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WHITE PAPER

THE DIFFERENCES BETWEEN IFRS 16 AND ASC 842

CONTENTS

1 INTRODUCTION

In 2016, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) issued new standards on lease accounting. The development originally started as a joint project of the boards in 2006 to develop consistent requirements for lease accounting. However, different paths were taken by the boards throughout the process.

This becomes particularly evident in the accounting for lessees. Both standards require the lessee to recognize a right-of-use asset and a lease liability in the statement of financial position, but major differences exist due to differences in the lease accounting model. IFRS 16 uses a single model whereas ASC 842 contains a dual model which still distinguishes between operating and finance lease for lessees, as under previous guidance. This white paper summarizes key differences in lease accounting between ASC 842 and IFRS 16 for both lessees and lessors.

2 SCOPE AND RECOGNITION EXEMPTIONS

2.1 Scope Exemptions

Under ASC 842, only property, plant, and equipment is within the scope of the new guidance whereas all intangible assets are exempt. Under IFRS 16, lessees may apply the standard to leases of intangible assets as well. Only certain licensing agreements, i.e. motion picture films, video recordings, plays, manuscripts, patents, and copyrights, are not in the scope of IFRS 16.

2.2 Practical Expedients

IFRS 16 contains two practical expedients for lessees:

- Short-term leases with a lease term of 12 months or less and
- Leases of low-value assets.

For such leases, lessees may choose not to recognize a right-of-use asset and a lease liability and expense the lease payments on a straight-line basis. ASC 842 provides this accounting policy choice only for short-term leases.

3 LEASE ACCOUNTING MODEL

3.1 Single Model vs. Dual Model for Lessees

Lessees have to classify each lease as either operating lease or finance lease (see flowchart below).

Initial measurement is identical for operating and finance leases and in line with IFRS 16. Subsequent measurement for finance leases is also identical to IFRS 16, i.e. lessees are required to recognize depreciation ("amortization" in ASC 842) of the right-of-use asset and interest expense on the lease liability as separate line items in the income statement. Due to straight-line amortization and decreasing interest expense, there is a so-called front-loading effect in the income statement, because total lease expense is higher in the beginning of the lease term.

For operating leases, though, lessees recognize a single periodic lease expense in operating activities which represents the allocation of lease payments and initial direct costs on a straight-line basis over the lease term. Depreciation and interest expense are calculated for subsequent measurement of lease liability and right-of-use asset, but they are not presented as separate line items in the lessee's income statement. Amortization of the right-of-use asset is determined as the difference between the constant lease expense and interest expense. However, after an impairment loss, the right-of-use asset is amortized on a straight-line basis over the remaining lease term which leads to a decreasing periodic lease expense, like under finance leases.

3.2 Classification Requirements for Lessors

For lessors, ASC 842 distinguishes between operating, sales-type, and direct financing leases (see flowchart below). The accounting for sales-type leases is similar to the requirements of IFRS 16 for manufacturers and dealers, including recognition of revenue, cost of goods sold and any initial direct costs in the income statement when control of the leased asset transfers to the lessee. In direct financing leases, only selling losses resulting from the lease are directly recognized in the income statement. Selling profit and initial direct costs are deferred and included in the measurement of the net investment in the lease and therefore allocated over the lease term.

Accounting for operating leases is identical under ASC 842 and IFRS 16. Lease payments are recognized as lease income on a straight-line basis over the lease term unless another systematic basis is more representative of the pattern in which benefit is expected to be derived from the use of the underlying asset.

4 ASC 842 LEASE CLASSIFICATION CRITERIA

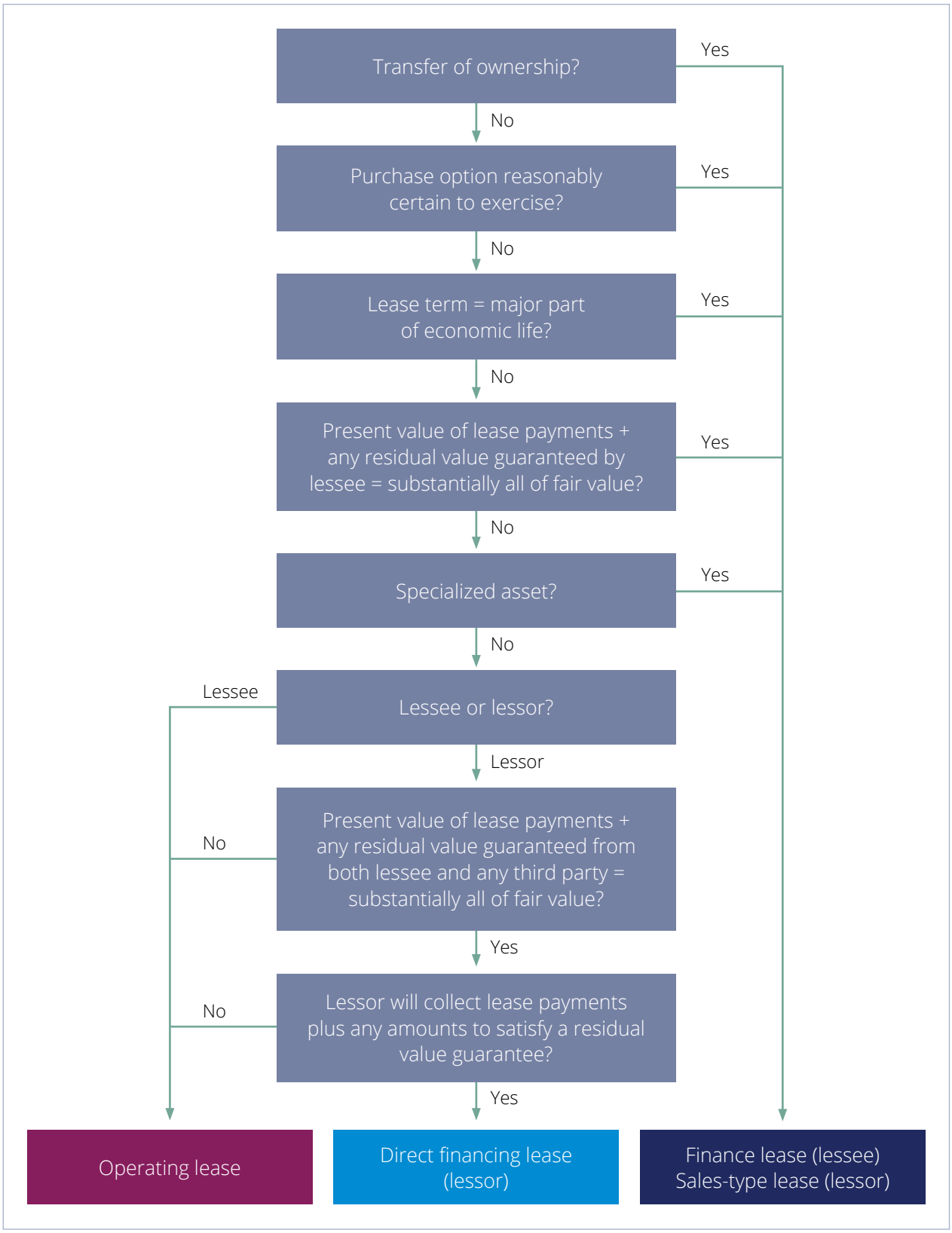

Figure 1: ASC 842 Classification criteria (ASC 842-10-25-1 to -7)

5 OTHER TOPICS

Remeasurement of the Lease Liability due to Changes in an Index or Rate

In both standards, the lease liability is measured by the lessee using the effective interest method and remeasured to reflect any lease modifications and changes in the lease payments. IFRS 16 also requires the lessee to remeasure the lease liability due to changes in variable lease payments based on an index or rate at the date of the change. Under ASC 842, changes in an index or rate alone do not require a remeasurement of the lease liability.

Lease Modifications

In case of a scope reduction of the right-of-use asset, there is an option under ASC 842 to decrease the right-of-use asset based on the change in lease liability or on the remaining right-of-use asset. Under IFRS 16, the requirement is to account for such modifications based on the remaining right-of-use asset.

Subleases

According to IFRS 16, the reference for classification of the sublease for the sublessor is the right-of-use asset from the head lease agreement, not the underlying asset (unless the lease was originally classified as a short-term lease, in which case the sublease is automatically classified as an operating lease). ASC 842 requires sublessors to classify a sublease by reference to the underlying asset.

Sale and Leaseback Transactions

Both IFRS 16 and ASC 842 require the transfer of the leased asset to be identified as a sale in accordance with IFRS 15 and ASC 606, respectively. Under US GAAP, a leaseback classified as a finance lease by the seller-lessee or as a sales-type lease by the buyer-lessor is not classified as a sale. In this case, the transaction is treated as a financing transaction and the seller-lessee recognized a financial liability. In addition, under IFRS 16 the gain on sale is limited to the amount that relates to the rights transferred to the buyer-lessor. Under ASC 842, the gain on sale is fully recognized (adjusted for any off-market adjustments that are also required under IFRS 16).

Transition Guidance

IFRS 16 provides an accounting policy choice between a full retrospective method and a modified retrospective method for transition. ASC 842 only allows a modified retrospective method. However, ASC 842 provides a choice regarding the transition date. Entities can elect whether the date of initial application is the beginning of the earliest period presented or the beginning of the period of adoption.

6 DISCLOSURES

6.1 Disclosures for Lessees

	Year Ending December 31,	
	20X2	20X1
Lease cost		
Finance lease cost:	$XXX	$XXX
Amortization of right-of-use assets	XXX	XXX
Interest on lease liabilities	XXX	XXX
Operating lease cost	XXX	XXX
Short-term lease cost	XXX	XXX
Variable lease cost	XXX	XXX
Sublease income	(XXX)	(XXX)
Total lease cost	$XXX	$XXX
Other information		
(Gains) and losses on sale and leaseback transactions, net	$(XXX)	$XXX
Cash paid for amounts included in the measurement of lease liabilities	XXX	XXX
Operating cash flows from finance leases	XXX	XXX
Operating cash flows from operating leases	XXX	XXX
Financing cash flows from finance leases	XXX	XXX
Right-of-use assets obtained in exchange for new finance lease liabilities	XXX	XXX
Right-of-use assets obtained in exchange for new operating lease liabilities	XXX	XXX
Weighted-average remaining lease term—finance leases	X.X years	X.X years
Weighted-average remaining lease term—operating leases	X.X years	X.X years
Weighted-average discount rate—finance leases	X.X%	X.X%
Weighted-average discount rate—operating leases	X.X%	X.X%

Figure 2: Illustration of disclosures for lessees (ASC 842-20-55-53)

Under ASC 842, lessees are required to disclose information separately for operating leases and for finance leases. There are also some additional disclosures compared to IFRS 16, like the weighted-average remaining lease term and the weighted-average discount rate.

7 SUMMARY

The basic concepts of the IASB and FASB joint project, including the definition of a lease as well as general requirements about recognition, measurement, and presentation, are coherent in both standards. Under both US GAAP and IFRS, right-of-use assets and lease liabilities are recognized for most leases in the balance sheet. The main difference between IFRS 16 and ASC 842 is the differentiation of operating and finance leases for the lessee which is still required under US GAAP and which affects subsequent measurement. With this dual lease model, the FASB aims to prevent that operating leases heavily affect the KPIs of companies in the income statement. Due to the front-loading effect and separate presentation of depreciation and interest expense, the single model under IFRS 16 has a greater impact on performance KPIs.

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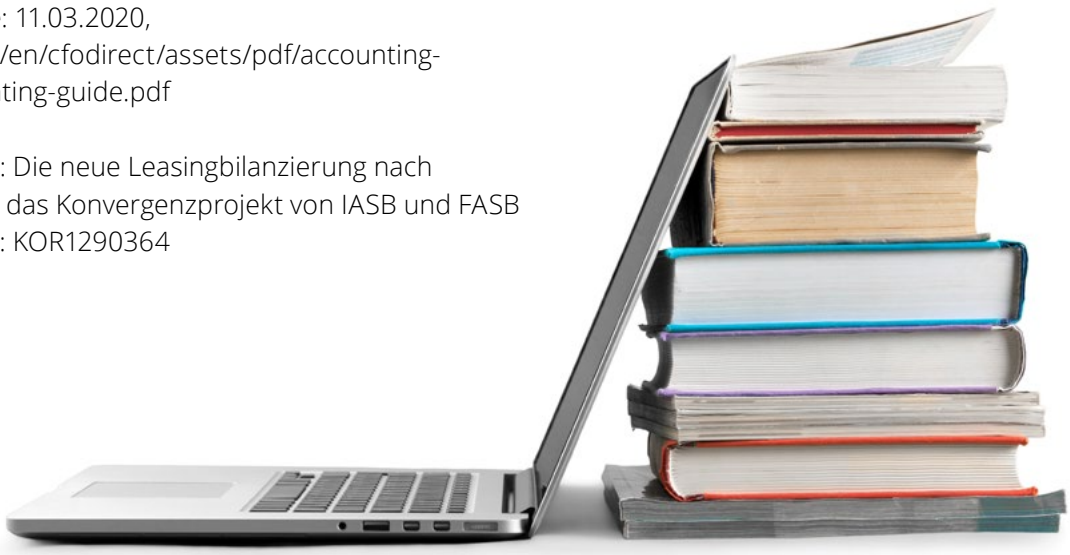

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