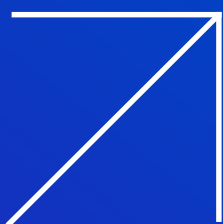




Technical Alert

# FRS 102 periodic review amendments



Leases

# Introduction

The amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and other FRSs – Periodic Review 2024 (the periodic review) included fundamental changes to the accounting for leases. This alert summarises the key requirements of revised Section 20 Leases, particularly for lessee accounting.

A summary of other changes arising from the periodic review can be found in the FRS 102 periodic review – Overview [alert](#).

Lessees are now required to recognise a right-of-use asset (ROU asset) and a corresponding lease liability on the balance sheet for all leases other than those that are either short-term leases with a term of less than 12 months or leases of low value assets. The amendments to Section 20 Leases provide an on-balance sheet lease accounting model based on the principles of IFRS 16 Leases and removes the distinction between an operating lease and finance lease for lessees.

Lessor accounting remains largely unaffected, as there is still a distinction between operating and finance leases.

The changes are effective from 1 January 2026. Earlier application is permitted, provided that all amendments included in the periodic review are applied together. If an earlier application date is adopted, this fact must be disclosed.

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### S&W observations

The recognition of an ROU asset and lease liability may result in significant changes to balance sheet and statement of profit or loss financial metrics. For example, an increase in liabilities recognised on the balance sheet may impact financial metrics such as gearing, or may impact debt covenants. Metrics such as EBITDA would also increase as interest and depreciation are adjusted for. Additionally, the initial application of the amendments may involve a significant amount of time to collect and analyse data, and assess the overall impact on the financial statements.

## Section 20 scope

**This section applies to all leases, including leases of ROU assets in a sublease, except for:**

- Leases to explore for, or use, non-regenerative resources
- Leases of biological assets within the scope of Section 34 Specialised Activities held by a lessee
- Service concession arrangements within the scope of Section 34
- Licences of intellectual property granted by a lessor within the scope of Section 23 Revenue from Contracts with Customers
- Rights held by a lessee under licensing agreements within the scope of Section 18 Intangible Assets for items other than goodwill, such 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

1. Identifying a lease

# 1. Identifying a lease

## 1.1 Definition of a lease

The amendments provide a revised approach to identifying a lease. At the inception date, the contract should be assessed for whether it is, or contains, a lease. A contract is, or contains, a lease if the contract conveys a **right to control the use of an identified asset** for a period of time in exchange for consideration. This assessment is made at the inception date of the contract and is only re-assessed if the terms and conditions of the contract are changed.

The inception date of the contract is the earlier of date of the lease agreement and the date of commitment by the parties to the principal terms and conditions of the lease, and it may not be the same as the commencement date of the lease. The commencement date is the date on which the underlying asset is made available by the lessor, for use by the lessee.

### 1.1.1 Identified asset

A key element of the definition of the lease is having an identified asset. For a lease to exist, there must be an identified asset explicitly or implicitly specified in the contract at the time the asset is made available for use by the customer. For example, this might be the right to use a specific floor of a building or to use a specific vehicle.

If there is no identified asset, there is no lease. In circumstances where an asset is specified, the asset doesn't constitute an "identified asset" if the supplier has a substantive right to substitute the asset throughout the period of use.

A supplier's right to substitute the asset is substantive only if it both:

- a) has the practical ability to substitute alternative assets throughout the period of use; and
- b) would benefit economically from doing so

Substitution rights are evaluated based on facts and circumstances at the inception date. If the customer cannot readily determine whether the supplier has a substantive substitution right, the customer shall presume that it does not.

A portion of an underlying asset can be an identified asset if it is physically distinct, such as a floor of a building. However, a portion of an underlying asset that is not physically distinct (eg a percentage of the capacity of a fibre optic cable) is not an identified asset unless the portion is substantially all of the underlying asset's overall capacity.

### 1.1.2 Right to control the use

A contract is or contains a lease when, throughout the period of use, the customer has both the following:

- The right to direct the use of the identified asset
- The right to obtain substantially all the economic benefits from using the asset throughout the lease period. If the customer has the right to control the use of the identified asset for only a portion of the contract's term, the contract contains a lease for that portion of the term

## Right to direct the use of the identified asset

The right to direct the use of the identified asset entails the customer having the right to direct how and for what purpose the asset is used throughout the period of use, in a manner that affects the economic benefits derived from its use.

However, if the relevant decisions about how and for what purpose the asset is used must be predetermined, then the right to direct use is only present if either:

- The customer has the right to operate the asset throughout the period of use, without the supplier having the right to change those instructions
- Or the customer designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose it will be used throughout the period of use

## Right to obtain substantially all the economic benefits

A customer can obtain economic benefits from the use of an asset directly or indirectly in many ways. These economic benefits include the primary output (holding the asset), any byproducts and any other economic benefits from a commercial transaction (eg subleasing the asset).

However, only benefits that fall within the defined scope of a customer's right to use the asset should be considered. For example, if subleasing the asset is prohibited under the contract, any potential benefit from doing so should be disregarded. Ultimately, determining whether the customer obtains substantially all of the economic benefits involves a degree of judgment.





## Example 1 - Identifying a lease: Concession space

A shopping mall operator (the Mall) enters into a contract with an ice cream company (Mobile Ices) to use a space in the Mall to sell its products over a three-year period. The contract specifies the square feet of the space but allows the Mall to allocate the location from several areas within the mall that would meet the size requirement in the contract. The Mall retains the right to change the location of the space allocated to Mobile Ices at any time during the contract term. Mobile Ices uses its own pop-store, which can be easily moved, so there are minimal costs to the Mall associated with changing the space for the customer.

Mobile Ices controls its own pop-up store but not the space in which it can operate. The Mall has the “substantive right to substitute” the space that Mobile Ices can operate from because:

- a) The Mall has the practical ability to change the space used by Mobile Ices throughout the period of use as there multiple areas that meet the specifications for the space in the contract, and the Mall has the right to direct where Mobile Ices operates from.
- b) The Mall can benefit economically from substituting the space to best maximise the layout of all pop-up stores . For example, having the ice creams nearer the entrances as people come in on hotter days but nearer the food hall. on colder days. Since the pop-up store is mobile, there would be minimal costs involved in a move.

Although the amount of space Mobile Ices uses is specified in the contract, there is no identified asset as the Mall has substantive substitution rights on the space Mobile Ices uses. With no identified asset, it also follows that the contract does not contain a lease.

## 1.2 Portfolio application

While Section 20 specifies the accounting for an individual lease, as a practical expedient an entity may apply the requirements to a portfolio of leases with similar characteristics (eg a similar lease term for a similar class of underlying asset in a similar economic environment). In accounting for a portfolio, an entity shall use estimates and assumptions that reflect the size and composition of the portfolio.

## 1.3 Combination of contracts

If two or more contracts are entered into at or near the same time with the same counterparty (or related parties of the counterparty), then the contracts must be combined and

accounted for as a single contract if one or more of the following criteria are met:

- a) The contracts are negotiated as a package with an overall commercial objective that cannot be understood without considering the contracts together
- b) The amount of consideration to be paid in one contract depends on the price or performance of the other contract
- c) The rights to use underlying assets conveyed in the contracts (or some rights to use underlying assets conveyed in each of the contracts) form a single lease component, as described in section 1.4.

## 1.4 Separating components of a contract

In identifying separate lease components, the right to use an underlying asset is a separate lease component if the lessee can benefit from use of the underlying asset on its own or together with other readily available resources, and the underlying asset is neither highly dependent on nor highly interrelated with the other underlying assets in the contract.

As well as containing multiple leases, a contract may contain multiple components, of which some may relate to the lease of an asset and some may relate to non-lease elements, such as services. For example, an office lease agreement may include rental payments for the use of the office space along with additional services as daily cleaning, on-site security, and maintenance of communal areas. In this case, the lease component is the right to use the office space, while the cleaning, security and maintenance services represent the non-lease components.

For a contract that is, or contains, a lease, an entity shall account for each lease component within the contract as a lease separately from non-lease components of the contract, unless the entity applies the practical expedient.

The practical expedient allows a lessee to elect, by class of underlying asset, not to separate lease components from non-lease components. Instead, each lease component and any associated non-lease components are accounted for as a single lease component. For example, applying the practical expedient to the example of an office lease arrangements with additional services would result in a single lease component comprising the right to use the office space, along with the cleaning, security and maintenance services.

If the practical expedient is not taken, a lessee shall allocate the consideration in the contract to each lease component on the basis of the relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components.

The relative stand-alone price of lease and non-lease components shall be determined on the basis of the price the lessor, or a similar supplier, would charge an entity for that component, or a similar component, separately. If an observable stand-alone price is not readily available, the lessee shall estimate the stand-alone price, maximising the use of observable information.

2. Lease term



### S&W observations

The implication of applying the practical expedient is that operating costs associated with non-lease components (which are ordinarily expensed as incurred) are instead capitalised as part of the ROU asset and corresponding lease liability. This results in an increase in both the ROU asset and lease liability recognised on the balance sheet. Consequently, there is a shift in the expense profile from operating expenses to depreciation and interest charges. This reclassification leads to an increase in EBITDA, as depreciation and interest are excluded from its calculation, but will also reduce net profit in the earlier years of the lease and increase it in the later years.

# 2. Lease term

## 2.1 Lease term

The lease term begins at the commencement date, being the date on which the lessor makes the underlying asset available for use by the lessee. This may not be the same as the inception date and includes any rent-free periods provided to the lessee by the lessor.

The term of a lease, initially assessed at the commencement date, is defined as the aggregate of:

- The non-cancellable period of the lease, including any period where only the lessor has the option to terminate the lease
- Periods covered by an option for the lessee to extend the lease if the lessee is reasonably certain to exercise that option
- Periods covered by an option for the lessee to terminate the lease if the lessee is reasonably certain not to exercise that option.

### 2.1.1. Non-cancellable periods

To assess the non-cancellable period of a lease, an entity shall determine how long the contract is enforceable. A contract is no longer enforceable if either party to the lease has the right to terminate without permission from the other party, with no more than an insignificant penalty. An “insignificant penalty” considers the broader economics of the contract and is not solely limited to a penalty written in the contract. In the diagram on the next page, if the

contract is no longer enforceable from December 2032, then there is no contract from this date and, consequently, no lease.

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. This is because the lessee has an obligation to pay for the right to use the underlying asset for the period of the lease unless and until the lessor decides to terminate the lease.

### 2.1.2. Options to extend or terminate the lease

When a lessee can choose between a shorter or a longer period, the lease term shall be the shorter period unless the lessee is reasonably certain to choose the longer period. Factors to consider in the assessment of whether an option in a lease is reasonably certain to be exercised or not include the following:

- a) The contractual terms and conditions compared with expected market rates
- b) Significant leasehold improvements expected to have significant economic benefit when the option becomes exercisable
- c) The costs relating to the termination of the lease
- d) The importance of the underlying asset to the lessee’s operations

- e) Conditionality associated with exercising the option
  - f) An entity's past practice
- The lessee is reasonably certain they will not exercise their termination option in January 2027

The diagram below reflects the above guidance in a simple example where the lease term is from February 2025 until the start of December 2029. In this example:

- There are no lessor termination options

- The lessee is not reasonably certain they will be exercising their extension option



## Example 2 - Determining the lease term

Mount Limited leases an office building with a ten year contract and a break clause at seven years. Rent payments are £60,000 a year during the initial term and £65,000 a year after the break clause, all payable at the beginning of each year.

On entering the lease, Mount Limited incurs initial direct costs of £24,000, of which £18,000 relates to a payment to the former tenant and £6,000 relates to a commission paid to the estate agent. As an incentive, the building owner agrees to reimburse Mount Limited the real estate commission of £6,000 and its leasehold improvements costs of £8,000.

Mount Limited considers its business plan and the expected value of the leasehold improvements at the break clause date. With other relevant facts and circumstances, it is unable to confirm it is reasonably certain it will not exercise the break clause. Therefore, Mount Limited determines that the lease term is seven years.



## S&W observations

Judgement may be required when assessing an extension or break option. "Reasonably certain" for an extension option is quite a high bar, higher than a "probable" threshold. As such, the factors listed above need to be carefully considered in assessing whether an extension option is reasonably certain to be exercised. The assessment will require consideration of all relevant facts and circumstances that create an economic incentive for the lessee to extend or terminate the lease.

# 3. Lessee accounting – initial measurement of the lease liability

At the commencement date, a lessee shall recognise an ROU asset and a lease liability on the balance sheet. The ROU asset represents the lessee's right to the use the leased asset, while the lease liability reflects the lessee's obligation to make lease payments. In measuring the lease balances, a lessee must first calculate the lease liability and then calculate the ROU asset.

## 3.1 Measurement of the lease liability

At the commencement date, a lessee shall measure the lease liability at the present value of the lease payments not yet paid at that date.

The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If the rate cannot be readily determined, the lessee shall choose, on a lease-by-lease basis, to apply either the lessee's incremental borrowing rate or the lessee's obtainable borrowing rate (see section 3.2). The amendments simplify the IFRS 16 requirements related to discounting lease liabilities by permitting the use of the lessee's "obtainable borrowing rate" as an alternative to the lessee's "incremental borrowing rate" where the rate implicit in the lease cannot readily be determined.

The following lease payments should be included in the measurement of the liability:

- Fixed payments (including in-substance fixed payments), less

any lease incentives receivable

- Variable lease payments that depend on an index or rate, initially measured using the index or rate as at the commencement date
- 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

## 3.2 Discount rate

The interest rate implicit in the lease is the rate that would result in the present value of the lease payments and the unguaranteed residual value equalling the sum of the underlying asset's fair value and any initial direct costs of the lessor.

As the information is not usually available to readily determine the interest rate implicit in the lease, the lessee shall choose, on a lease-by-lease basis, to apply either the lessee's incremental borrowing rate (IBR) or the lessee's obtainable borrowing rate (OBR).

## Incremental borrowing rate (IBR)

The IBR is defined as the rate of interest that 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 ROU asset in a similar economic environment.

## Obtainable borrowing rate (OBR)

The OBR is defined as the rate of interest that 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.



### S&W observations

Conceptually, the IBR and OBR are different rates: The IBR is a rate with a similar security or in a similar economic environment, while the OBR does not require a similar security or economic environment. Consequently, the IBR may be lower than the OBR, which reflects an unsecured interest rate. The IBR also requires an estimation of the value of the ROU asset, while the OBR focusses on the known payment details of the lease contract.

Determining the appropriate interest may involve judgement, particularly if a lessee doesn't have existing borrowings.

## 3.3 In-substance fixed lease payments

In-substance fixed lease payments are payments that may, in form, contain variability, but that, in substance, are unavoidable. For example, these may include payments that 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. Some payments may initially contain variability but become in-substance fixed payments when the variability is resolved.

4. Initial measurement of the right-of-use asset - lessee accounting



# 4. Initial measurement of the right-of-use asset – lessee accounting

At the commencement date, a lessee shall measure the ROU asset at cost. The cost of the ROU asset shall comprise:

- The amount of the initial measurement of the lease liability (see section 3 above)
  - Any lease payments made at or before the commencement date, less any lease incentives received
  - Any initial direct costs incurred by the lessee
  - Any amount recognised in accordance with Section 21 Provisions and Contingencies at the commencement date as an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the
- condition required by the terms and conditions of the lease
  - Any amount recognised at the commencement date in accordance with Section 24 Government Grants or, for a public benefit entity in accordance with Section 34 Specialised Activities, in respect of non-exchange transactions





### Example 3a - Initial measurement of the ROU asset and lease liability

Mount Limited (see Example 2 above, for background) considers its business plan, the expected value of the leasehold improvements at the break clause date and with other relevant facts and circumstances. Consequently, it is unable to confirm it is reasonably certain it will not exercise the break clause and, therefore, determines that the lease term is seven years.

The interest rate implicit in the lease is not readily determinable. Mount Limited's incremental borrowing rate is 5.5% per annum, which reflects the fixed rate at which the lessee could borrow an amount similar to the value of the ROU asset, in the same currency, for a seven-year term with similar collateral.

So, how does the lessee initially account for the lease?

At the lease commencement date, Mount Limited pays the first year rent, incurs initial direct costs, and receives lease incentives from the lessor. The lease liability is measured at the present value of the remaining six annual rent payments of £60,000, discounted at the interest rate of 5.5% per annum, resulting in an initial lease liability of £359,732. However, while the lease payments comprise of seven payments of £60,000, the first payment is made on 1 January (ie the commencement date) and therefore the lease liability is immediately reduced by the first lease payment.

**Mount Limited initially recognises an ROU asset and lease liability as follows:**

Account	Debit	Credit
ROU asset	£359,732	
Lease liability		£359,732
Lease liability	£60,000	
Cash (lease payment on 1 Jan)		£60,000
ROU asset	£24,000	
Cash (initial direct costs)		£24,000
Cash (lease incentive)	£14,000	
ROU asset		£14,000



5. Subsequent measurement - lease accounting

# 5. Subsequent measurement – lessee accounting

## 5.1 ROU asset

After initial recognition, a lessee shall measure the ROU asset by applying the cost model (cost less accumulated depreciation and impairment losses, and adjusted for any remeasurement of the lease liability), unless it is eligible to and chooses to apply the fair value model in Section 16 Investment Property or the revaluation model in Section 17 Property, Plant and Equipment.

## 5.2 Lease liability

After initial recognition, the lease liability shall be measured by:

- Increasing the carrying amount for the interest expense (the unwinding of the discount) on the lease liability
- Reducing the carrying amount for the amount of lease payments made
- Remeasuring the carrying amount for the effects of any reassessment, lease modifications, and revised in-substance fixed lease payments

The lessee shall also recognise in profit or loss both the interest on the lease liability and variable lease payments not included in the measurement of the lease liability (see section 4 above). These variable lease payments should be recognised in the period in which the event or condition that triggered those payments occurred.

The unwinding of the discount is treated as an interest expense in the income statement. Any cash outflows of interest are presented as cash flows from either operating or financing activities in the cash flow statement, depending on the entity's policy for classifying interest payments. Principal payments of lease liabilities appear as cash flows from financing activities.

## 5.3 Reassessment of the lease liability

Where there are changes to the terms and conditions of existing leases, a lessee needs to first consider the modification guidance (see section 5.4 below). If the modification does not result in a separate lease, the lessee shall remeasure the lease liability to reflect changes to lease payments. The amount of the remeasurement of the lease liability shall be recognised as an adjustment to the ROU 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.

The impact on the discount rate arising from changes within the existing terms and conditions of a lease are approached as follows:

- A change in the lease term or in the assessment of an option to purchase the underlying asset results in remeasurement of the lease liability using a revised

discount rate	unchanged discount rate
– A change in 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 a rate used to determine those payments results in remeasurement of the lease liability using an	A lessee shall determine the revised discount rate as the interest rate implicit in the lease for the remainder of the lease term. If that rate cannot be readily determined, the lessee shall use either the lessee's incremental borrowing rate or the lessee's obtainable borrowing rate at the date of reassessment.



### Example 3b - Subsequent measurement of a lease and accounting change in the lease term

Mount Limited (see background in Example 2), at the end of Year 4 of the lease, initiates a strategic office consolidation plan. As part of this initiative, Mount Limited decides to centralise its operations by relocating staff from multiple smaller leased sites into the originally leased building.

This consolidation involves significant leasehold improvements recognised separately as property, plant and equipment, which creates an economic incentive for Mount Limited to not exercise the break clause in the original lease. The decision represents a significant event within Mount Limited's control and directly impacts the assessment of whether it is now reasonably certain to exercise the break clause option.

The original building now offers greater utility and operational efficiency compared to alternative assets available for similar cost. Moving to a different building would result in additional expenses and logistical challenges due to the disruption of having the workforce split across multiple sites.

Consequently, at the end of Year 4, Mount Limited concludes that it is now reasonably certain not to exercise the break clause option.

At the end of Year 4, Mount Limited reassesses the lease using an updated incremental borrowing rate of 6.5% per annum. This reflects the interest rate at which Mount Limited could borrow an amount similar to the value of the ROU asset, in the same currency, for a six-year term, and with similar collateral. The ROU asset is depreciated on a straight-line basis, as the economic benefits are expected to be consumed evenly throughout the lease term.

The ROU asset and the lease liability from Year 1 to Year 4 are as follows:

Lease liability					Right-of-use asset (ROU asset)			
Year	Beginning balance £	Cashflow £	Interest @ 5.5% £	Closing balance £	Year	Beginning balance £	Depreciation charge £	Closing balance £
1	359,732	(60,000)	16,485	316,217	1	369,732	(52,819)	316,913
2	316,217	(60,000)	14,092	270,309	2	316,913	(52,819)	264,094
3	270,309	(60,000)	11,567	221,876	3	264,094	(52,819)	211,275
4	221,876	(60,000)	8,903	170,779	4	211,275	(52,819)	158,456

At the end of the year, before accounting for the change in the lease term, the lease liability is £170,779 (representing the present value of three remaining payments of £60,000, discounted at the original interest

rate of 5.5% annum). An interest expense of £8,903 is recognised in Year 4. The carrying amount of the ROU asset is £158,456.

Mount Limited remeasures the lease liability at the present value of three payments of £60,000 followed by three payments of £65,000, all discounted at the revised discount rate of 6.5% per annum. The remeasured lease liability is £321,016. Mount Limited increases the lease liability by £150,237, which represents the difference between the remeasured liability of £321,016 and its previous carrying amount of £170,779. The corresponding adjustment is made to the ROU asset to reflect the cost of the additional ROU, recognised as follows:

Dr ROU asset	£150,237
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**Cr Lease liability** **£150,237**

Following the remeasurement, the carrying amount of Mount Limited's ROU asset becomes £308,693 (£158,456 + £150,237). From the beginning of Year 5, the interest expense on the lease liability is calculated using the revised discount rate of 6.5% per annum.

The ROU asset and the lease liability from Year 5 to Year 10 are as follows:

Lease liability					Right-of-use asset (ROU asset)			
Year	Beginning balance £	Cashflow £	Interest @ 6.5% £	Closing balance £	Year	Beginning balance £	Depreciation charge £	Closing balance £
5	321,016	(60,000)	16,966	277,982	5	308,693	(51,449)	257,244
6	227,982	(60,000)	14,169	232,151	6	257,244	(51,449)	205,796
7	232,151	(60,000)	11,190	183,341	7	205,796	(51,449)	154,347
8	183,341	(65,000)	7,692	126,033	8	154,347	(51,449)	102,898
9	126,033	(65,000)	3,967	65,000	9	102,898	(51,449)	51,449
10	65,000	(65,000)	-	-	10	51,449	(51,449)	-

## 5.4 Lease modifications

Accounting for lease modifications is based on an assessment of whether the modification gives rise to a separate lease or not.

A lessee shall account for a lease modification as a separate lease if **both**:

- The modification increases the scope of a lease by adding the right to use one or more underlying assets

- The change in price is commensurate with the stand-alone price, taking into account any appropriate adjustments that reflect the circumstances of the particular contract

If the modification fails the above criteria to be accounted for as a separate lease, the lessee shall, at the effective date of the lease modification:

- Reallocate the consideration where the lease contains

multiple components	Where the lease liability is remeasured, the discount rate remains unchanged where any of the following apply:
<ul style="list-style-type: none"> <li>– Determine the new lease term (where applicable)</li> <li>– Remeasure the lease liability</li> </ul>	<ul style="list-style-type: none"> <li>– Any additional consideration is insignificant to the original consideration of the lease</li> <li>– A decrease in the consideration is commensurate with the stand-alone price related to the change in the ROU assetThe consideration is decreased without a corresponding decrease to the use of the ROU asset</li> </ul>
Where the modification results in a reduction in the scope of the lease (ie the right to use underlying assets is decreased), there is a partial or full termination of the lease. Consequently, the lease liability is remeasured with any gain or loss relating to the partial or full termination recognised in profit or loss. If there is no reduction in the scope of the lease, the lease liability is remeasured with a corresponding adjustment to the ROU asset (ie no gain/loss in profit or loss).	In all other cases, a revised discount rate is determined at the effective date of the modification in accordance with section 3.2. above.



#### Example 4 - Modification that is a separate lease

Granite Distribution Limited, a distributor, has a seven-year lease for four warehouse units in an industrial park. Due to expansion of its business, it requires additional space at the end of Year 3 of the lease and agrees with the lessor to lease another two units. The two additional units become available for use at the end of Year 3 and are leased at a stand-alone price, reflective of the current market rate. There is no change to the term of the lease for the original four units. The two additional units have a lease term of four years so that the lease for these additional units will cease at the same time as the original lease.

Granite Distribution Limited will account for the modification as a separate lease from the original lease of the four units. This is on the basis that:

- There is an increase in the scope of the lease as there is a right to use two additional units
- The price is commensurate with the stand-alone price

At the end of Year 3, Granite Distribution Limited will account for a ROU asset and lease liability for the additional two units. The discount rate used will be determined at the date the asset is available for use (the end of Year 3, in accordance with section 3.2 above). This discount rate is likely to be different to that of the original seven-year lease, as it is determined at a different date with different market conditions. There will be no adjustment to the accounting of the original seven-year lease.

If the price for the additional two units was not a stand-alone price, the modification would not be treated as a separate lease. In this circumstance, the lessee would be required to reallocate the consideration and remeasure the lease liability at a revised discount rate at the effective date of the modification (see Example 3b for a detailed calculation).

# 6. Presentation and disclosures – lessee accounting

## 6.1 Presentation

If the lessee does not present the ROU asset separately, the lessee shall:

- Include the ROU assets, in the same categories/line items that which the corresponding underlying assets would be presented in if they were owned (i.e. property, plant and equipment versus intangible assets)
- Disclose which categories/line items in the statement of financial position include those ROU assets

ROU assets that meet the definition of investment property must be presented within the investment property line.

Depreciation of a ROU asset is calculated in accordance with Section 17 Property, Plant and Equipment and presented in the income statement as appropriate. The depreciation expense and the interest expense cannot be combined and presented together in the income statement.

Lease liabilities are either presented separately from other liabilities on the face of the statement of financial position or are disclosed separately, in the notes. After initial recognition, the lease liability is increased by the unwinding of the discount and reduced by the lease payments made to the lessor. The unwinding of the discount is treated as an interest expense in the income

statement, and any cash outflows of interest are presented as cash flows from either operating or financing activities in the cash flow statement, depending on the entity's policy for the classification of interest payments. Principal payments of lease liabilities appear as cash flows from financing activities.

## 6.2 Summary of disclosure requirements – lessees

A lessee shall provide a general description of its significant leasing arrangements. If necessary to enable users to understand its significant leasing arrangements, a lessee shall provide additional qualitative and quantitative information. The key disclosure requirements are summarised below. Depending on the particular facts and circumstances, additional disclosures might be necessary.



Area	Summary of requirements
ROU asset	<p>The gross carrying amount and the accumulated depreciation at the beginning and end of the reporting period and a reconciliation of the carrying amount at the beginning and end of the reporting period (without comparatives). This reconciliation should show separately:</p> <ul style="list-style-type: none"> <li>– Depreciation charge</li> <li>– Additions</li> <li>– Disposals</li> <li>– Acquisitions through business combinations</li> <li>– Revaluations</li> <li>– Impairment losses recognised or reversed in profit or loss.</li> </ul>
Lease liabilities	Interest expense
Recognition and measurement exemptions	Expenses relating to short-term leases or expenses relating to leases of low-value assets
Other disclosures - income statement	<ul style="list-style-type: none"> <li>– Expense relating to variable lease payments not included in lease liabilities</li> <li>– Income from subleasing ROU assets</li> <li>– Gains or losses arising from sale and leaseback transactions</li> </ul>
Total cash outflow for leases	<p>A lessee shall disclose information about future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of lease liabilities. This may include the following:</p> <ul style="list-style-type: none"> <li>– Variable lease payments (includes key variables on which payments depend and how they affect them)</li> <li>– Extension options and termination options</li> <li>– Residual value guarantees</li> <li>– Leases not yet commenced to which the entity is committed</li> <li>– Short-term lease commitments</li> </ul>
Qualitative disclosures	<ul style="list-style-type: none"> <li>– Nature of the lessee's leasing activities</li> <li>– Restrictions or covenants imposed by leases</li> <li>– Sale and leaseback transactions</li> <li>– Transitional provisions and practical expedients applied by the entity.</li> </ul>
Other considerations	<ul style="list-style-type: none"> <li>– For ROU assets meeting the definition of investment property or heritage assets, a lessee shall apply the disclosure requirements of Section 16 Investment Property and Section 34 Specialised Activities, with some amendments.</li> <li>– If a lessee measures ROU assets at revalued amounts applying Section 17 Property, Plant and Equipment, the lessee shall provide the disclosures required by paragraphs 17.31(a) and 17.32A for those ROU assets.</li> </ul>

# 7. Initial application

The amendments to FRS 102 require a lessee to apply the modified retrospective approach, where an entity measures its ROU assets and lease liabilities as of the initial application date and comparatives are not restated. Instead, the cumulative impact of initially applying the amendments must be recognised as an adjustment to the opening balance of equity. The date of initial application is the beginning of the reporting period in which an entity first applies the amendments.

When the entity first applies the revised Section 20, the entity is not required to disclose the adjustment of the impact of each financial line item in the current and previous years. However, it must disclose, for the current period, the amount of adjustment to profit or loss for the effect of applying the revised requirements. If this is impracticable, an explanation must be provided.

Certain practical expedients are available on initial application, of which the following are key:

- An entity is not required to reassess whether a contract is, or contains, a lease at the date of initial application
- An entity may apply a single discount rate to a portfolio of leases with reasonably similar characteristics
- Carrying amounts of ROU assets and lease liabilities previously calculated under IFRS 16 Leases for group reporting purposes (for existing FRS 102 reporters) or in the entity's own accounts (for first-time adopters of FRS 102) can be used as opening balances at the date of initial application or the date of transition, respectively. Where this expedient taken, the lessee is required to disclose the fact and apply this expedient to all leases
- Leases that will end within 12 months of the date of initial application can be accounted for as short-term leases
- Hindsight can be used, for example when determining the lease term for contracts containing extension or termination options



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