PKF Francis Clark

FRS 102 revenue changes

Practical guide for businesses

FRS 102 revenue: what's changing and what it means for your business

Changes are coming to how businesses recognise revenue under FRS 102.

From **1 January 2026**, a new five-step model will determine when and how contracts with customers are recorded. While most attention focuses on revenue, the changes can also affect how contract costs are accounted for.

If you are familiar with IFRS 15, this is broadly the same approach.

Why this matters to you

The outgoing rules are relatively broad, which means:

- Similar transactions can be treated differently across businesses
- Key areas often rely on judgement

The new model introduces a more structured and consistent approach. In many cases, this will improve clarity but it could also change the timing of revenue and cost recognition. The impact will depend heavily on how your contracts are structured and the specific terms within them.

What could be affected?

Even if your overall income doesn't change, the timing of when revenue and costs are recognised might, and that can have knock-on effects on:

- Reported profits (up or down in certain years)
- Bank covenants
- Bonuses or profit linked rewards
- Internal reporting and KPIs
- Business valuations

For many businesses, there may be no impact. However, even common transactions can produce different timing outcomes under the new rules.

When does this start to matter?

Starts
For accounting periods beginning on or after 1 January 2026, meaning most businesses will first apply the new rules in their 2026 or 2027 financial statements (depending on their year end).

Early adoption
Allowed, but you must apply all the changes (including leases). This can be helpful if you want to align with group reporting (such as IFRS 15, the international revenue standard) or adopt a consistent approach sooner.

How do you transition?

You have two main approaches:

Option 1 Catch-up approach:

- Adjust opening reserves at the start date to reflect the new rules
- No restatement of prior year

Option 2 Full restatement:

- Update prior year figures for comparison
- Provides more consistent year-on-year reporting

What has changed: the new five-step model

This is a brief overview of what has changed.

Previous approach:

- Risks and rewards model
- Limited guidance
- Can lead to inconsistent approaches across companies

New approach:

- A five-step model
- Focuses on when the customer receives the benefit (obtains control)
- A significantly more detailed standard

The five-step model is set out below in a simplified form:

Step	What does it mean?	What might this look like in practice?
1. Identify the contract	Do we have an agreement with the customer that both parties have accepted and intend to follow, including what will be provided and how and when it will be paid for?	This may be a signed contract, a purchase order accepted by both parties, standard terms and conditions that have been agreed, or an arrangement that has arisen through normal trading practices, such as a customer selecting goods in a shop and agreeing to pay at the till.
2. Identify what you are promising to deliver (performance obligations)	What exactly are we promising to provide and are there multiple separate obligations?	This may include a single product or service, or a package that combines several elements such as equipment, installation, support and training.
3. Determine the transaction price	How much are we expecting to be paid?	This may be a fixed amount, or include discounts, rebates, bonuses, penalties or other amounts that depend on future events.
4. Allocate the transaction price to the promises in the contract	If there are multiple promises, how is the price allocated between them?	Allocation between promises is often based on standalone prices, costs or market information, although estimates may sometimes be required.
5. Recognise revenue when (or as) the promise to the customer is fulfilled	When do we actually record the income?	Revenue may be recognised at a point in time, such as when goods are delivered and control passes to the customer, or over time as services are provided and the customer receives the benefit.

The accounting follows the substance of your contracts but applying the model can require careful judgement in practice. Some revenue streams are more likely to be affected than others: see next page.

Disclosures and accounting policies

The changes to revenue recognition are not limited to measurement and timing: they may also affect how revenue is described and disclosed in the financial statements.

Accounting policies may need to be updated to reflect the new terminology and approach, including references to performance obligations, control and variable consideration.

In the period of transition, additional disclosures are required to explain how the new standard has been applied and its impact. This may include explaining changes in revenue recognition, quantifying the effect on the current and comparative period figures, and setting out the reasons for significant movements. The extent of these disclosures will depend on the transition approach adopted (for example, a full restatement or a catch up approach).

Businesses should therefore review both their accounting policies and disclosures to ensure they clearly reflect the new model.

Which revenue streams are more likely to change?

a) Over time vs point in time recognition

Revenue is recognised either gradually over the life of the contract as promises are delivered, or at a single point in time when the promise to the customer is fulfilled. The key change under the new model is how businesses determine which approach applies in practice.

Revenue is recognised over time if one of the following applies:

- The customer receives the benefit as the work is carried out
- The customer effectively owns or controls what is being created as it is developed
- The promised goods or services are specific to the customer and cannot easily be sold to another customer, and the business has a right to payment for work completed to date (including a reasonable profit margin)

If none of the above conditions are met, revenue is recognised at a point in time, typically when control passes to the customer.

Manufacturing contract example
Company A manufactures equipment for a customer over a 2-year period. The contract contains a single promise to deliver the completed equipment.

The equipment is not highly specialised and could be sold to another customer if the contract were terminated.

Old FRS 102
Contracts of this nature were often recognised over time using percentage of completion, provided they were defined as 'construction contracts' and the outcome could be measured reliably.

In this case, Company A would likely have recognised revenue over time.

New FRS 102
Under the new model, the key judgement in this example is whether the contract meets the criteria for revenue to be recognised over time.

The customer doesn't benefit until they receive the equipment and they don't control the equipment as it is constructed; so recognition hinges on the third test about whether the goods are specific to the customer.
In this case, the equipment is not specific to the customer and can be sold to another customer.

As a result, the criteria for recognising revenue over time are not met. Revenue is now recognised at a point in time when the equipment is delivered to the customer.

b) Multiple promises within a contract (sometimes referred to as a 'bundle of goods')

Under previous rules, contracts which included multiple promises were often treated as a single transaction. The new model requires businesses to identify and account for each separate promise within the contract.

In practice, judgment is often needed to decide whether a contract contains one promise or several separate promises. Goods or services are considered distinct if both of the following apply:

a) The good or service is individually able to benefit the customer.

b) The promise to transfer the good or service is separate from other promises in the contract.

Where a contract contains more than one promise, the transaction price must then be allocated between them and revenue recognised separately for each element.
The allocation should reflect the price the business would normally charge for each promise if sold separately. Where this is not directly observable, estimates may be required taking into account costs, margins and market evidence.

Warranties should be considered carefully. Standard warranties that simply provide assurance that a product is free from defects would not normally be treated as a separate promise. However, separately purchasable or extended warranties are more likely to treated separately.

Care should be taken where different parts of the contract are recognised at different times (for example some over time and others at a point in time), as this can affect the overall timing of revenue recognition.

Example
Company A enters into a contract to manufacture the same specialist equipment as in the previous example, and to install it at the customer's site.

As outlined in the previous section, under previous rules contracts of this nature were often treated as a single arrangement, with revenue recognised over time.

In this case, the installation could be carried out by another provider. Under the new model, this means the customer can benefit from the equipment on its own and the installation is separate from, rather than integral to, the manufacture of the equipment. The contract is therefore treated as two separate promises: the equipment and the installation service.

Each promise must then be assessed separately to determine when revenue is recognised.

This results in the following treatment:

- Using the conclusion from the previous example, where the equipment is not specific to the customer and can be sold to another customer, revenue is recognised at a point in time when delivered
- The installation service is performed at the customer's site and may be recognised over time as the work is carried out

c) **Variable consideration** (or other estimates)

When a contract includes amounts that can vary, such as discounts, rebates, bonuses or penalties, and are uncertain at the outset, the amount of revenue must be estimated.

Revenue is then recognised only to the extent that it is highly probable that the amount will not need to be reduced later as uncertainty is resolved. This means that where outcomes are uncertain, revenue may need to be recognised more cautiously, and often later, than under previous rules.

There are two methods of estimation:

- Expected value – based on a range of possible outcomes, weighted by their likelihood
- Most likely amount – based on the single most likely outcome

The most appropriate method will depend on the circumstances.

Example – performance linked fees
Company B provides advisory services and earns fees based partly on achieving performance targets.

Under previous rules, revenue was often recognised as services were performed, sometimes including estimates of success based on past experience.

Under the new model, these arrangements are treated as variable consideration. Company B must estimate the expected fee but can only recognise amounts that are 'highly probable' not to reverse.

For example:

- If £100k is possible but uncertain → not recognised
- If £50k is highly probable → £50k can be recognised
- The remaining unrecognised amount is deferred until uncertainty is resolved

d) Principal vs agent scenarios

A business can either provide goods or services directly to customers (acting as principal) or arrange for another party to provide them (acting as agent).

Where the business is the principal, revenue must be recognised on a gross basis (the full amount). Where the business is an agent, revenue must be recognised on a net basis (typically the commission or fee earned).

The way these rules are described has changed. Previous rules started with the risks and rewards borne by the business. The new model starts with whether the business is promising to provide the goods or services itself or arrange for them to be provided and whether it controls the goods or services before they are provided to the customer.

The factors that need to be considered are fairly similar – e.g. who controls the goods before they are transferred, who does the customer see as primarily responsible for them, who holds the risk of inventory not selling – but there is a high degree of judgement.

Auditors will expect you to resurface any old documentation about its approach and re-assess whether it fits with the new rules. This is a good area to discuss ahead of time.

e) Contracts with modifications

The previous rules had limited requirements relating to modification of revenue contracts.

A contract modification will be treated as a separate contract, with the five-step model applied to it independently, if both of the following applies:

1. The modification adds distinct goods or services to the existing contract.

2. The modification increases the price by an amount that reflects what you would normally charge for the additional goods or services.

If these conditions are not met, the modification instead needs to be accounted for as an adjustment to the original contract. In practice, this may involve revisiting the revenue and profit recognised to date and reassessing how the remainder of the contract should be accounted for.

Costs

The changes are often viewed as a revenue issue, but they also cover costs from contracts with customers.

Costs should be expensed unless:

1. They are eligible to be capitalised as tangible fixed assets, intangible fixed assets, or inventories under existing rules; or

2. They provide future benefit by helping deliver goods or services to the customer in later periods, are specific to a particular contract and are expected to be recovered. In these circumstances, the costs may be carried on the balance sheet initially and recognised as an expense over the period the related goods or services are provided.

There is no longer a 'matching' concept: revenue follows the rules above and costs follow the rules here. If they are recognised at different times, this impacts profit.

Costs are also important if you use them to measure progress (stage of completion) towards a performance obligation recognised over time.

If you are measuring contract completion based on costs, watch what you include in your workings. Material orders might initially sit in inventory and only be counted towards the contract when they are included in the project. Inefficiencies such as wastage do not indicate progress and should not be included in the assessment of contract completion.

Upfront set up fees example
A software provider charges a customer a one-off implementation fee together with an ongoing annual subscription.

The implementation activities include configuring the system, migrating data and setting up user access.

Although the software provider incurs costs in configuring the system, migrating data and setting up user access, these activities do not necessarily represent progress towards providing the ongoing software service to the customer, so they will not impact revenue.

The costs do relate to a specific contract, are expected to be recovered and create a resource (the migrated data) that the provider will use to provide future services: so, they would be capitalised as a contract asset and amortised over the length of the contract.

Practical next steps

In practical terms, businesses should focus on the revenue streams most likely to be affected and take early steps to understand where change may arise.

1. Identify and document the business's main revenue streams.
2. Review standard customer contracts and terms & conditions.
3. Identify higher risk arrangements as an initial area of focus, including:
   - long term or more complex contracts
   - contracts with multiple promises
   - principal vs agent arrangements
   - variable pricing or performance linked fees
4. Assess whether revenue is recognised at a point in time or over time, and whether this will change.
5. Document key judgements and estimates in your accounts clearly, particularly around:
   a. Performance obligations
   b. Transfer of control
   c. Variable consideration ('highly probable')
6. Summarise in a clear concise accounting policy that describes each category of sales, when you recognise revenue, and what the key judgements are.
7. Consider wider impacts including effects on profits, KPIs, covenants and remuneration schemes.
8. Engage early with auditors and advisers to avoid late surprises!

How we can help

We can support you through the changes and help you navigate areas of uncertainty:

- **Impact assessments** – high level review of revenue streams to identify where changes are most likely to arise
- **Contract and revenue stream reviews** – detailed analysis of specific contracts to assess accounting treatment and quantify impacts
- **Policy development** – support with updating accounting policies and disclosures
- **Judgement framework support** – helping you apply concepts such as control, performance obligations, and 'highly probable' consistently
- **Transition support** – assistance with transition approach, opening balance adjustments and comparatives

For businesses where we act as auditor, the scope of support we can provide may be limited by independence requirements. However, we would be happy to discuss the implications of the changes at a high level and work with you to coordinate support where needed.

If you have any questions on the changes or would like to discuss the support options available, please contact your usual adviser or give us a call.