
A CHANGE IS COMING **LEASE ACCOUNTING**

A guide to the 2026 changes and understanding
the impact it will have on your business

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Introduction

In the fast-evolving world of financial reporting, lease accounting is undergoing a significant transformation under UK GAAP.

This eBook is designed to guide you through the upcoming changes, set to take effect on 1 January 2026, and help you understand what they mean for your business. No longer will lease payments be treated simply as an expense; instead, they will form an integral part of your balance sheet. As a result, you will gain a clearer picture of your long-term financial commitments, though not without certain challenges that require proactive planning.

Throughout this eBook, we will explore the reasons behind these changes, the practical impact on your financial metrics, and the steps you can take to ensure a smooth transition. Whether you are a finance professional, business owner, or a stakeholder interested in the future of accounting standards, this guide aims to provide you with a comprehensive yet accessible overview.

Understanding the Current Landscape

Lease Accounting Today

Under the existing UK GAAP framework, leases are recorded as a monthly expense. When a company makes a lease payment, it is simply deducted from the income statement as an operational cost. This method has been straightforward and has allowed businesses to manage their day-to-day operations without the added complexity of recognising long-term obligations.

However, this simplicity comes with a cost. By treating lease payments as mere expenses, companies have been able to keep long-term financial commitments off their balance sheets. This means that while the immediate cash flow impact is visible, the true extent of your long-term liabilities is obscured.



Understanding the Current Landscape

The Need for Change

As stakeholders increasingly demand greater transparency and comparability in financial reporting, the limitations of the current system have become more apparent. Investors, lenders, and regulators alike want a more complete picture of an organisation's financial health, including all future obligations. This has paved the way for a fundamental shift in how leases are accounted for.



The New Lease Accounting Framework

A Shift to On-Balance-Sheet Recognition

The forthcoming changes mean that all leases, regardless of whether they are operating or finance leases, must be recognised on the balance sheet. This new approach requires companies to record two key elements:

Right-of-Use Asset:

- This represents the value of having exclusive access to a leased asset for the duration of the lease term. Even if you do not own the asset, the right to use it must be recorded as an asset.

Corresponding Liability:

- In tandem with the asset, a liability is recorded to reflect the commitment to make future lease payments. This liability is calculated as the present value of those future payments, ensuring that your balance sheet accurately reflects long-term obligations.

The New Lease Accounting Framework

Breaking Down Lease Payments

Under the new system, each lease payment is divided into two components:

Interest Expense:

- This element, recognised on the income statement, represents the cost of financing the lease

Principal Reduction:

- The remaining portion of the payment is used to reduce the outstanding lease liability on your balance sheet

Additionally, the right-of-use asset will be depreciated over its useful life, which further influences future financial statements.



Financial Implications for Your Organisation

Enhanced Transparency

One of the primary benefits of the new lease accounting model is the increased transparency it provides. By recognising long-term lease commitments, stakeholders can obtain a clearer view of the true financial position of an organisation. This change ensures that all future obligations are visible, thereby improving the overall quality of financial reporting.

Impact on Key Financial Metrics

While enhanced transparency is beneficial, it also brings about significant shifts in financial ratios:

EBITDA:

- With lease expenses now split between depreciation and interest, EBITDA figures may appear more favourable, which can influence business valuations.

Interest Coverage & Gearing Ratios:

- The additional liabilities and interest costs could affect these ratios adversely, potentially impacting borrowing terms and stakeholder perceptions.

Financial Implications for Your Organisation

Considerations for Banking Covenants

Increased liabilities and revised interest expenses may lead to breaches in existing banking covenants. It is therefore crucial to engage with financial partners early and communicate the impending changes to avoid any unforeseen complications.

Transitioning to the New Standard

No Retrospective Adjustments

One of the more practical aspects of the transition is that there will be no requirement to restate previous years' figures. The new standard applies only from 1 January 2026 onwards. However, this does mean that you must be vigilant when comparing year-on-year results, as past periods will not reflect the changes.

Identifying Lease Obligations

A critical part of the transition involves conducting a thorough review of all lease agreements, including:

Standard Leases:

- All conventional lease contracts must be reviewed to assess their impact under the new standard

Embedded Leases:

- Service contracts and outsourcing agreements may contain lease elements that need to be identified and accounted for

Transitioning to the New Standard

Evaluating Exemptions and Thresholds

Not all leases will necessarily require full balance sheet recognition. Short-term leases or those deemed to be of low value might qualify for exemption. However, under UK GAAP, each lease is assessed on its own merits, meaning that blanket de minimis rules (such as those under other standards) do not apply automatically.



Practical Steps for Implementation

Conduct a Comprehensive Lease Audit

Begin by creating an inventory of all lease agreements. This should include not only the obvious leases but also any embedded lease elements within other contracts. Assess the remaining terms, associated costs, and applicable interest rates for each lease.

Engage with Professional Advisers

Consulting with accountants and financial advisers is essential. They can help assess the broader impact on financial ratios, business valuations, and existing banking covenants. Their expertise will be invaluable in navigating the complexities of the transition.

Plan for System Integration

While many organisations may initially rely on Excel for lease calculations, the complexity of the new standard often warrants the adoption of a dedicated lease accounting system. Automated solutions offer benefits such as improved accuracy, better documentation, and easier updates when accounting standards change.

Practical Steps for Implementation

Communicate Proactively with Stakeholders

Open communication with lenders, investors, and other stakeholders is key. Ensure they understand the changes and the potential impact on your organisation's financial metrics. This proactive approach will help mitigate any concerns regarding altered financial ratios or breaches of banking covenants.



Conclusion

The shift to on-balance-sheet lease accounting under UK GAAP represents more than just a change in numbers—it is a fundamental transformation in how businesses report and manage their long-term commitments. While the new approach offers increased transparency and more accurate financial reporting, it also brings challenges that require careful planning and proactive management.

By understanding the changes, assessing the financial implications, and implementing systematic solutions, your organisation can not only comply with the new standards but also leverage this transition to enhance overall financial strategy and stakeholder communication. Preparing now will ensure that you are well-equipped to navigate the new era of lease accounting, starting from 1 January 2026.

About the Author

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Nick Kenderdine brings extensive experience in financial management and strategic planning to the forefront of lease accounting reform. As CEO of HAYNE Solutions, he is dedicated to helping organisations navigate the complexities of new financial standards and optimise their financial performance for a more transparent and resilient future.

