KRESTON REEVES
AN AAB GROUP COMPANY

FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland (September 2024)

▼ Worked examples for leases and revenue recognition on initial application

Example: Lease previously treated as an operating lease

Fire Prevention Limited signed a ten-year lease on 30 September 2024 to lease a warehouse facility and offices. Lease rentals are £100,000 per annum payable on a quarterly basis in arrears. The lease previously met the operating lease criteria in FRS 102 (January 2022). Fire Prevention Limited has an accounting reference date of 31 December. No upfront fees were payable on inception of the lease, and no lease incentives were granted. On 1 January 2026, the company could borrow money from a reputable high-street lender at a rate of 6% per annum[1]. The lease payments are profiled as follows:

	£
Lease rentals in the agreement	1,000,000
Lease rentals payable per annum	100,000
Lease rentals payable per quarter	25,000

VAT has been ignored for the purposes of this example.

Income statement rental expense in the periods to 31 December 2025

	£
Year to 31 December 2024	25,000 (£100,000 x 3/12)
Year to 31 December 2025	100,000

1 The discount rate should be the company's incremental borrowing rate or obtainable borrowing rate. The 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. The 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.

Transition to FRS 102 (Revised 2024)

The date of initial application of the new lease accounting rules is 1 January 2026. On this date, the committed lease rentals (i.e. unpaid lease rentals) amount to £875,000. Changes to lease accounting policies must be applied by using the modified retrospective approach.

Fire Prevention Limited can borrow money at 6% on 1 January 2026, hence on initial application *(Note: the figures used below have been annualised for illustrative purposes, with full payment made in arrears. In practice, these present value calculations should be performed on a quarterly basis for the most accurate outcome)*:

Year	Calculation £	Present value £
31.12.26	$100{,}000 \times 1 / 1.06^{1}$	94,340
31.12.27	$100{,}000 \times 1 / 1.06^{2}$	89,000
31.12.28	$100{,}000 \times 1 / 1.06^{3}$	83,962
31.12.29	$100{,}000 \times 1 / 1.06^{4}$	79,209
31.12.30	$100{,}000 \times 1 / 1.06^{5}$	74,726
31.12.31	$100{,}000 \times 1 / 1.06^{6}$	70,496
31.12.32	$100{,}000 \times 1 / 1.06^{7}$	66,506
31.12.33	$100{,}000 \times 1 / 1.06^{8}$	62,741
31.12.34	$75{,}000 \times 1 / 1.06^{9}$	44,392
Present value of lease payments		**665,372**

The above illustration demonstrates the concepts involved in arriving at the present value of the committed lease payments at the date of initial application of FRS 102 (September 2024) Section 20.

Please note, there is no retrospective restatement where a lease was previously classified as an operating lease (FRS 102, para 1.47). Paragraph 1.51(a) states that 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.

Fire Prevention Limited 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

Dr Property, plant and equipment	£665,372
Cr Lease liability	£665,372

Being the recognition of the lease at the date of initial application (1 January 2026)

Fire Prevention Limited could choose to present this as a right-of-use asset in the statement of financial position rather than within property, plant and equipment. Where it is recognised within property, plant and equipment, the entity should disclose which line items include right-of-use assets.

In the year of initial application of the new accounting treatment, the company may have already posted the lease rental payments to profit or loss i.e. Debit Rent expense; Credit Bank.

If the lease rentals have been posted to profit or loss during the year of transition and the amounts paid, a journal to reallocate these will need to be made. Rental payments are recorded as a reduction in the lease liability under the new lease accounting requirements and the income statement charges will reflect interest on the lease liability and depreciation of the right-of-use asset (see below):

Journal 2

Dr Lease liability	£100,000
Cr Rent expense	£100,000

Being the reallocation of the lease payments

A further journal will also need to be recorded to include the year-end finance cost (interest) for the lease liability as at 31 December 2026, which will be calculated in the next step (see Journal 4).

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 one-hundred-and five-month useful economic life (eight years and nine months), the right-of-use asset is depreciated at an amount of £76,042 per annum (£665,372 / 105 x 12):

Journal 3

Dr Depreciation charge (P+L)	£76,042
Cr Accumulated depreciation (BS)	£76,042

Being depreciation of right-of-use asset for the year ended 31 December 2026

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	Opening balance	Interest at 6%	Cashflow	Closing balance
31.12.26	665,372	39,922	(100,000)	605,294
31.12.27	605,294	36,318	(100,000)	541,612
31.12.28	541,612	32,497	(100,000)	474,109
31.12.29	474,109	28,447	(100,000)	402,556
31.12.30	402,556	24,153	(100,000)	326,709
31.12.31	326,709	19,602	(100,000)	246,311
31.12.32	246,311	14,779	(100,000)	161,090
31.12.33	161,090	9,665	(100,000)	70,755
31.12.34	70,755	4,245	(75,000)	-

Journal 4

Dr Finance cost (P+L)	£39,922
Cr Lease liability	£39,922

Being interest charge on lease liability for the year ended 31 December 2026

Presentation of the lease liability at 31 December 2026

At 31 December 2026, the lease liability is split between the portion falling due within one year of £63,682 (£605,294 – £541,612) and the portion falling due after more than one year of £541,612, to comply with the statutory formats of the balance sheet.

Lessees must present lease liabilities separately from other liabilities and disclose which line items in the statement of financial position include these liabilities if not presented separately in the statement of financial position.

Impact on the financial statements

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

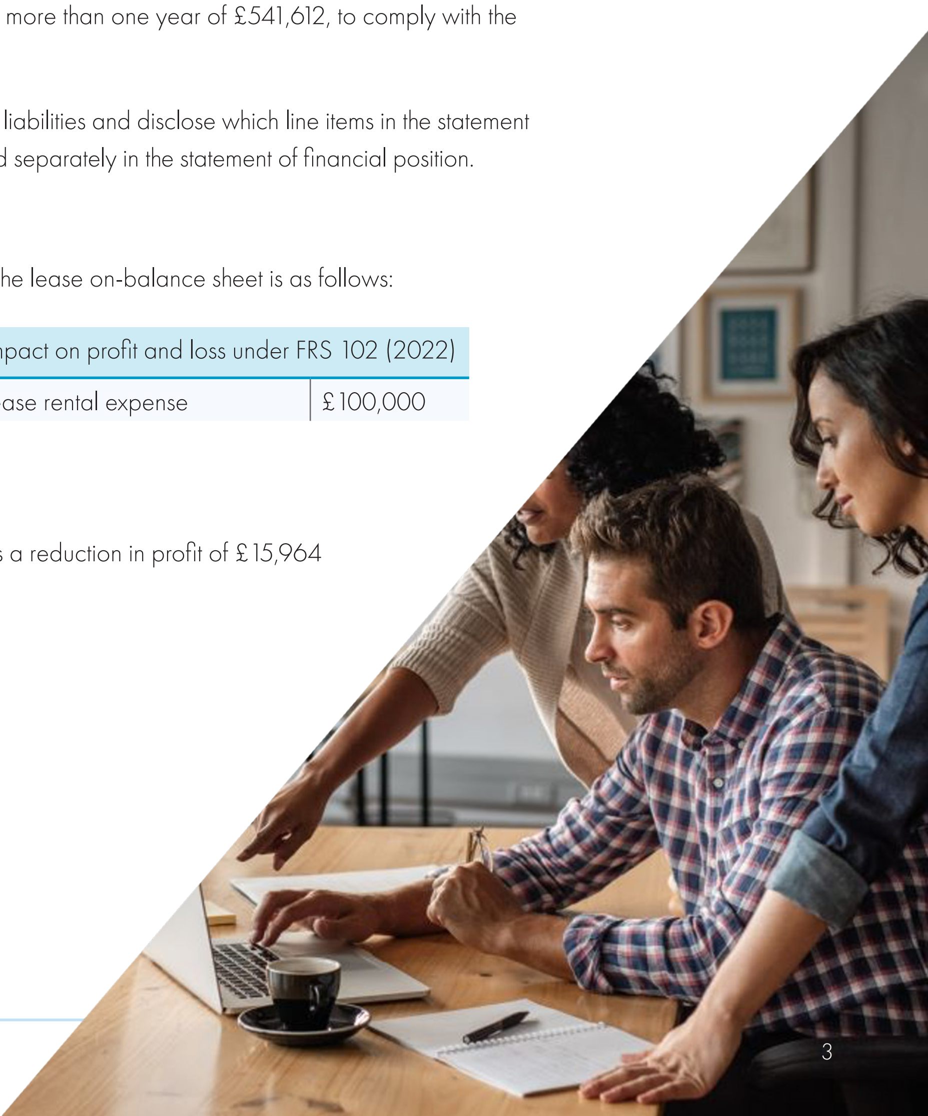
Impact on profit and loss under FRS 102 (2024)	
Depreciation charge	£76,042
Finance cost	£39,922
Total impact	£115,964

Impact on profit and loss under FRS 102 (2022)	
Lease rental expense	£100,000

Overall impact for the year ended 31 December 2026 is a reduction in profit of £15,964

Impact on balance sheet under FRS 102 (2024)	
Reduction in cash	(£100,000)
Right-of-use asset	£589,330
Lease liability	(£605,294)

Impact on balance sheet under FRS 102 (2022)	
Reduction in cash	(£100,000)



Additional asset is recognised of £589,330 with a current lease liability of £63,682 and a non-current lease liability of £541,612 as at 31 December 2026.

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.

Disclosures

FRS 102 para 76 – 85 describes the additional disclosures required to be made by lessees.

Example: Revenue recognition (allocating the transaction price and recognising the revenue)

FRS 102 (September 2024), Section 23, *Revenue from Contracts with Customers*, has a five-step comprehensive model for recognising revenue. FRS 102 para 23.4 clarifies that the objective of the model is for an entity to recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and/or services.

Some contracts contain more than one performance obligation. For example, a company could sell an item of equipment to a customer and provide one year's servicing and maintenance. FRS 102, para 23.65 requires the entity to allocate the transaction price to each performance obligation identified on a relative stand-alone selling price basis, unless allocating discounts or variable amounts on an alternative basis.

Where a customer is offered a discount for purchasing a bundle of goods and services, the discount is allocated across all performance obligations within the contract in proportion to their stand-alone selling prices, unless observable evidence suggests that this would be inaccurate.

Fire Prevention Limited sells specific fire prevention equipment with one year's free servicing and maintenance support. A standard contract for this equipment has revenue of £50,000. The sale of the equipment and the servicing and maintenance support have both been identified as separate performance obligations. Historically, the company has recognised the income arising from these contracts at one point in time, on completion of the installation of the equipment.

On a stand-alone basis, the equipment would sell for £45,000. Other similar support services provided by the company (all of which generate a profit), attract a markup of 50%. It is expected that the technical support service will cost £15,000. During the year ended 31 December 2025 the company entered into various contracts which now need to be considered in the context of the five-step model.

The selling price of the equipment on a stand-alone basis is £45,000 but there is no observable selling price for the provision of servicing and maintenance support. FRS 102, para 23.69 requires the stand-alone selling price to be estimated. FRS 102, para 23.70 suggests the following suitable methods:

(a) an adjusted market assessment approach

(b) expected cost plus a margin approach

(c) residual approach.

The entity determines that it can estimate the stand-alone selling price of the servicing and maintenance support using an expected cost plus a margin approach. Based on this approach, the selling price of the servicing and maintenance support service would be £22,500 (£15,000 x 150%).

The total of the stand-alone selling prices of the equipment and servicing and maintenance support is £67,500 (£45,000 + £22,500). However, the total consideration is only £50,000. This means the customer is receiving a discount for purchasing a bundle of goods and services of 25.93% (£17,500/£67,500).

FRS 102, para 23.74 assumes that discounts relate to all performance obligations within a contract unless this basis does not depict the amount of consideration to which the entity expects to be entitled (in which case the entity uses a method that does reflect such amounts).

The transaction price allocated to the equipment is £33,333 (£45,000 x 74.07%).

The transaction price allocated to the servicing and maintenance support is £16,667 (£22,500 x 74.07%).

Revenue is recognised when (or as) the entity satisfies a performance obligation by transferring a good or service to a customer. A performance obligation is said to be satisfied over time if one of the following criteria in FRS 102, para 23.81 (a) to (c) is met:

(a) The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.

(b) The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced.

(c) The entity's performance does not create an asset with alternative use to the entity, and the entity has an enforceable right to payment for performance completed to date.

If a performance obligation is not satisfied over time, then it is satisfied at a point in time. The entity must determine the point in time at which a customer obtains control of a promised asset.

Fire Prevention Limited has determined that under FRS 102 (September 2024) the equipment revenue should be recognised on completion of the installation of the equipment and the servicing and maintenance support revenue is a separate performance obligation which is performed over time and should be recognised based on the output method based on time elapsed.

Fire Prevention Limited has identified a number of contracts at 31 December 2025 where the equipment had been installed less than twelve months previously and the company was still within the twelve-month window for servicing and maintaining the equipment (i.e. contracts that are not completed as of the date of initial application).

Based on the time elapsed from installation of the equipment, the entity has calculated total revenue of £375,000 related to the year ending 31 December 2026. This is revenue previously recognised at the point of installation where there was an ongoing obligation to service and maintain the equipment and should be recognised over time under the revision to FRS 102.

Changes to revenue accounting policies as a result of the FRS 102 amendments can be applied by either using the fully retrospective approach or the modified retrospective approach.

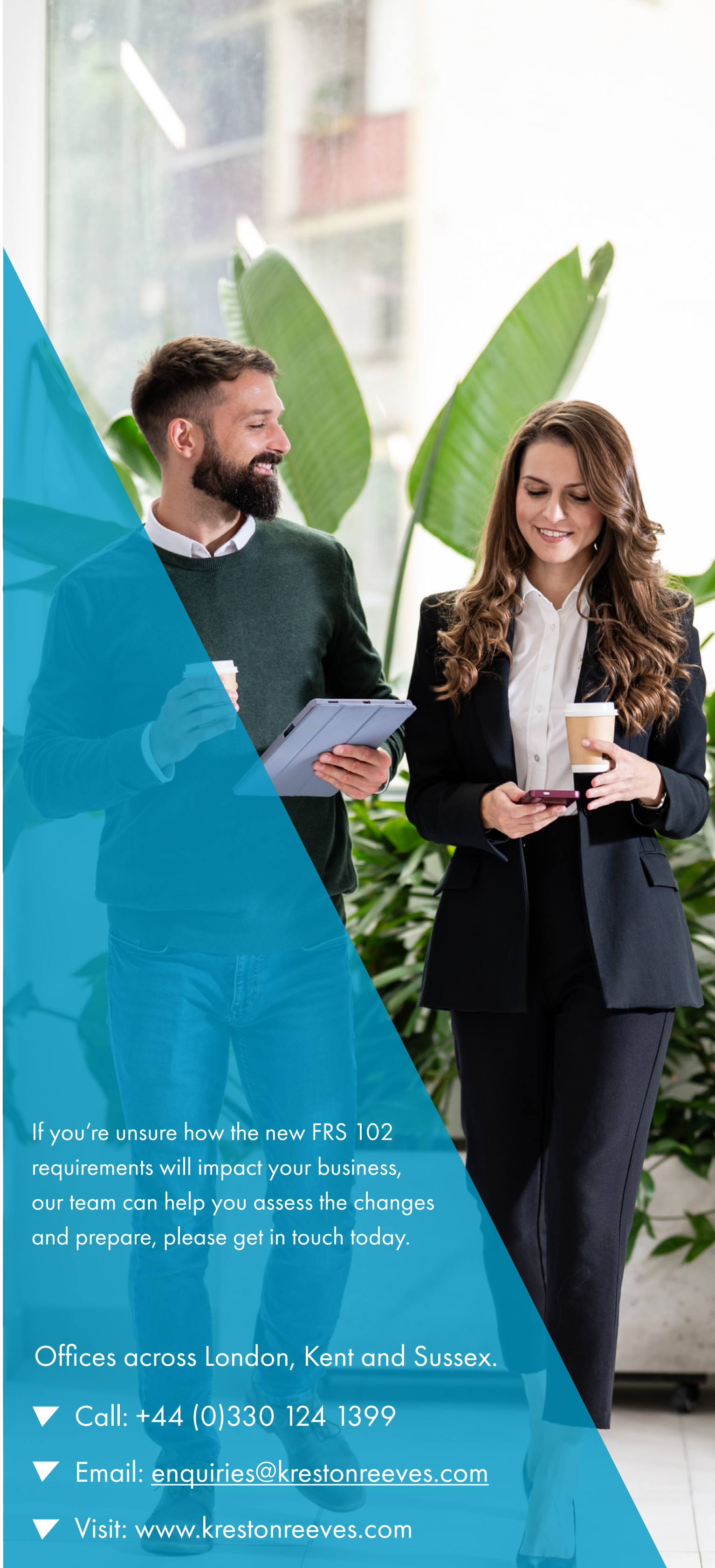
Fire Prevention Limited has chosen to apply the modified retrospective approach when recognising the changes to the revenue accounting policy. As a result, the comparatives for 2025 are not restated. Instead, any adjustments arising from the FRS 102 amendments are recognised in the opening balances as at 1 January 2026. The cumulative effect of the change in the revenue recognition policy has been recognised as an adjustment to the opening balance of retained earnings as at 1 January 2026.

Journal 5

Dr Retained earnings	£375,000
Cr Revenue (P+L)	£375,000

Being servicing and maintenance revenue deferred at 1 January 2026 and subsequently recognised during 2026

The costs incurred during the year ended 31 December 2025 directly in relation to servicing and maintenance are assumed to accrue evenly over the performance period.



If you're unsure how the new FRS 102 requirements will impact your business, our team can help you assess the changes and prepare, please get in touch today.

Offices across London, Kent and Sussex.

- Call: +44 (0)330 124 1399
- Email: enquiries@krestonreeves.com
- Visit: www.krestonreeves.com