

Navigating the New Lease Accounting

A Guide to the FRS 102 (Section 20) Update for existing and Potential
Clients

A Major Shift in UK Accounting

The new rules for leases are the biggest change to UK GAAP in years. We're here to make this simple and help you prepare.

When Does This Apply?

2026

Effective 1 Jan 2026

This is mandatory for accounting periods starting on or after **1 January 2026**.

we can help you start now by giving a roadmap.

Early adoption is permitted, but let's discuss if this is the right strategy for your business.

The Old Way vs. The New Way

The "Old way" (Before)

Most leases (like offices, cars, or equipment) were treated as '**Operating Leases**'.

They were kept '**off-balance sheet**', and the payments were a simple 'Rent' expense in your Profit and Loss statement.

The "New way" (After)

This distinction is gone. Almost ALL leases must now be brought '**on-balance sheet**'.

This means you will record a new '**Right-of-Use Asset**' and a new '**Lease Liability**'.

Visual Example: A 5-Year Office Lease (£450k)

Balance Sheet (The "Old way")

Assets: £0 **Liabilities: £0**

The significant £450k commitment was 'off-balance sheet' and not visible here.

Balance Sheet (The "New way")

Assets: +£450,000

(Right-of-Use Asset)

Liabilities: +£450,000 (Lease Liability)

The commitment is now fully visible, giving a truer view of the company's position.

The Accounting: Journal Entry Comparison

Action	The "Old Way" (Operating Lease)	The "New Way" (on-Balance Sheet)
Day 1 (Lease Start)	No Entry	Dr: Right-of-Use Asset Cr: Lease Liability
Monthly Payment	Dr: Rent Expense (Profit and Loss) Cr: Cash	Dr: Interest Expense (Profit and Loss) Dr: Lease Liability Cr: Cash
Year-End Entry Entry	No	Dr: Depreciation Expense (Profit & Loss) Cr: Accum. Depreciation (Asset)

How Are the Numbers Calculated?

Step 1: The Lease Liability

This is the present value of all future payments.

- Start with all **fixed future payments** (e.g., £10,000 per quarter).
- Add any **variable payments** based on an index (e.g., Retail Price index-linked increases).
- Add any **purchase options** or **residual value guarantees**.
- Discount this total to its **present value** using **Interest Rate Implicit in the Lease or incremental borrowing rate or Obtainable Borrowing Rate**.

Step 2: The Right-of-Use Asset

This starts with the Liability, then adjusts.

- Start with the **Lease Liability** (from Step 1).
- **ADD:** Any payments made before the lease started.
- **ADD:** Any **initial direct costs** (e.g., legal fees).
- **ADD:** Estimated **reinstatement costs** (to restore the asset).
- **LESS:** Any **lease incentives** received from the landlord.

Example: The Profit and Loss Front-Loading¹¹



*The simple 'Rent' expense is replaced by Depreciation & Interest. This new total expense is "front-loaded," meaning it's **higher in the early years** of the lease and lower in the later years.*

What's Mandatory vs. Voluntary?

- ◆ **Mandatory:** Adopting this new on-balance sheet model for all leases starting from 1 Jan 2026.
- 🔘 **Voluntary (Exemptions):** You can choose to keep leases off-balance sheet IF they are:
 1. **Short-term** (12 months or less)
 2. For **low-value assets** (e.g., laptops, small office furniture and other small IT equipment).
- 📅 **Voluntary (Early Adoption):** You can choose to adopt this standard before 2026.

Impact on our Isle of Man Clients



E-Gaming

- Brings leased servers and office spaces onto your balance sheet, increasing assets and liabilities.
- Alters EBITDA and covenant metrics—critical for advising clients with leased gaming infrastructure.



Agriculture

- Brings leased farmland, machinery, and office spaces onto your balance sheet, increasing assets and liabilities.
- Alters EBITDA and covenant metrics—important for advising charities with significant leased equipment or property.



CSP's

Primarily affects your own office leases, growing your balance sheet. Also key for advising clients who hold leased assets.



Investment Managers

Office leases will impact gearing ratios, which could be relevant for your regulatory capital calculations and reporting.



Charities

Leased shops and offices come on-balance sheet, affecting total assets and how reserves are presented and perceived.



Insurance Intermediaries

Similar to Corporate Service Providers, office leases will increase assets and liabilities, impacting key ratios used by stakeholders and regulators.

The Real-World Impact (The “so what?”)

This isn't just an accounting change; it has real business consequences. As your auditors, this is where we add value:




Earnings Before Interest, Taxes, Depreciation, and Amortization will look better, as rent expense is removed (it's replaced by Depreciation and Amortization and Interest).

Gearing & Debt ratios will look worse due to the new, large liability on the balance sheet.

Bank Loan Covenants might be breached. This is the primary risk to check immediately.

Company size thresholds (e.g., qualifying as 'small' for audits) may be crossed.

What To Do Before Effective Date(Our Advice)

-  **Inventory:** Start gathering all your lease agreements. This includes "hidden" leases inside service contracts (e.g., printers, Information Technology equipment).
-  **Assess:** We can help you model the financial impact. Let's run the numbers before it's mandatory so there are no surprises.
-  **Communicate:** Talk to your bank and stakeholders early. We can help you explain the changes and manage any covenant impacts.

Our Commitment to You

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Our job as your auditors is to help you see around the corner. By preparing for this change before the effective date, you ensure a smooth, compliant transition in 2026 with no surprises. ||

- **The Atla Team**

We're Here to Help

Let's navigate this change together. Get in touch to start planning.

<https://atla.im/>

Atla Audit and Assurance Team

This presentation is for information purposes only and does not constitute formal advice. Please contact us for advice specific to your circumstances.