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New FASB Lease Accounting Standards Impact US Businesses in China

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US-based businesses with subsidiaries in China need to prepare financial statements that are consistent with **US Generally Accepted Accounting Principles (GAAP (http://www.china-briefing.com/news/2017/05/31/china-gaap-vs-u-s-gaap-and-ifrs.html)**) and the new Financial Accounting Standards Board (FASB) lease accounting standards.

While Chinese subsidiaries need to file financial statements consistent with **China GAAP (http://www.china-briefing.com/news/2015/07/03/understanding-chinas-current-accounting-practice-chinese-gaap-vs-chinas-tax-system.html)**, often these financial statements need to be translated to US GAAP. Recent International Accounting Standards Board (IASB) standards have also changed the way leases are recorded in the financial statements in line with the new US GAAP standards.

The new lease accounting guidance

In February 2016, the FASB issued new lease accounting guidance [ASU No. 2016-02, Leases (Topic 842)]. This new guidance was initiated as a joint project with the IASB to simplify lease accounting and improve the quality of and comparability of financial information for users. The IASB also issued guidance in IFRS 16 during January 2016.

This new guidance eliminates the historical concept of off-balance sheet treatment for "operating leases" for lessees for the vast majority of lease contracts.

Under ASU No. 2016-02 (Topic 842) and IFRS 16, at inception, a lessee must classify all leases with a term of over one year as either finance or operating leases, with both classifications resulting in the recognition of a defined "right of-use" asset and a lease liability on the balance sheet.

However, recognition on the income statement will differ depending on the lease classification: finance leases recognize the amortization of the right-of-use asset separate from interest expense for the lease liability while operating leases recognize a single total lease expense.

(http://www.china-briefing.com/news/wp-content/uploads/2017/07/Related-Link_CB-icons_2017.jpg) RELATED: China's Accounting Standards: Chinese GAAP vs. US GAAP and IFRS (http://www.china-briefing.com/news/2017/05/31/china-gaap-vs-u-s-gaap-and-ifrs.html)

Lessor accounting will be substantially unchanged from the previous lessor requirements under U.S. GAAP and IFRS. These new standards will take effect for nonpublic companies in fiscal years beginning after December 15, 2019.

Public companies' compliance is required for fiscal years beginning after December 15, 2018. Early adoption is permitted. For leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements; lessees and lessors must apply a modified retrospective transition approach.

The new lease model

What is a lease?

A contract that conveys the "right to use" for an underlying asset for a period of time in exchange for consideration. You need to assess whether:

- Fulfillment depends on the use of the identified asset;
- The lease contract conveys the right to control the use of the identified asset.

What does the new model look like?

Lessees will recognize a "right-of-use asset" and a "lease liability" on their balance sheet for virtually all of their leases.

- The liability will be equal to the present value of lease payments. The obligation will be accounted for similar to debt and amortized using the effective interest rate method.
- The asset will be based on the liability, plus any prepayments, initial direct costs, less incentives received, etc.

For income statement purposes:

- Operating leases will result in straight line expense (similar to current operating leases);
- Finance leases will result in a front-loaded expense (similar to current capital leases).

(http://www.china-briefing.com/news/wp-content/uploads/2017/07/Professional-Service_CB-icons-2017.jpg) Accounting and Reporting Services from Dezan Shira & Associates (http://www.dezshira.com/services/accounting-reporting)

Disclosures and other considerations

Events that require a periodic re-measurement of your lease obligation:

- Early renewals;
- Lease extensions;
- Early cancellations;
- Expansion of leased space;
- Contraction of leased space;
- Blend & extend impairments; and,
- Rental rate changes.

Impairment needs to be addressed:

- A lessee must also assess whether a "right-of-use asset" is impaired and recognize any impairment expense in accordance with GAAP/IFRS rules.

Disclosures in the financial statements:

- Extensive quantitative and qualitative disclosures including:
  - Significant judgements made by management; and,
  - Insight into the extent of revenue and/or expense recognized and expected to be recognized from existing leases.

(http://www.china-briefing.com/news/wp-content/uploads/2017/08/CB-Implementation-approach-01-002.jpg)

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