



FRS 102 Transition Guide:

Your Step-by-Step Approach to Lease Accounting

A 10-Step Guide for
UK and Irish Accounting Teams

FRS 102 TRANSITION GUIDE

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Understanding the Impact and Scope of FRS 102 Lease Accounting

Transitioning to FRS 102 necessitates a fundamental shift in how leases are accounted for in the United Kingdom and Republic of Ireland. Previously, many leases, especially operating leases, were kept off-balance sheet. FRS 102 mandates that the majority of lease obligations are recognised on the balance sheet, providing a more transparent view of an organisation's financial commitments. This transition impacts how businesses report their financial position, and requires a more in-depth understanding of assets and liabilities.

The Key Changes from Previous UK GAAP

The most significant change under FRS 102, compared to previous UK GAAP (primarily FRS 19), lies in the accounting treatment for lessees. While the distinction between finance and operating leases remains, FRS 102 introduces a more unified approach to how these leases are recognised and measured.

Finance Leases

The accounting treatment is largely consistent with prior standards. A right-of-use (ROU) asset and a lease liability are recognised on the balance sheet.

Operating Leases

This is where the core change occurs. Previously, operating leases were primarily expensed in the income statement. Under FRS 102, a lessee must also recognise a ROU asset and a lease liability on the balance sheet.

This recognition of operating leases on the balance sheet means that both assets and liabilities increase. This impacts key financial ratios, such as:

Gearing Ratio (Debt-to-Equity)

This ratio will likely increase, reflecting the higher liabilities.

Asset Turnover Ratio

This ratio may decrease, as the asset base increases with the recognition of ROU assets.

Profitability Ratios (e.g., Return on Assets)

These ratios could be affected, depending on how the lease expense is recognised and the impact on depreciation and interest expense.

The FRS 102 Transition: Are You Prepared?

To get a clearer picture of the work ahead, start by asking:

- Q How many assets does your company lease?
- Q What types of assets are leased (e.g., property, vehicles, equipment)?
- Q What is the remaining lease term for each contract?
- Q Are there significant variations in lease terms, payment schedules, or other lease conditions?
- Q Does the company maintain a centralised and complete record of all leases, including key dates and terms?
- Q Have service contracts been assessed for embedded leases?
- Q What is the organisation's materiality threshold for lease capitalisation?

Transitioning to FRS 102 can be a complex undertaking, requiring significant time and resources. **Proactive preparation is essential.** This guide provides a roadmap to help you navigate the transition effectively.

Keys to a Successful Transition

A smooth transition to FRS 102 hinges on three critical elements:



Finance Leases

The accounting treatment is largely consistent with prior standards. A right-of-use (ROU) asset and a lease liability are recognised on the balance sheet.



Technology

For organisations with more than a few leases, investing in robust lease accounting software is crucial. Software automates calculations, centralises data management, and generates compliant reports, significantly reducing the risk of errors and saving time.



Processes

Implementing well-defined processes for identifying, collecting, and validating lease data is vital for a complete and accurate lease inventory. Establishing sustainable processes for ongoing lease management ensures continued compliance and accurate financial reporting.

STEP 1

Understand Your Lease Portfolio

The first step in your FRS 102 transition is to develop a comprehensive understanding of your lease portfolio.



Identify all lease agreements

This includes leases for property, vehicles, equipment, and any other assets.



Identify any prepaid lease payments and initial direct costs

These need to be included in the initial measurement of the right-of-use asset.



Determine the lease term

This is the non-cancellable period of the lease.



Assess lease modifications

Determine if any of your leases have been modified. If so, you will need to account for these modifications separately.



Identify the discount rate

This is the rate of interest implicit in the lease. If this cannot be readily determined, the lessee's incremental borrowing rate should be used.



Consider embedded leases

Many service contracts contain embedded leases. A contract contains a lease if the customer has the right to control the use of an identified asset for a period of time in exchange for consideration.



Calculate the lease payments

This includes the fixed payments required by the lease, less any lease incentives receivable.



Determine the appropriate accounting treatment

Each lease needs to be classified as either a finance lease or an operating lease.



Identify any variable lease payments

Variable lease payments are those that depend on an index or a rate.

Determining Lease Classification Under FRS 102

FRS 102 retains the distinction between finance and operating leases. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of the leased asset to the lessee. If the lease does not transfer substantially all the risks and rewards of ownership to the lessee, the lease is classified as an operating lease.

Here are some examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease:

- Q The lease transfers ownership of the asset to the lessee by the end of the lease term.
- Q The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised.
- Q The lease term is for the major part of the economic life of the asset even if title is not transferred.
- Q At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset.
- Q The leased assets are of such a specialised nature that only the lessee can use them without major modifications being made.

Materiality Considerations

While FRS 102 requires most leases to be on the balance sheet, materiality remains an important consideration.

Low-value assets

Leases of low-value assets (e.g., computers, small office equipment) may be excluded from on-balance sheet recognition if they are deemed immaterial.

Short-term leases

Leases with a lease term of 12 months or less may be excluded from on-balance sheet recognition. This is a policy choice.

Materiality threshold

Establish a clear, documented materiality policy, including both quantitative and qualitative factors. Obtain agreement from your external auditors on this policy.

Practical example of materiality

- » Company A has annual revenues of £500 million and total assets of £200 million.
- » They have 300 employees, each with a leased laptop costing £80 per month on a 3-year lease.
- » The total undiscounted lease payments are £864,000.
- » This represents 0.17% of annual revenue and 0.43% of total assets.
- » Company A, with auditor agreement, may exclude these leases from on-balance sheet recognition, considering them immaterial.

STEP 2

Identify a Point Person

The transition to FRS 102 requires close coordination across multiple departments. Designating a central point person is crucial for a smooth and efficient process.



Responsibilities

This individual will oversee all aspects of the transition, including:

- » Project planning and execution
- » Interdepartmental communication
- » Data collection and validation
- » Software selection and implementation
- » Coordination with external auditors
- » Establishing internal policies and procedures



Software Owner

The point person will also serve as the primary contact for your lease accounting software vendor, managing user access, system usage policies, and vendor support.



Ideal candidate profile

- » Financial Controller
- » Finance Manager
- » Senior Accountant
- » Strong technical accounting skills
- » Project management experience
- » Detailed understanding of the organisation's lease portfolio

STEP 3

Select Lease Accounting Software

For most organisations, especially those with a moderate to large lease portfolio, dedicated lease accounting software is essential for FRS 102 compliance.

Benefits of lease accounting software



Efficiency

Automates complex calculations and reporting, saving significant time and reducing errors.



Accuracy

Ensures compliance with FRS 102 requirements.



Audit trail

Provides a clear audit trail for easy verification and reconciliation.



Scalability

Easily accommodates changes in your lease portfolio.



Centralised data management

Provides a single source of truth for all lease data.



Improved decision-making

Enables better analysis of lease obligations and their impact on financial statements.



Streamlined auditing

Facilitates easier verification and reconciliation.



Enhanced financial decision-making

Provides deeper insights into lease obligations.



Long-term efficiency

Reduces ongoing time spent on lease administration.

Key features to look for in a lease accounting software:

- » FRS 102 compliance
- » User-friendly interface
- » Data import and export capabilities
- » Automated calculations
- » Customisable reporting
- » Multi-currency support
- » Audit trail
- » Internal controls
- » Integration with ERP systems
- » Strong vendor support

When to implement

Early software adoption is recommended to allow for:

- » Sufficient time for implementation and data migration
- » Thorough testing and validation
- » Training and user adoption
- » A self-paced approach to the FRS 102 transition

Use these resources to identify the best solution for your organisation:

[How to Choose the Right Accounting Software for Your Business](#)

[Making the Business Case for Lease Accounting Software](#)

[Lease Accounting Software RFP Template](#)

[Webinar: FRS 102: Detailed Lease Transition Example](#)

[Your Essential Guide: 13 Key Questions for FRS 102 Software Selection](#)

STEP 4

Identify Departments with Leases

To ensure a complete lease inventory, identify all departments within your organisation that may have lease agreements. Appoint a key contact person within each department to facilitate information gathering.

- Q Attend meetings related to the FRS 102 transition.
- Q Provide necessary lease documentation.
- Q Serve as the primary liaison for the transition project.
- Q Compile a comprehensive list of all leases and leased assets within their department, including key details.

Consider providing controlled software access: Implement role-based access permissions in your lease accounting software to allow departmental contacts to input data directly.



Key departments to involve

Estates/Facilities Management
Property leases.

Financial Reporting
Existing lease schedules and financial statement disclosures.

Procurement/Supply Chain
Equipment and vehicle leases.

Finance (FP&A and Treasury)
Budgeting, discount rates, and lease payment information.

Information Technology (IT)
Computer, network equipment, and software leases.

STEP 5

Get a Listing of Leased Assets

Each department should compile a detailed listing of all leased assets, including the following information for each lease:

- Q Asset description
- Q Asset number (if applicable)
- Q Lease start date
- Q Lease end date
- Q Lease term
- Q Discount rate
- Q Lease payments (amount, frequency, currency)
- Q Any variable lease payments
- Q Any prepaid lease payments
- Q Initial direct costs



Read these blogs for more detailed ways to ensure your lease inventory is complete:

[FRS 102 Section 20: A Step-by-Step Guide to Creating a Lease Inventory](#)

[FRS 102 Leases Explained: Summary, Examples, Journal Entries, and Disclosures](#)

To assist departments in gathering this information:

Estates/Facilities Management

Contact external property agents for a comprehensive list of property leases.

Procurement/Supply Chain/IT

Request a complete listing of leased assets from key vendors.

Finance (FP&A)

Review existing lease information gathered during the budgeting process.

Treasury

Obtain lease information directly from vendors or leasing companies, if applicable.

STEP 6

Identify Locations and Properties

Identify all physical locations of your organisation, including owned and leased properties. For each location, designate a point person to assist with the FRS 102 transition.



Lease asset tracker

Use a centralised lease asset tracker to ensure consistency and completeness. Include all identified locations in the tracker.



Local point person

Ideally, this should be a member of the finance team with a detailed understanding of the location's operations and asset base.



Data consolidation

The central transition lead should reconcile the lease data received from each location, eliminate duplicates, and create an initial consolidated lease listing.



Lease data template

Provide each location point person with a standardised template to capture essential lease data, including:

- » Asset type
- » Asset number
- » Lease start date
- » Lease end date
- » Payment information

Don't start from scratch!

Use this [Lease Asset Tracker](#) as your template.



STEP 7

Validate Completeness & Create a 5-Year Schedule

Reconcile with financial statement disclosures

Obtain your organisation's five-year lease commitment disclosures from the notes to your most recent annual financial statements. Compare this information with the consolidated lease inventory listing. Investigate and rectify any discrepancies.

Review data completeness and consistency

The central transition lead should thoroughly review all gathered lease information to ensure that all required data fields are complete and that the data is reasonable and consistent across all sources.

Create a 5-year lease liability schedule

This schedule should show the timing of the lease payments over the next 5 years and is crucial for the disclosures required in the financial statements.

 The schedule should show a reconciliation between the undiscounted lease payments and the lease liability.

 The total of the lease payments in the schedule should agree to the lease payments in the lease agreement.

STEP 8

Collect Details of Most Recent Rent Expenses

Gather a detailed breakdown of your rent expense for the most recently completed financial year.



Sources

- » Annual financial statements and supporting documentation
- » Corporate accounting department's straight-line rent expense schedules



Identify

- » Missing leases
- » Incorrect lease terms
- » Variable rent components



Purpose

Comparing total rent expense with individual lease payments can help identify missing leases or inconsistencies in recorded lease terms.

STEP 9

Perform Reasonableness Test for Rent Expenses

Calculate straight-line rent expense

Using the lease inventory data, calculate the straight-line rent expense for each lease.

Compare with actual rent expense

Compare the calculated straight-line rent expense with the total rent expense from Step 8. The two amounts should be materially consistent.

Investigate discrepancies

- Q **Calculated expense significantly lower:**
Incomplete lease inventory.
- Q **Actual expense significantly lower:**
 - » Rent expense recorded in other general ledger accounts.
 - » Prior year disclosure errors.
 - » Identification of embedded leases.

Example

- Q A company has total rent expense of £1,000,000 in its financial statements.
- Q The company's lease inventory shows total straight-line rent expense of £800,000.
- Q The £200,000 difference could be due to embedded leases, which should be investigated.



STEP 10

Record Transition Adjustments

By this stage, your organisation should have a comprehensive and reconciled lease inventory. You are now ready to record the necessary transition adjustments to adopt FRS 102.



Lease accounting software

Using a dedicated lease accounting software like FinQuery is highly recommended to automate complex calculations and generate accurate transition journal entries.



Initial journal entry

- » Debit Right-of-Use Asset
- » Credit Lease Liability



Ongoing accounting

The software will also automate the ongoing accounting for leases, including:

- » Depreciation of the right-of-use asset
- » Interest expense on the lease liability
- » Variable lease payments
- » Lease modifications

Transition Approaches

FRS 102 allows entities to apply the standard retrospectively or using a modified retrospective approach.

Q Full Retrospective Application:

- » Apply the new accounting requirements as if they had always been in effect.
- » Restate prior period financial statements.
- » Can be complex and time-consuming, but provides the most comparable information.

Q Modified Retrospective Application:

- » Apply the new accounting requirements to leases existing at the date of transition.
- » Do not restate prior period financial statements.
- » Simpler to apply, and the most commonly used.

Benefits

Automating the transition and ongoing accounting will:

- Q Reduce the risk of errors
- Q Save time
- Q Ensure compliance
- Q Improve the accuracy of your financial statements
- Q Provide valuable insights into your lease portfolio

First-Time Adoption Exemptions

FRS 102 provides some optional exemptions for first-time adopters, which can simplify the transition process. These include exemptions relating to:

- Q Lease classification
- Q Initial direct costs
- Q Retrospective application

Disclosures

FRS 102 has detailed disclosure requirements. These include:

- Q Information about the nature of the entity's leasing activities
- Q The amounts recognised in the financial statements
- Q A maturity analysis of lease liabilities
- Q A reconciliation of the lease liabilities
- Q Information about short-term leases, low-value leases, and variable lease payments



FAQs

What is a right-of-use (ROU) asset?

An asset that represents a lessee's right to use an underlying asset for the lease term.

What is a lease liability?

The present value of the lease payments.

What discount rate should I use?

The interest rate implicit in the lease. If this rate cannot be readily determined, the lessee's incremental borrowing rate should be used.

What are initial direct costs?

Costs incurred by the lessee in obtaining a lease.

What are lease incentives?

Payments made by the lessor to the lessee associated with the lease.

What are lease modifications?

Changes to the terms and conditions of a lease.

What is an embedded lease?

A lease within a contract that is not explicitly identified as a lease.

How do I account for variable lease payments?

Variable lease payments are expensed in the period in which they are incurred.

Are there any exemptions?

Yes, there are exemptions for short-term leases and low-value assets.



Transitioning to FRS 102 is not a one-time event.
Ongoing compliance requires robust processes and tools.

FinQuery helps you stay compliant by:



Providing a centralised platform
for managing all lease data



Tracking all lease modifications



Automating calculations and
journal entries



Alerting you to key lease dates
and changes



Generating compliant reports



Ensuring data accuracy with
built-in controls

Automated Lease & Prepaid and Accrual Accounting. *Streamlined Contract Management.*

8500+ Customers

93 Countries

250+ Partners

200+ Team Members
Across North America & EMEA



Contract
Management



Lease Accounting &
Lease Management



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