U.S. GAAP vs. IFRS: Leases

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Introduction

Currently, more than 120 countries require or permit the use of International Financial Reporting Standards (IFRS), with a significant number of countries requiring IFRS (or some form of IFRS) by public entities (as defined by those specific countries). Of those countries that do not require use of IFRS by public entities, perhaps the most significant is the U.S. The U.S. Securities and Exchange Commission (SEC) requires domestic registrants to apply U.S. generally accepted accounting principles (GAAP), while foreign private issuers are allowed to use IFRS as issued by the International Accounting Standards Board (which is the IFRS focused on in this comparison). While the SEC continues to discuss the possibility of allowing domestic registrants to provide supplemental financial information based on IFRS (with a reconciliation to U.S. GAAP), there does not appear to be a specified timeline for moving forward with that possibility.

Although the SEC currently has no plans to permit the use of IFRS by domestic registrants, IFRS remains relevant to these entities, as well as private companies in the U.S., given the continued expansion of IFRS use across the globe. For example, many U.S. companies are part of multinational entities for which financial statements are prepared in accordance with IFRS, or may wish to compare themselves to such entities. Alternatively, a U.S. company's business goals might include international expansion through organic growth or acquisitions. For these and other reasons, it is critical to gain an understanding of the effects of IFRS on a company's financial statements. To start this process, we have prepared a series of comparisons dedicated to highlighting significant differences between U.S. GAAP and IFRS. This particular comparison focuses on the significant differences between U.S. GAAP and IFRS when accounting for leases.

The guidance related to accounting for leases in U.S. GAAP that is the subject of this comparison is included in the Financial Accounting Standards Board's Accounting Standards Codification (ASC) Topic 842, *Leases*. For information about the effective date of ASC 842, refer to our white paper, Leases: Overview of ASC 842. In IFRS, the guidance related to accounting for leases is included in IFRS 16, *Leases.*

Comparison

The significant differences between U.S. GAAP and IFRS with respect to the accounting for leases (excluding differences related to the accounting for sale-leasebacks and subleases) are summarized in the following table.

	U.S. GAAP	IFRS
Both lessees and lessors		
Relevant guidance	ASC 842	IFRS 16
Scope	Applies to all leases of property, plant and equipment. Scope exclusions include: • Rights to use intangible assets. • Rights to explore for or use nonregenerative resources. • Rights to use biological assets. • Rights to use inventory. • Rights to use assets under construction.	Applies to all leases (i.e., not limited to property, plant and equipment).
Lessee accounting		
Short-term leases (for purposes of lessee accounting policy election)	Defines a short-term lease as one with a lease term of 12 months or less and does not include a purchase option that the lessee is reasonably certain to exercise.	Defines a short-term lease as one with a lease term of 12 months or less and does not include a purchase option. The likelihood of the lessee exercising the purchase option is not considered.
Low-value assets exemption for lessees	No exemption for low-value assets is provided. Although, materiality considerations apply in the same manner as such considerations apply to all U.S. GAAP.	Permits an entity to elect to recognize payments for a lease of a low-value asset on a straight-line basis over the lease term. Although the term *low value* is not defined, IFRS 16's Basis for Conclusions implies that the term refers to assets that, when new, individually have values of $5,000 or less.
Lessee lease classification	Under a dual model, lessees classify leases as either operating or finance leases, depending on five classification criteria.	Only one accounting model exists for lessees. All leases are treated in a manner similar to finance leases under ASC 842.

	U.S. GAAP	IFRS
Subsequent accounting	For finance leases, the right-of-use asset is amortized on a straight-line basis. The lease liability is accreted using the interest method, and is decreased for payments made. The expense recognition pattern generally is front-loaded. For operating leases, the expense recognition pattern is generally straight line.	Only one accounting model exists for lessees. The accounting is similar to that for finance leases under U.S. GAAP.
Variable lease payments that do not depend on an index or rate	Lessees recognize these payments in the period in which it becomes probable that the target that triggers the payment will be achieved.	Lessees recognize these payments in the period in which the target is achieved.
Incremental borrowing rate	The lessee's incremental borrowing rate is the rate that would be paid to borrow, on a collateralized basis over a similar term, an amount equal to the lease payments in a similar economic environment.	The lessee's incremental borrowing rate is the rate that would be paid to borrow, over a similar term and with similar collateral, an amount sufficient to obtain an asset with a value similar to the right-of-use asset in a similar economic environment.
Lessor accounting		
Lessor lease classification	Lessors assess classification at commencement. The first test is to determine if the lease meets any of the five criteria that are also applied by lessees. If any of those criteria are met, the lessor classifies the lease as a sales-type lease. If none of those criteria are met, but two additional criteria are met, the lease is classified as a direct finance lease. Otherwise, the lease is classified as an operating lease.	Lessors assess classification at inception. A lease is classified as a finance lease if it transfers substantially all of the risks and rewards of ownership. If not, the lease is classified as an operating lease.

	U.S. GAAP	IFRS
Selling profit	Selling profit is recognized at commencement for a sales-type lease when collectibility is probable, and deferred and (if relevant) recognized over the lease term for a direct financing lease.	Selling profit for a finance lease is recognized at commencement.
Separation of lease and nonlease components	A practical expedient may be elected, under which the lessor does not separate lease components and nonlease components (if certain conditions are met).	No practical expedient is provided related to the separation of lease and nonlease components.
Presentation of sales taxes	Lessors are provided with a practical expedient to present sales tax collected from lessees on a net basis.	No practical expedient is provided related to the presentation of sales taxes.
Lessor costs paid by lessee	Lessor costs paid directly by a lessee to a third party should be excluded from lease payments.	No guidance is provided with respect to the treatment of lessor costs paid directly by a lessee to a third party.

These are the significant differences between U.S. GAAP and IFRS related to accounting for leases (excluding differences related to the accounting for sale-leasebacks and subleases). Refer to ASC 842 and IFRS 16 for all of the specific requirements applicable to accounting for leases. In addition, refer to our U.S. GAAP vs. IFRS comparisons series for more comparisons highlighting other significant differences between U.S. GAAP and IFRS.

Consult your RSM US LLP service provider concerning your situation and any specific questions you may have. You may also contact us toll-free at 800.274.3978 for a contact person in your area.

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U.S. GAAP vs. IFRS: Leases resulted from the efforts and ideas of various RSM US LLP professionals, including members of the National Professional Standards Group, as well as contributions from RSM UK and RSM Canada professionals.