



FRS 102 periodic review – Section 20 leases

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Summary

The FRC has issued **Amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and other FRSs – Periodic Review 2024**, concluding its second periodic review of the standard. One of the key changes in this periodic review is a complete revision of accounting for leases by lessees. Section 20 Leases introduces a new, on-balance sheet method for accounting for leases, removing the distinction between operating and finance leases for lessees.

This change aligns with IFRS 16 Leases and means more entities will show a “right-of-use” asset and a lease liability, similar to how finance leases were treated before. However, there are exceptions for short-term leases and low-value leases, which do not need to be recorded on the balance sheet.

Accounting by lessors remains largely unchanged, maintaining the distinction between operating and finance leases. While the guidance for lessors has been updated, their overall accounting practices will not change significantly.

The effective date for the amendments is periods beginning on or after 1 January 2026, with early adoption permitted, provided that all amendments made to FRS 102 as a result of the periodic review are applied at the same time. The new requirements are not being extended to the micro-entities regime of FRS 105, where the existing lease accounting treatment will be retained.

Summary of impact

Situation	Details
Who is affected?	Entities that lease assets as a lessee or lessor
What is the impact on lessees?	All leases will be accounted for “on-balance sheet”, other than short-term and low value leases Lease expense will typically be “front-loaded” Lease liability will exclude: • Option periods unless exercise is reasonably certain • Contingent payments that are linked to sales/usage and future changes in an index/rate Such recording of additional assets and liabilities may alter EBITDA calculations and gearing ratios, potentially impacting banking and finance covenants, and/or affecting the size of the company under company law thresholds
What is the impact on lessors?	Only minor changes from the existing requirements
Are there other changes?	A new definition of a lease will result in some arrangements previously classified as leases ceasing to be so, and vice versa New guidance on sale and leaseback accounting New and different disclosures
When are the changes effective?	Annual periods beginning on or after 1 January 2026 Various transition reliefs exist Early application is permitted provided all other changes to FRS 102 are adopted at the same point



Definition: Identifying a lease

A contract is, or contains, a lease if the contract conveys the **right to control the use** of an **identified asset** for a period of time in exchange for **consideration**. The control assessment is based on whether the customer can direct the asset's use and obtain its economic benefits.

Identified asset

An **identified** asset may be explicitly specified in the contract, or implicitly specified when it is made available to the customer.

An asset is not identified if the supplier has a substantive right to substitute it for another asset. A supplier's right to substitute the asset is substantive if it both:

- Has the practical ability to substitute alternative assets throughout the period of use; and
- Would benefit economically from doing so.

A capacity portion of an asset can be an identified asset if it is physically distinct (e.g. a floor of a building)

Right to control the use

For a lease to exist, the customer must, **throughout the lease term**, have both:

- Right to direct the use of the identified asset:
 - This is usually present if the customer has the right to decide how and for what purpose the asset is used. If the decisions about the use of the asset are predetermined, the customer would still have control if it: (a) has the right to operate the asset; or (b) designed the asset or some aspect of it in a way the predetermines its use.
- Right to obtain substantially all the economic benefits from the use:
 - A customer can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding or sub-leasing the asset.

Two or more contracts should be accounted as a single contract if the following conditions are met:

- Entered into at, or near, the same time
- With same counterparty, or related parties of the counterparty, and
- Meet one or more of the following:
 - a Negotiated as a package – commercial objective cannot be understood without considering together
 - b Consideration paid in one contract depends on price or performance of the other contract
 - c Rights to use underlying assets in the contracts form a single lease component

Multiple components and non-lease components

Contracts may contain both lease and non-lease components, and it may contain more than one component. A lease component is separate if:

- The lessee can benefit from use of the identifiable underlying asset either on its own or together with readily available resources; and
- The underlying asset is not highly dependent on, or highly interrelated with, other assets in the contract.

The consideration in the contract is allocated to each lease component based on the relative stand-alone price of each lease component and the aggregate stand-alone price of the non-lease components.

As a practical expedient, a lessee may elect, by class of underlying asset, not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component.

Key differences from IFRS 16

IFRS 16 contains lots of application guidance on how to identify a lease. There is less detailed guidance within Section 20 but, in our view, the principles remain the same. No practical differences are expected in terms of which contracts would be considered to contain a lease.



Accounting by lessees

Recognition exemptions

Under the new requirements, most leases will be recognised on-balance sheet, as a right-of-use asset and a corresponding lease liability. There are two exceptions available, under which the leases can continue to be recognised akin to operating leases under the previous version of the standard, with the expense taken to the Profit & Loss account on a straight-line basis, or another systematic basis that is more representative of the pattern of the lessee's benefit.

Short-term leases

- Election made by class of underlying asset
- At the commencement date, has a lease term of 12 months or less
- Leases that contain purchase options cannot be considered short-term lease
- Treat any lease modifications or changes in lease term as new lease
- Examples of classes of assets could include rental cars, prefabricated office space and scaffolding equipment.

Low-value assets

- Election available on lease-by-lease basis
- Qualification based on the value of asset when new, regardless of age of leased asset
- Assessment is not affected by materiality of the asset to the company, value of the lease payments, or size, nature and circumstances of the lessee
- Highly dependent / interrelated assets do not qualify, unless they are, in aggregate, of low-value
- A lease cannot qualify as a lease of a low-value asset if the lessee subleases, or expects to sublease, the leased asset
- Examples of low-value underlying assets could include tablets, personal computers, small items of office furniture.

Key differences from IFRS 16

The FRC concluded that a key contributor to making the on-balance sheet model proportionate for FRS 102 preparers would be to take a more permissive approach to defining low-value assets. As a result, Section 20 focuses on ensuring that the most significant leased assets are recognised on-balance sheet (including properties, vehicles and large equipment), but it allows some flexibility for preparers to determine whether other assets are of low value. FRS 102 provides guidance on lease classification and recognition requirements but does not define a particular financial threshold to distinguish between low-value and other leases. As such, we expect that more assets will be considered low-value when applying Section 20, and they will therefore be permitted to remain off-balance sheet.



Initial recognition of leases

For lessees, the distinction between operating and finance leases has been removed, with all such arrangements now simply classed as “leases”. Unless one of the recognition exemptions above apply, a lessee will now be required to recognise:

Statement of financial position

- Right-of-use (ROU) asset
- Lease liability

Statement of financial performance

- Depreciation expense on right-of-use asset
- Interest expense on lease liability

As there will be no changes to the underlying lease agreements, and therefore no change to cash payments made, there is no impact on the Statement of Cash Flows.

Initial measurement

To recognise a lease in accordance with the new accounting provisions, a lessee will first calculate the value of the lease liability. The lease liability then forms the basis for calculating the right-of-use asset.

Lease liability

The lease liability is initially measured as the **present value of all lease payments, discounted using an appropriate interest rate.**

The interest rate to be used in the calculation is the interest rate implicit in the lease. If this is not readily determinable, the lessee may use its incremental or obtainable borrowing rate. Discount rates are discussed elsewhere in this document.

In-substance fixed lease payments are those that may contain variability, but that, in substance, are unavoidable. For example – a payment contingent on an event with no real possibility of not occurring, such as a minimum payment that is guaranteed regardless of usage is effectively fixed in substance, even if its nominal amount varies in the lease agreement. Payments which are genuinely variable (i.e., where that variation is not linked to an index or rate) and uncertain are excluded until the variability is resolved.

Examples of **variable lease payments** that depend on an index or a rate include those linked to a consumer price index, to a benchmark interest rate or to reflect percentage changes in market rents. Variable lease payments not linked to indexes/rates are not included in this calculation.

This approach ensures that only payments that are genuinely fixed or unavoidable are included in lease liability measurements, while genuinely variable and uncertain payments are excluded until the outcome is known.

Lease payments = present value of

=

+

Fixed payments (including in-substance fixed payments), less any lease incentives receivable

+

Variable payments dependent on an index or rate (measured initially at commencement)

+

Expected payments under residual value guarantees (a guarantee made to a lessor that the value of an underlying asset at the end of a lease will be at least a specified amount)

+

Exercise price of purchase options (if reasonably certain to exercise)

+

Penalties for terminating the lease (if the term reflects this option)

Having calculated the initial value of the lease liability, the lessee uses this value as the starting point for calculating the right-of-use (ROU) asset value, and adjusting for the elements discussed below. In practice, this may mean that the initial value of the ROU asset will not be equal to the initial value of the lease liability.

Right of use assets

The ROU asset is initially measured at cost.

If the lessee makes any lease payments before the lease commencement date, these are included in the ROU asset's initial measurement.

Lease incentives are benefits provided by the lessor to the lessee to encourage lease commencement, such as rent-free periods or cash incentives. These incentives effectively reduce the lease payments that the lessee is obligated to make and are therefore deducted from the value of the ROU asset at the outset.

Initial direct costs are the incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained, such as commissions paid to sales agents and legal fees and other costs incurred in originating the lease agreement. These costs are included in the measurement of the ROU asset to the extent that they have been incurred by the lessee (not the lessor). These direct costs must be 'incremental' and entity must not allocate administrative tasks such as a portion of finance and management salaries related to obtaining a lease to the initial measurement of the right-of-use asset.

Some leases require assets to be returned in a specific condition, meaning the lessee must spend money to restore them. Certain assets may also have high transportation and removal costs to return them to the lessor, as specified in the lease. For example, a manufacturing company may install specialized equipment that must be removed at the end of the lease term. If the lessee is likely to pay for restoring or removing assets at the end of the lease, and these costs can be reliably estimated, they are added to the lease's right-of-use (ROU) asset, except when they relate to producing inventory, where Section 13 Inventories would be applied. Such liabilities are determined in accordance with the requirements in Section 21 Provisions and Contingencies.

ROU assets at cost

-  Initial lease liability measurement
-  Prepaid lease payments
-  Lease incentives received
-  Initial direct costs incurred by the lessee
-  Costs to dismantle, remove, or restore the asset/
site per Section 21 Provisions and Contingencies,
and any amounts recognised in accordance
with Section 24 Government Grants or
Section 34 Specialised Activities (in respect
of non-exchange transactions)

Discount rate

The discount rate to be used in calculating the lease liability will be a matter of **judgement**. The Standard requires that the entity uses the interest rate implicit in the lease, if this is readily determinable. However, where an entity cannot readily determine this rate, it should use either its incremental borrowing rate or its obtainable borrowing rate. The choice of interest rate should be applied on a lease-by-lease basis.

Interest rate implicit in the lease

- The interest rate implicit in the lease is the rate that causes the present value of the lease payments and the unguaranteed residual value to equal the sum of the fair value of the underlying asset and any initial direct costs to the lessor. Using the implicit rate represents the true financing cost of leasing an asset as opposed to paying for it up-front or buying it outright without financing. However, it may prove complex to calculate, if the lessee is not able to determine the quantity of initial direct costs incurred by the lessor.

Incremental borrowing rate (IBR)

- The IBR is the rate that a lessee would have to pay on the commencement date of the lease for a loan of a similar term and with similar security, to obtain an asset of similar value to the right-of-use asset in a similar economic environment. It is important to remember this requirement of “similarity” as many lessees may end up using their internal rate of borrowing for every lease because it is likely to be relatively easy to obtain, but the rate should be for a “similar” loan to the lease to represent the true nature of the lease.

Obtainable borrowing rate (OBR)

- The lessee’s obtainable borrowing rate for any given lease is the rate of interest that the 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 difference between IBR and OBR is that OBR only requires consideration of factors related to the monetary value of the lease and not the nature or location of the right-of-use asset. OBR will therefore be simpler to determine, and we expect that lessees will be able to use the same OBR for multiple leases of similar value.

Public benefit entities: Deposit rate

- A public benefit entity that is unable readily to determine either the interest rate implicit in the lease, or the lessee’s incremental or obtainable borrowing rate for a lease, may use the rate of interest otherwise obtainable by the public benefit entity on deposits held with financial institutions.

Key differences from IFRS 16

IFRS 16 requires a lessee to use the IBR where the interest rate implicit in the lease cannot be obtained. Section 20 introduces an alternative discount rate option in this scenario. The OBR is a new concept in FRS 102. It is a significant simplification, because it will be easier to determine than IBR, and we expect that a lessee will be able to use the same OBR for multiple leases of similar value.

Lease term

The lease term begins **at the commencement date** of the lease, which is the date on which the lessor makes an underlying asset available for use by a lessee. The lease term also includes any rent-free periods provided to the lessee by the lessor. The total lease term will be the aggregate of:

- 1 **Non-cancellable** period of the lease;
- 2 Optional extension periods, if lessee is **reasonably certain** to exercise the option; and
- 3 Periods covered by option to terminate lease, if lessee is **reasonably certain not** to exercise the option. If only the lessor has the right to terminate the lease, the non-cancellable period is deemed to include the period covered by the lessor's option to terminate.

Non-cancellable leases

In assessing the length of the non-cancellable period of a lease, an entity shall determine the period for which the contract is enforceable. A lease is no longer enforceable when either the lessee or the lessor has the right to terminate the lease without permission from the other party with no more than an insignificant penalty.

Option extension periods

When determining whether an option in a lease is reasonably certain to be exercised, an entity should consider at least the following factors:

- The contractual terms and conditions when compared with market rates
 - Considering whether the contractual terms of the lease for the optional periods compare favourably with market rates – for example, the amount of any variable lease payments for the lease or other contingent payments. An extension may be more likely if rates are favourable when compared to other options in the relevant market.
- Significant leasehold improvements
 - Whether significant leasehold improvements undertaken/expected to be undertaken will have significant economic benefit when the option becomes exercisable. Such significant expenditure may indicate an intention to extend the lease for a longer period.

- Termination of the lease
 - Costs relating to the termination of the lease, such as relocation costs, costs of identifying another suitable asset or termination penalties and similar costs that are associated with returning the underlying asset in a contractually specified condition or location. Significant termination costs may deter a lessee from terminating a contract.
- Importance of the underlying asset
 - Importance of the underlying asset to the lessee's operations – for example, its location, whether the asset is specialised in nature and whether suitable alternatives may be available to the lessee. If an entity has a specialist asset, this could indicate a significant economic incentive to exercise a purchase or renewal option if a suitable alternative is not readily available.
- Criteria for exercising the option
 - Whether certain criteria must be met prior to the option being exercised, together with an assessment of the likelihood that those conditions will exist. Complex criteria, or conditions not wholly within the control of the entity, may make exercising the option less favourable.

Reassessment of options

An entity only need reassess whether it is reasonably certain to exercise a termination option or an extension option upon the occurrence of a significant event or a significant change in circumstances that is both:

- 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 lease term, or to not exercise an option that was previously included in its determination of lease term.

Unless both of these factors are present, no reassessment of such options takes place.

Revising the lease term

An entity should revise the lease term if there is a change in the non-cancellable period of a lease. Such a change could arise if, for example, the lessee exercises an option not previously included in the determination of the lease term. Revising the lease term due to a change in non-cancellable periods is generally accounted for prospectively. It involves re-measuring the lease liability using the remaining lease payments over the new lease term discounted at the original rate, adjusting the ROU asset accordingly, and updating amortization schedules.

Rolling leases

Entities can enter into 'rolling leases,' which have no fixed end date and are terminated when either party chooses to end the lease. Sometimes, a lease automatically becomes a rolling lease after an initial fixed period. In such cases, the entity must carefully determine the enforceable lease period and the non-cancellable portion - such as notice periods or penalties for early termination - as these may impact accounting treatment.

Where such renewal clauses are present, the entity must assess whether the renewal period is enforceable and include it in the lease term if it is reasonably certain to be exercised. If a lease is cancellable within a short notice period (e.g., 30 days) and generally does not extend beyond 12 months, it may be able to avail of the short-term lease exemption, and recognise the lease through the profit & loss account rather than on the balance sheet.

For leases longer than 12 months or with significant renewal options, the entity should recognize a lease liability and a right-of-use asset. This involves estimating the total lease term—including renewal options likely to be exercised—and discounting future lease payments at an appropriate rate, in accordance with the standard provisions of Section 20.

Subsequent measurement

Following initial recognition, the entity has an accounting policy choice for the right-of-use asset. The accounting policy choice must be applied consistently across all ROU assets in that class of asset.

- Cost less depreciation and impairment – this will be the most common accounting policy choice and is the default accounting treatment. The asset is depreciated over the earlier of the end of the lease term and the useful life of the asset, unless the lease transfers ownership at the end of the lease (or the cost of the asset reflects that the lessee will exercise a purchase option), in which case the asset is depreciated over its useful life. The entity should consider any requirements for impairment as per Section 27 Impairment of Assets, and adjust the carrying value of the ROU asset accordingly.
- Revaluation model – a lessee may opt to apply the revaluation model under Section 17 Property, Plant and Equipment, provided the election is applied to all ROU assets within that particular class of PPE.
- Fair value model – where the ROU asset meets the definition of investment property, the fair value model should be accounted for in accordance with the provisions of Section 16 Investment Property, unless applying the exemption for **investment property** rented to another group entity, in which case the cost model is used

Changes to terms of lease contracts

Changes to the conditions of the lease, such as a change in the term of the lease or the timing or amount of payments, fall into one of two categories – a re-assessment of the lease liability or a full lease modification.

It is important to note that variable lease payments that are not included in the original measurement of the lease liability – i.e., those that are not linked to an index or rate, such as turnover-based rentals – are not considered a change to a lease contract. Instead, they are recognised in profit or loss in the period in which the event or condition that triggers those payments occurs.

Re-assessment of lease liability

A re-assessment of the lease liability takes place if there is a change in lease payments, but no change to other conditions such as the underlying asset that is the subject of the lease.

This approach is used when:

- There is a change in the lease term; a lessee shall determine the revised lease payments on the basis of the revised lease term; or
- There is a change in the assessment of an option to purchase the underlying asset; a lessee shall determine the revised lease payments to reflect the change in amounts payable under the purchase option.

A revised discount rate is usually required to be determined, and the revised payments are discounted using this revised rate. In the same way as on initial recognition, the entity should determine the revised discount rate as being the updated interest rate implicit in the lease, or, where this cannot be readily determined, the entity's incremental borrowing rate or obtainable borrowing rate at the date of the reassessment.

However, where there is a change to the amounts expected to be payable under a residual value guarantee, or a change in future lease payments resulting from a change in an index or rate used to determine those future payments, then an unchanged discount rate is used. Instead, the revised cash flows are remeasured using the same discount rate as on the initial recognition of the lease.

In each of the above circumstances, a lessee shall recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset. However, if the carrying amount of the right-of-use asset is reduced to zero and there is a further reduction in the measurement of the lease liability, a lessee shall recognise any remaining amount of the remeasurement in profit or loss.

Lease modifications

Where both of the following circumstances are present, the change is accounted for as a separate lease:

- The modification increases the scope of the lease (i.e., adds the right to use one or more underlying assets), and
- The consideration paid in the lease increases commensurate with the extension of the scope.

In this circumstance, the changes are treated separately from the original lease. The additional asset(s) and consideration are treated as if they are a separate lease in their own right and accounted for accordingly.

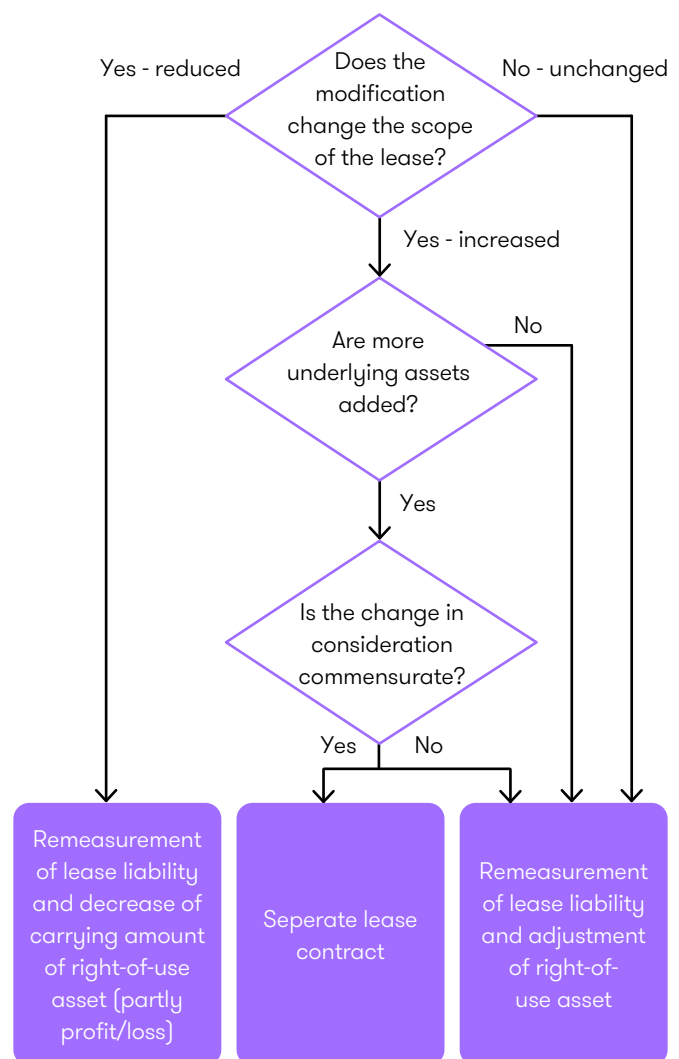
Otherwise, a modification is accounted for by reallocating the consideration (i.e., by determining the number of lease components, and allocating the stand-alone prices across each component, as done on initial recognition), determining the new lease term (if applicable), and remeasuring the revised liability using a revised discount rate.

A simplification is available, whereby the lessee can use an unchanged discount rate, in any of the following circumstances:

- The additional consideration is insignificant to the total consideration of the original lease;
- The scope of the lease is decreased by removing the right to use one or more underlying assets with a commensurate decrease in consideration; or
- The consideration payable is decreased for the remaining term of the lease but the scope of the lease is not decreased by removing the right to use one or more underlying assets.

If an unchanged discount rate is used, this should be disclosed alongside the carrying amount of lease liabilities which have been remeasured.

In summary, a lease modification is accounted for as follows:



Key differences from IFRS 16

A lessee applying IFRS 16 must use a revised discount rate for all lease modifications which are not accounted for as separate leases.

Generally, when applying Section 20, a lessee also uses a revised discount rate to account for lease modifications that are not separate leases. However, Section 20 allows a lessee to use an unchanged discount rate in the following scenarios:

- The additional consideration from the lease modification is insignificant relative to the total consideration of the original lease;
- The lease modification decreases the scope of the lease by removing the right to use one or more underlying assets, and the consideration for the lease decreases by an amount commensurate with the stand-alone price for the decrease in scope; or
- The lease modification decreases the consideration payable for the remaining term of the lease, but it does not decrease the scope of the lease by removing the right to use one or more underlying assets.



Accounting by lessors

The amendments to Section 20 Leases include relatively few changes to lessor accounting, but the elements pertaining to lessors have been significantly expanded and now contain more detailed information than before. For instance, the section specifies the costs and items that are included in the net investment of a finance lease. Lessors are still required to classify leases as either finance or operating, depending on whether substantially all of the risks and rewards incidental to ownership of the underlying asset have been transferred.

A substantive change to lessor accounting relates to the classification of subleases. If an entity is both lessee and lessor of the same underlying asset, it is required to assess whether the sublease is a finance or an operating lease with reference to the right-of-use asset arising from the headlease and not with reference to the underlying asset.

In other words, if the sublease transfers substantially all the risks and rewards incidental to ownership of the ROU asset, it would be classified as a finance lease, whereas if the sublease does not transfer substantially all risks and rewards, it would be classified as an operating lease.

If the sublease is for a term that is less than 12 months and the lease does not contain a purchase option, the entity may elect to apply the short-term lease exemption. Under this exemption, the entity is not required to recognize a right-of-use asset or a lease liability. Instead, lease payments are recognized on a straight-line basis over the lease term. Headleases cannot avail of the low-value lease recognition exemption.

Classification as finance lease or operating lease

The differences between accounting for finance and operating leases, by a lessor, are summarised below. These are largely unchanged from the accounting under the previous version of FRS102.

	Finance lease	Operating lease
Recognition	The PPE asset being leased is derecognised. The finance lease is recognised as a receivable on the balance sheet, being the net investment in the lease. As there is no PPE asset, there will be no depreciation expense going through the profit & loss account.	Income is recognised on a straight-line basis, unless a different systematic basis better reflects the asset's diminishing benefit or the lease payments are structured to increase in line with expected general inflation. Costs incurred in earning lease income, including depreciation, are recognised as expenses. The asset being leased continues to be held as PPE.
Initial measurement	The net investment in the lease is measured using the interest rate implicit in the lease. The initial measurement of the lease payments is included in the net investment in the lease and will include all payments expected to be received by the lessor in accordance with the contract.	A lessor adds initial direct costs incurred in securing an operating lease to the asset's carrying amount, spreading these costs as expenses over the lease term in alignment with lease income recognition.
Subsequent measurement	Finance income is recognised over the lease term, based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the lease. The aim is to allocate finance income over the lease term on a systematic and rational basis. Lease payments relating to the period are applied to the gross investment in the lease, in order to reduce both the principal and the unearned finance income. Derecognition and impairment rules are applied to the net investment in the lease, in accordance with standard accounting requirements for financial instruments.	Depreciation for assets under operating leases follows the lessor's usual policy for similar assets and is computed according to either Section 17 Property, Plant and Equipment or Section 18 Intangible Assets other than Goodwill guidelines recognition. The lessor applies Section 27 Impairment of Assets to assess potential impairments and recognise any impairment losses for assets under operating leases recognition.

	Finance lease	Operating lease
Reassessment and lease modifications	If a modification to a finance lease adds the right to use additional underlying assets and the consideration increases proportionately, it is accounted for as a separate lease. If, given the modification, the lease would have been an operating lease at outset, it is accounted for as a new lease from the modification's effective date lease. The carrying amount of the underlying asset is measured as the net investment in the lease immediately before the effective date of the lease modification. Otherwise, the lessor applies relevant accounting policies chosen for derecognition and impairment in line with accounting for financial instruments.	A lessor treats a modification to an operating lease as if initiating a new lease from the modification's effective date. This includes incorporating any prepaid or accrued lease payments from the original lease into the payments for the new lease arrangement recognition.
	The following are recognised: • Revenue, being the fair value of the asset or the present value of lease payments, discounted at a market interest rate, whichever is lower. • Cost of sale, being the cost (or carrying amount, if different) of the underlying asset less the present value of the unguaranteed residual value.	
	Manufacturer or dealer lessor Selling profit/loss, being the difference between these two figures, is recognised upfront, aligning with the lessor's policies for outright sales, in accordance with Section 23 Revenue from Contracts with Customers of FRS102. This approach applies regardless of whether the lessor transfers the asset. Manufacturer or dealer lessors ensure that profit or loss from finance leases mirrors that from outright sales, adjusted for normal selling prices and any relevant discounts.	A manufacturer or dealer lessor does not recognise any selling profit on entering into an operating lease because it is not the equivalent of a sale recognition.

Key differences from IFRS 16

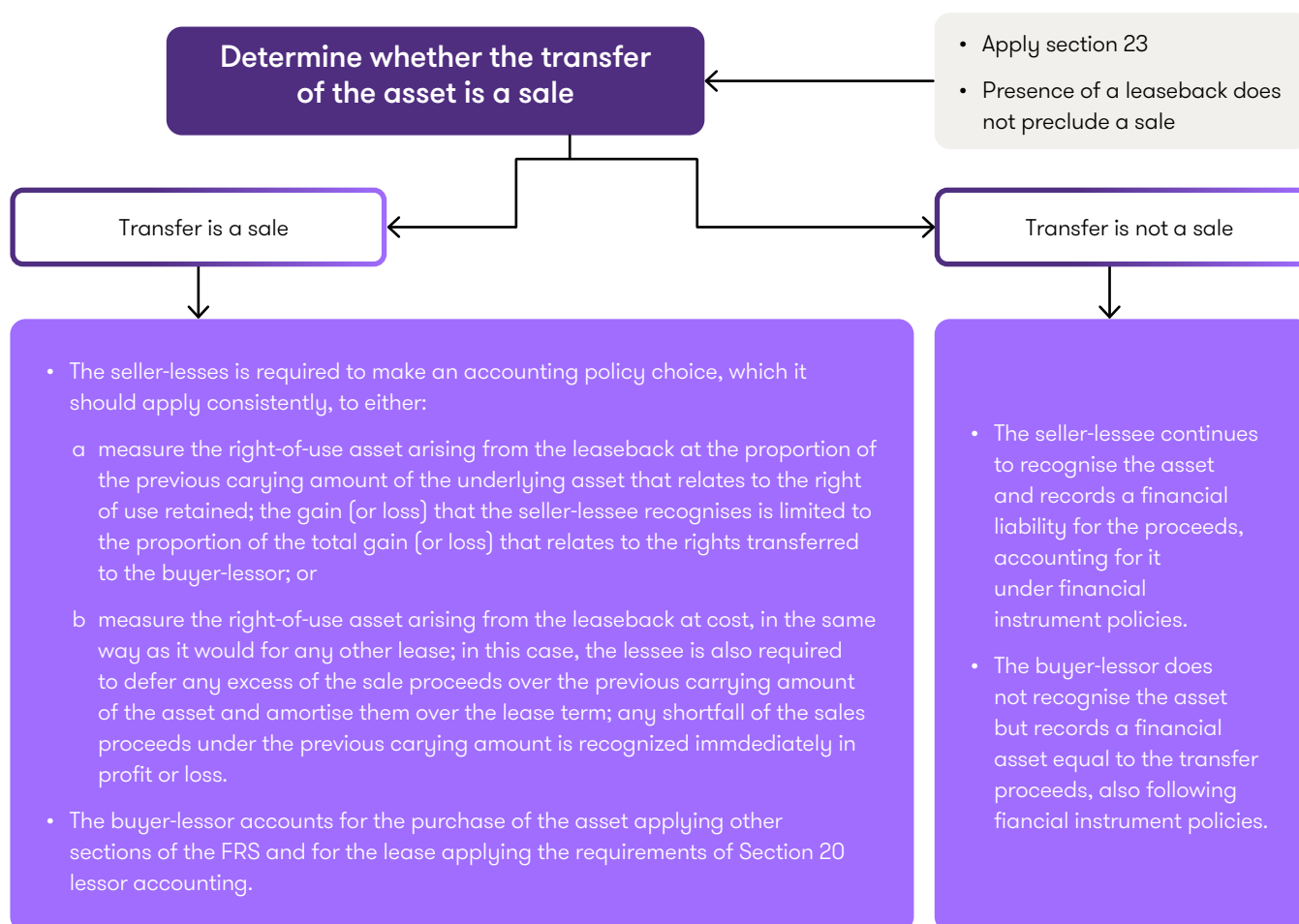
Similar to IFRS 16, a lessor in an operating lease recognises lease payments received as income on a straight-line basis, unless another systematic basis is more representative of the pattern in which benefit from the use of the underlying asset diminishes.

However, Section 20 continues to specify a third method of recognising operating lease income. If lease payments are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increase, such inflationary increases would be recognised as variable lease payments in the period to which they relate. This condition is not met if the lease payments vary according to factors other than general inflation.



Sale-and- leaseback

Section 20 Leases requires an entity to determine if the transaction qualifies as a sale for which revenue is recognised, or whether the transaction is a collateralised borrowing. This determination is not specifically expanded upon in this factsheet, but rather is summarised below.



Key differences from IFRS 16

IFRS 16 permits only one approach for the seller-lessee to measure the right-of-use asset in a sale and leaseback; however, Section 20 provides an accounting policy choice. Section 20 allows a seller-lessee to apply either:

- The IFRS 16 approach of measuring the right-of-use asset at the proportion of the previous carrying amount of the underlying asset that relates to the right of use retained; or
- An approach similar to that previously required for the seller-lessee in a finance lease – that is, measure the right-of-use asset arising from the leaseback at cost, with any excess of the sale proceeds over the previous carrying amount of the asset deferred and amortised over the lease term. Any shortfall of the sales proceeds compared to the previous carrying amount is recognised immediately in profit or loss.



Transition to the new standards

Lessees

Lessees are required to apply a **modified retrospective approach** on transition to revised Section 20 Leases. A lessee **must not restate its comparative figures**; rather it recognises the cumulative effect of initially applying the amendments as an **adjustment to the opening balance of retained earnings on the date of initial application**. For example, an entity preparing accounts for the year to 31 December 2026 will have a date of initial application of 1 January 2026, and any impact of applying the new Standard will be reflected as an adjustment to opening reserves at 1 January 2026; the comparatives for the year ended 31 December 2025 are not changed.

As a practical expedient, a lessee that is already preparing IFRS 16 information for the purpose of consolidated financial statements is permitted to transition to revised Section 20 Leases by recognising the IFRS 16 carrying amounts of its right-of-use assets and lease liabilities at the date of initial application. Again, the entity is not permitted to adjust comparative figures.

If the above practical expedient regarding IFRS group reporting is not available or is not taken, the lessee measures, **for each lease previously classified as an operating lease:**

- The lease liability by discounting the remaining lease payments using either the incremental borrowing rate or obtainable borrowing rate at the date of initial application; and
- The right-of-use asset at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments recognised on the balance sheet immediately before transition. Consideration should be made for any impairment of the right-of-use asset that may be required. A practical expedient is offered to instead allow entities to determine, immediately before the date of initial application, to determine whether the lease is onerous, and therefore apply Section 21 **Provisions and Contingencies** rather than the requirements of Section 27 **Impairment of assets**.

For leases **previously classified as operating leases**, a lessee can choose to apply various practical expedients, on a lease-by-lease basis, when first applying the Periodic Review 2024 amendments. These are:

- Applying a single discount rate to a portfolio of leases with reasonably similar characteristics;
- Relying on previous onerous lease assessments rather than assessing whether right-of-use assets recognised on the balance sheet on the date of initial application are impaired.
- Applying the recognition exemptions for leases of low-value assets and short-term leases; and
- The use of hindsight in assessing the terms of a lease, such as in assessing whether an extension or termination option is likely to be exercised when determining the lease term.

For operating leases **previously accounted for as investment property**, applying the fair value model as set out in Section 16 **Investment Property**, do not require any adjustment on initial application. The lessee shall account for the right-of-use asset and the lease liability arising from those leases applying Section 16 Investment Property and the revised Section 20 Leases, respectively, from the date of initial application. For leases previously accounted for as operating leases, but which will be accounted for as investment property from the date of initial application, the right-of-use asset shall be measured at that date at fair value.

For each lease **previously classified as a finance lease**, a lessee recognises a right-of-use asset and lease liability at the date of initial application at the carrying amount of the leased asset and finance lease liability immediately before that date. There will therefore be no adjustment to retained earnings at the date of initial application in respect of leases previously classified as finance leases. However, depending on the circumstances of the lease, subsequent measurement of leases previously classified as finance leases may differ from that which would have been measured using the old lease accounting model, for example if there are lease modifications after the date of initial application.

The practical expedients an entity applies, if any, on transition to the new requirements must be disclosed.

Lessors

If a lessor is **not an intermediate lessor**, it makes no adjustments on transition for its leases and accounts for those leases applying the revised Section 20 from the date of initial application.

If a lessor is an **intermediate lessor**, it must reassess the classification of its operating leases at initial application of the revised Section 20 Leases with reference to the remaining contractual terms and conditions of the head lease and sublease at that date. If the operating lease is reclassified as a finance lease as a result of this assessment, it is then accounted for as a finance lease from the date of initial application.

Sale and leaseback

An entity shall not reassess sale and leaseback transactions entered into before the date of initial application to determine whether the transfer of the underlying asset satisfies the requirements in Section 23 Revenue from Contracts with Customers, applying the Periodic Review 2024 amendments, to be accounted for as a sale.

If a sale and leaseback transaction was previously accounted for as a sale and finance lease, unless it applies the practical expedient of using IFRS 16 consolidated figures to calculate opening balances, the seller-lessee shall:

- Account for the leaseback in the same way as it accounts for any other finance lease that exists at the date of initial application; and
- Continue to amortise any gain or loss on sale over the lease term.

If a sale and leaseback transaction was previously accounted for as a sale and operating lease, unless it applies the practical expedient of using IFRS 16 consolidated figures to calculate opening balances, the seller-lessee shall:

- Account for the leaseback in the same way as it accounts for any other operating lease that exists at the date of initial application; and
- Adjust the leaseback right-of-use asset for any deferred gains or losses that relate to off-market terms recognised in the statement of financial position immediately before the date of initial application

Key differences from IFRS 16

Overall, the transition approach is similar to that in IFRS 16. However, IFRS 16 provided more options than FRS 102, which mandates a particular approach for many aspects of transition. Most notably, IFRS 16 allowed an accounting policy choice on transition between fully retrospective application and modified retrospective application, and it included different options for measuring the right-of-use asset. However, Section 20 requires a lessee to apply the modified retrospective approach to all leases and to measure the right-of-use asset equal to the liability.

If a lessee already calculates IFRS 16 balances for group reporting purposes, it can choose to recognise these amounts as its opening balances on transition to revised Section 20. This is a significant simplification that is likely to save substantial time and effort for preparers that use it.

Unlike IFRS 16, Section 20 of FRS 102 does not require an explanation of differences between operating lease commitments reported under previous Section 20 and initial lease liabilities measured in accordance with revised Section 20.



Disclosure requirements

Presentation and disclosure

There are several disclosures introduced under the revised Section 20. Additional disclosures, other than those listed below, may be required by company law or other regulation. There are some exemptions for entities applying Section 1A **Small Entities**, or entities that fall within the reduced disclosure framework within paragraph 1.12, but even with these provisions, these entities will still see an increase in required disclosures.

Lessee

- ROU assets and lease liabilities can be presented separately in the statement of financial position or disclosed in notes, and it must be clear what categories of PPE the ROU assets are included within.
- Investment property ROU assets are presented separately as investment property in the statement of financial position.
- A description of the significant leasing arrangements and additional qualitative and quantitative information if necessary to enable users to understand significant leasing arrangements should be included.
- Specific disclosures are required in respect of the lease liability, for example, the total interest expense, total cash outflows, variable lease payments not included in lease liabilities and the carrying amounts of remeasured lease liabilities.
- Specific disclosures are required in respect of the ROU assets which include a reconciliation of the carrying amount at the beginning and end of the reporting period.
- Disclosure should be made of the expense relating to short-term leases and low-value assets with certain exceptions.
- Disclosure of any lease commitments, including those for short-term and low-value leases, disaggregated by maturity periods should be presented.
- Disclosure of any practical expedients applied in respect of accounting for portfolio of leases and separating lease and non-lease components should be made, as well any as practical expedients used in transitioning to the new requirements.
- Income from subleasing ROU assets and gains or losses arising from sale and leaseback transactions must be shown.
- Specific disclosures are required for ROU assets carried at revalued amounts under a fair value model.

Lessor

Lessor – General

- Disclosure must be given of the lessor's significant leasing arrangements, including both qualitative and quantitative information necessary to enable users to understand those arrangements. This includes, where relevant, information about variable lease payments, renewal or purchase options and escalation clauses, subleases, and restrictions imposed by lease arrangements.

Lessor – Operating leases

- A lessor must present underlying assets subject to operating leases on its statement of financial position based on the nature of each specific asset.
- Lease income must be shown, separately disclosing income relating to variable lease payments that do not depend on an index or a rate, in the statement of profit and loss account.
- For property, plant, and equipment under operating leases, the lessor should apply Section 17 **Property, Plant and Equipment**, disclosure requirements, distinguishing these assets from owned assets. Further disclosures under Section 16 **Investment Properties**, Section 18 **Intangible Assets other than Goodwill**, Section 27 **Impairment of Assets**, and Section 34 Specialised **Activities** should also be applied as necessary.
- A maturity analysis of lease payments receivable should be provided, detailing undiscounted payments annually for at least five years and totals for subsequent years.

Lessor – Finance leases

- Disclosure must be made of selling profit or loss associated with finance leases, finance income from the net investment in the lease and income related to variable lease payments not factored into the net investment.
- Disclosure of qualitative and quantitative explanation of the significant changes during the reporting period in the carrying amount of the net investment in finance leases must be made.
- A maturity analysis of lease payments receivable must be provided, reconciling undiscounted payments with the net investment and disclosing unearned finance income and allowances for uncollectible payments.

A woman with dark hair and round glasses is shown from the waist up, holding a tablet in her left hand and gesturing with her right hand. She is wearing a grey sweater and light-colored trousers. The background is a deep blue with faint, glowing white lines forming concentric circles. In the background, there is a faint projection of code, including lines like 'php get_sid', 'php get_for', and 'temp'.

Appendix

Example – Lease previously treated as an operating lease

Sunnie Ltd signed a five-year lease on 22 December 2024 to lease a bonded warehouse facility. Lease rentals are CU137,500 per annum payable monthly. The lease previously met the operating lease criteria in FRS 102 (January 2022). Sunnie Ltd has an accounting reference date of 31 March. No upfront fees were payable on inception of the lease and no lease incentives were granted. On 1 April 2026, the company could borrow similar amounts of money from a reputable high street lender at a rate of 7% per annum. The lease payments are profiled as follows:

	CU	
Lease rentals in the agreement	687,500	
Lease rentals payable per year	137,500	
Lease rentals payable per month	11,458	(rounded)

VAT/equivalent sales taxes have been ignored for the purposes of this example.

In the years to 31 March 2026

The following lease payments have been recognised in profit or loss as the lease was previously accounted for as an operating lease under FRS 102 (January 2022), as Sunnie has not yet adjusted for the new accounting requirements.

	CU	
Year to 31 March 2025:	34,375	(CU137,500 × 3/12)
Year to 31 March 2026:	137,500	

Lease rentals not paid at each reporting date are as follows:

	CU	
1 April 2025	653,125	
1 April 2026	515,625	
1 April 2027	378,125	
1 April 2028	240,625	
1 April 2029	103,125	

Transition to FRS 102 (2024)

The date of initial application of the new lease accounting rules is 1 April 2026, and therefore, the first set of accounts to use the new accounting requirements will be those prepared to 31 March 2027. At 1 April 2026, the committed lease rentals (i.e. unpaid lease rentals) amount to CU515,625. Being an operating lease, this was previously not included on the balance sheet, but disclosed as a commitment.

Sunnie Ltd can borrow money at 7% on 1 April 2026. Hence on initial application, the present value of its future lease payments was:

	CU	CU
31 March 2027	$137,500 \times 1/1.07^1$	128,505
31 March 2028	$137,500 \times 1/1.07^2$	120,098
31 March 2029	$137,500 \times 1/1.07^3$	112,241
31 December 2029	$103,125 \times 1/1.07^3$	84,181
Present value of committed lease payments		445,025

There is no retrospective restatement where a lease was previously classified as an operating lease. The lessee recognises a lease liability at the date of initial application at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate or the obtainable borrowing rate.

Sunnie Ltd recognises the right-of-use asset at the amount of the lease liability (as calculated above) adjusted for any prepaid or accrued lease payments (although there are no prepaid or accrued lease payments in this example):

Journal 1

1 April 2026	CU
Dr Property, plant and equipment	445,025
Cr Lease liability	445,025
Being recognition of lease at date of initial application	

Sunnie Ltd could choose to present this as a right-of-use asset on the face of the balance sheet rather than within property, plant and equipment. It could also recognise the asset within property, plant and equipment and disclose which line items include right-of-use assets.

The journal entries for lease rentals during the transition year, in accordance with the new lease accounting requirements, will be recorded as follows:

Journal 2

1 April 2026 - 31 March 2027	CU
Dr Lease liability	137,500
Cr Cash	137,500
Being recognition of lease rentals payments during the year of transition	

Journal 3

At 31 March 2027, a journal will be required to allocate the finance cost of CU28,607 as follows:

31 March 2027	CU
Dr Finance cost (profit and loss)	28,607
Cr Lease liability	28,607
Being interest charge on lease liability	

Subsequent measurement of right-of-use asset

The right-of-use asset is then depreciated in accordance with FRS 102, Section 17 Property, Plant and Equipment. Where there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset is fully depreciated over the shorter of the lease term and its useful economic life.

In addition, the lessee must carry out an assessment at each reporting date as to whether the right-of-use asset is impaired in accordance with FRS 102, Section 27 Impairment of Assets.

For the purposes of this example, assuming a four-year useful economic life, the right-of-use asset is depreciated at an amount of CU111,256 (i.e., CU445,025 / 4):

Journal 4

1 April 2026 - 31 March 2027	CU
Dr Depreciation charges (profit and loss)	111,256
Cr Accumulated depreciation balance sheet (RoU asset)	111,256
Being depreciation of right-of-use asset	

Subsequent measurement of the lease liability

The lease liability is subsequently measured using the amortised cost method in accordance with FRS 102, Section 11 Basic Financial Instruments. This uses an effective interest rate and is accounted for as follows:

Year/period	Opening balance	Cash flow	Interest @ 7%	Closing balance
	CU	CU	CU	CU
31 March 2027	445,025	(137,500)	28,607	336,132
31 March 2028	336,132	(137,500)	21,607	220,239
31 March 2029	220,239	(137,500)	14,157	96,896
31 December 2029	96,896	(103,125)	6,229	–

The above calculation results in a slightly lower effective interest rate (of 6.43% rather than 7%) as the payments have been apportioned over three years plus the final ending balance of nine months to ensure each period has an effective interest charge in profit or loss.

Summary of impact of journals 1 to 4

Year ended 31 March 2027	Asset	Liability	P&L impact
Property, plant and equipment	333,769		Journals 1 and 4
Lease liability		336,132	Journals 1, 2 and 3
Impact on profit and loss account			139,863 Journals 3 and 4

Presentation of the lease liability at 31 March 2027

At 31 March 2027, the lease liability is split between the portion falling due within one year of CU115,893 (CU336,132 – CU220,239) and the portion falling due after more than one year of CU220,239 to comply with the statutory formats of the balance sheet.

Impact on the financial statements

The overall impact on the financial statements of moving the lease on-balance sheet is as follows:

Impact on profit and loss FRS 102 (2024)		Impact on profit and loss FRS 102 (2022)	
Depreciation charge	CU111,256	Lease rental expense	CU137,500
Finance cost	CU28,607		
Total impact	CU139,863		

Overall impact is a reduction in profit of CU2,363.

Impact on balance sheet FRS 102 (2024)		Impact on balance sheet FRS 102 (2022)	
Reduction in cash	(CU137,500)	Reduction in cash	(CU137,500)
Right-of-use asset	CU333,769		
Lease liability	(CU336,132)		

Additional asset is recognised of CU333,769 with a current lease liability of CU115,893 and a non-current lease liability of CU220,239.

If there are issues such as lease incentives (e.g. a rent-free period) then the calculations above may become a little more complex. For clarity, under FRS 102, lease incentives are amortised over the period of the lease.



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