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Financial Reporting Alert

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The New FASB Lease Standard

The Financial Accounting Standards Board (FASB) issued its new Lease standard today, following the International Accounting Standards Board's (IASB) issuance of IFRS 16 - Leases earlier this year (January 13, 2016). Although the standards are not converged as originally intended, the central issue of bringing operating leases onto the balance sheet is aligned.

What is the effective date?

Under U.S. GAAP, public entities will adopt the standard for annual and interim periods beginning December 15, 2018. Private companies receive a one-year deferral from that date, and early adoption is permitted for all entities. Under IFRS, the effective date is for annual periods beginning on or after January 1, 2019, with earlier application permitted if IFRS 15 - Revenue from Contracts with Customers, is also applied.

Why the change?

The primary objective was to increase transparency and comparability among organizations by recognizing lease assets and liabilities on the balance sheet and disclosing key information.

What are the key provisions?

Under both standards, virtually all leases would be recognized on the balance sheet. However, the boards split on their views regarding the lessee income recognition model. Under the IASB's standard, all leases would be presented in a manner similar to today's financing or sales-type leases (referred to as "Type A" leases). The FASB standard requires a dual model that, in addition to Type A leases, permits a straight-line expense recognition pattern similar to today's operating leases (referred to as "Type B" leases). Under the FASB's dual approach, determining whether a lease is Type A or Type B would be based on guidance similar to the classification model under current GAAP, but without the bright lines.

Lessor accounting is more aligned and intended to result in financial reporting similar to current U.S. GAAP and IFRS. Although the boards agreed on the basic model, they differed on how they would identify when the lessor has sold an asset via the lease arrangement. The IASB's focus is on the transfer of risks and rewards, which is consistent with the principle in its current literature, as well as GAAP. The FASB, on the other hand, has issued an approach based on the transfer of control of the asset, which is similar to the model in the new revenue recognition standard.

What should you do?

You should begin thinking about how the new rules may affect existing leases, as well as consider the potential implications for contemplated new agreements. You should also compile a complete inventory of your leases, and communicate with banks, rating agencies and financial analysts about how your company's financial metrics may be affected. Ensure you have the right team to transition to the new standard and start the strategic work now. Involve key stakeholders early and leverage technology specifically designed to assess the impact of new rules.

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