically be measured at the value of the lease liability as per stated below.

Liability:

A lease liability measured at the present value of remaining lease payments (based on the lessee's incremental borrowing rate) will be recognised on the balance sheet. This will be unwound as an interest expense. The lease liability will be reduced by the payments made.

Profit and Loss Account:

As the lease liability is unwound, an interest expense will be charged to the profit and loss account.

Depreciation will be charged on the right-of-use asset.

These amounts will need to be revisited following any changes such as to the lease term or rent reviews.

Exemptions you may be able to take

Two types of leases are exempt from this on-balance-sheet treatment:

- **Short-term leases** (less than 12 months)
- **Low-value asset leases**, where the value is determined by the underlying asset, not the payments.

You may also be able to use an obtainable borrowing rate in place of an incremental borrowing rate.

Transition Approach

Entities will apply a **modified retrospective approach** from the date of initial application, recognising a cumulative adjustment with no prior period restatement required. This cumulative effect is recorded against opening retained earnings.

These changes aim to increase transparency and comparability in financial reporting by requiring entities to disclose more comprehensive lease obligations.

How can DY help?

We can assist you by:

- **Assessing the likely impact on your business**
- **Providing advice on the accounting treatment and disclosures**
- **Advising on your updated lease accounting policies**

For any support or guidance please get in touch with Scarlett.



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