

STAFF PAPER

Accounting Standards Advisory Forum

(Previously presented as FASB Memo 264/ IASB AP 3C at the REG FASB | IASB Meeting in January 2014)

Project	Leases		
Paper topic	Lessee small-ticket leases		
CONTACT(S)	Sarah Geisman	sgeisman@ifrs.org	+44 (0)20 7246 6464
	Danielle Zeyher	dtzeyher@fasb.org	+1 203 956 5265
	Patrina Buchanan	pbuchanan@ifrs.org	+44 (0)20 7246 6468

This paper has been prepared by the staff of the IFRS Foundation and the FASB for discussion at a public meeting of the FASB or IASB. It does not purport to represent the views of any individual members of either board. Comments on the application of U.S. GAAP or IFRSs do not purport to set out acceptable or unacceptable application of U.S. GAAP or IFRSs. The FASB and the IASB report their decisions made at public meetings in FASB *Action Alert* or in IASB *Update*.

Purpose

1. The purpose of this paper is to discuss possible alternatives to address the application of the leases guidance to ‘small-ticket’ leases held by a lessee. This paper also includes a discussion of the short-term lease recognition and measurement exemption for lessees that was proposed in the 2013 Exposure Draft (‘the 2013 ED’).
2. This paper does not discuss the application of the leases guidance to small-ticket leases held by a lessor, or the short-term recognition and measurement exemption proposed in the 2013 ED for lessors. This is because some of the alternatives discussed in this paper may not be applicable to lessors, depending on which lessor model the boards decide upon.
3. The staff think there are a number of alternatives that the boards could consider to provide relief for small-ticket leases held by a lessee, taking into account the feedback and suggestions received on the 2013 ED:
 - (a) providing explicit materiality requirements within the leases guidance;
 - (b) expanding the recognition and measurement exemption for short-term leases;

- (c) permitting the leases guidance to be applied at a portfolio level; and
 - (d) providing an explicit scope exclusion for small-ticket leases or leases of noncore assets.
4. This paper is structured as follows:
- (a) Background
 - (b) Feedback received on the 2013 ED
 - (c) Staff analysis of alternatives to consider
 - (i) Materiality guidance
 - (ii) Short-term lease exemption
 - (iii) Unit of account
 - (iv) Scope exclusion: small-ticket leases and leases of noncore assets
 - (d) Summary of staff views
 - (e) Appendix A: Examples of possible application of a small-ticket/noncore scope exclusion.

Background

5. The 2013 ED proposed a recognition and measurement exemption for short term leases for lessees, proposing that:
- A lessee may elect, as an accounting policy, not to apply the requirements in paragraphs 25-35 and 37-57 to short-term leases. Instead, a lessee may recognise the lease payments in profit or loss on a straight-line basis over the lease term.
6. The 2013 ED defined short-term leases as leases that, at the commencement date, have a maximum possible term, including any options to extend, of 12 months or less.
7. The 2013 ED did not include any other specific scope exclusion or specific guidance for small-ticket leases.

Feedback received on the 2013 ED

Small-ticket leases—general

8. Many constituents commenting on the 2013 ED expressed concern about the costs of the application of the proposals in the 2013 ED to small-ticket leases. Constituents described small-ticket leases as leases that are large in number but small in dollar value, are secondary to a lessee's overall business, and involve the following underlying assets:
 - (a) information technology equipment (for example, computers, printers, photocopiers, mobile phones, and tablets);
 - (b) office equipment or furniture; and
 - (c) automobiles.
9. A few constituents also included property (ie real estate) or construction equipment in the list of what they considered to be secondary to their overall business.
10. These constituents are concerned that applying the proposals in the 2013 ED to these leases would involve a significant amount of time and effort, particularly if the unit of account was set at the individual lease level. In addition, these constituents think the costs of applying the proposals to small-ticket leases will not have a corresponding benefit. These constituents think that the benefit of applying the 2013 ED proposals will be relatively small, because these leases are not large-dollar-value leases and are not directly related to the lessee's overall business or operations.
11. For example, in one meeting, a lessee provided an overview of its leasing portfolio and noted that 98 per cent of its total leases (approximately 21,000 leases) make up less than 10 per cent of its total remaining lease payments (approximately \$90 million of approximately \$900 million). In another meeting, a lessee noted that 50 per cent of its total leases (approximately 1,500 leases) make up approximately 2.5 per cent of its total remaining lease payments (approximately €100 million of €3.9 billion).

12. A representative quote from the comment letters is as follows:

The proposals will also mean that a large number of low-value non-core assets...will need to be recognized on a lessee's balance sheet and detailed disclosures about their lease terms collated. In the case of [this entity], this will mean recognition of thousands of individual leases for low-value items (such as photocopiers and fax machines). The burden of preparing this information will simply not justify its inclusion in the financial statements. (CL 568)

Small-ticket leases—materiality

13. Some constituents stated that, although small-ticket leases are often individually immaterial, the materiality provisions in IFRS and U.S. GAAP do not offer sufficient relief, for the following reasons:
- (a) The leases proposals contain new concepts to which it is difficult and time-consuming to apply existing materiality provisions.
 - (b) Small-ticket leases can be individually immaterial but material in the aggregate.
 - (c) Although the materiality provisions ultimately determine the population of leases to which the 2013 ED should apply, the burden of proof required by auditors and regulators to demonstrate that leases are not material negates any potential benefit from applying the materiality provisions.
14. Some of these constituents suggested that the boards should add explicit materiality requirements to the leases guidance (for example, stating that leases that are less than a certain dollar amount, percentage of total assets, or percentage of total expenses are excluded from the scope of the leases guidance). Other constituents requested clarification of how the existing materiality guidance would apply to leases.

Small-ticket leases—short-term leases

15. Many constituents supported the recognition and measurement exemption for short-term leases. These constituents think that the exemption is a practical way to help reduce costs and exclude many small-ticket leases from the scope of the leases guidance while still providing relevant information to users.

16. A representative quote from the comment letters is as follows:

We welcome the fact that the [boards have] accepted the recommendation from [the entity] and other constituents to include an exemption for short-term leases for lessees. The costs of recognising these leases would outweigh the benefits. We do not envisage any significant structuring opportunities from providing this exemption, as it is likely they would be too costly to implement. (CL 38)

17. However, many other constituents do not think the short-term lease exemption provides enough relief for preparers, especially with respect to small-ticket leases. These constituents note that a lease rarely has a maximum possible term of 12 months or less, and offered examples of different small-ticket leases with longer maximum possible terms.

18. A representative quote from the comment letters is as follows:

If the proposals proceed [the representative body] considers that the relief in relation to short term leases is of little benefit to preparers and users and is unlikely to provide significant relief in practice.

We believe the maximum possible term of twelve months is too short to include anything but incidental leases in respect of office equipment, telecommunications, cars, hotel rooms, etc. It would appear that the major concerns about existing lessee accounting relate to the lack of recognition of significant operating assets. As such, we believe that short-term leases be defined as having a maximum possible term of three years with related extension options only being included in that threshold if

there is an economic incentive to exercise those options.

(CL 564)

19. Some of these constituents suggested extending the recognition and measurement exemption for short-term leases beyond one year. These constituents offered various suggestions as to what the threshold for the exemption should be, ranging from eighteen months to five years.
20. Other constituents suggested that the definition of ‘short-term’ should be based on an assessment of the lease term as defined in the 2013 ED (that is, the noncancellable term of the lease plus any optional periods for which the lessee has a significant economic incentive to exercise). They said that, for example, a one-year lease with a one-year extension option that a lessee does not have a significant economic incentive to exercise should still qualify as a short-term lease. These constituents think that it is beneficial to use the same definition when determining the lease term of all leases, including short-term leases.
21. Other constituents suggested changing the definition of ‘short term’ to depend on the life of the underlying asset (for example, a short-term lease would be one for which the lease term is less than 5 per cent of the life of the underlying asset) or the operating cycle of the lessee (for example, a short-term lease would be one in which the lease term is less than one operating cycle of the lessee).
22. Finally, some constituents do not agree with creating any short-term lease exemption. These constituents said that the costs of providing the short-term lease information do not outweigh the benefits to users. Some also think that the use of a bright line (12 months) in the proposal creates potential structuring opportunities that could result in an understatement of a lessee’s assets and liabilities.

Small-ticket leases—application of proposals in 2013 ED

23. Some constituents suggested that additional requirements should be added about how the lease proposals should be applied to small-ticket leases (assuming that those leases remain within the scope of the leases guidance).

24. Most of these constituents suggested that the boards should permit an entity to apply the proposals to a portfolio of contracts rather than at an individual lease level, similarly to the practical expedient in the Revenue Recognition proposals. These constituents stated that many small-ticket leases are part of master lease agreements or could otherwise be bundled into portfolios of similar contracts.
25. These constituents think that permitting the proposals to be applied at a portfolio level would significantly reduce:
- (a) the costs associated with applying the proposals to a large volume of leases; and
 - (b) the costs involved in applying particular aspects of the proposals, including determining the lease term and discount rate, separating lease and nonlease components, transition, and reassessment.
26. A representative quote from the comment letters is as follows:
- In cases where large volumes of assets, such as automobiles, trucks, copiers, computers, etc. are leased, it will be challenging to maintain the detailed accounting records due to the sheer number of these agreements. We think the Board should provide guidance for the recognition and valuation of groupings of similar leased assets with similar useful lives that would limit the total number of leases to be administered under the ED. These low value items represent significant reporting challenges for companies with decentralized global operations.
(CL633)
27. Other constituents suggested that a simplified version of the proposals should be developed for small-ticket leases, with practical expedients given for various areas of the proposals.

Small-ticket leases—noncore assets

28. Many constituents suggested that the boards should address the issue of small-ticket leases by excluding leases of ‘noncore’ underlying assets from the

scope of the leases guidance. These constituents think that applying the guidance only to leases of core assets would provide users with relevant and useful information about an entity's significant leases and, at the same time, considerably ease the burden for preparers, especially during transition.

29. A representative quote from the comment letters is as follows:

While we acknowledge that the Boards have discussed this topic, we strongly believe that the Proposed Standard should distinguish between core and non-core assets. In its present form, the Proposed Standard requires us to monitor and track a fifteen year lease of an office building, for example, with equal vigor as a two year lease of a small scanner and such assets may be in the aggregate too large to dismiss on the basis of materiality. We believe that the recording of the cash rentals for non-core assets as a straight-line expense fairly captures the economics of the underlying lease transactions or, at a minimum, reflects an appropriate consideration of cost vs. benefit. (CL 376)

Small-ticket leases—user feedback

30. Limited user feedback was received on the issue of small-ticket leases. Users generally support the short-term lease recognition and measurement exemption proposed in the 2013 ED. In addition, some users indicated that their analysis of leases is focused on the core leased assets of entities that engage in significant leasing activities. Accordingly, they would be comfortable with a scope exclusion for leases of noncore assets, assuming that such an exclusion could be developed by the boards.

Staff analysis of alternatives to consider

31. The following paragraphs analyse the advantages and disadvantages of each of the alternatives that the staff considered in providing relief to small-ticket leases held by a lessee.

Materiality guidance

32. A number of constituents suggested that the boards should explicitly exclude immaterial leases or provide further clarity around how the materiality provisions in IAS 1 *Presentation of Financial Statements* and Topic 105 *Generally Accepted Accounting Principles* apply to the leases guidance.
33. The staff do not think that the boards should consider providing an explicit scope exclusion for immaterial leases. Neither IFRS nor U.S. GAAP provide materiality requirements at a standards level, instead relying on the guidance in IAS 1 and Topic 105 to apply to all transactions. The staff do not think the boards should diverge from this approach only in the case of leases.
34. The staff have held discussions with representatives from accounting firms who also agree that explicit materiality requirements are not needed in the final leases guidance. These representatives also stated that the existing materiality guidance is capable of being applied to leases similarly to any other transaction accounted for under U.S. GAAP or IFRS. The determination of materiality for leases could be similar to the determination of materiality for property, plant and equipment when preparing IFRS or U.S. GAAP financial statements, although there will be a few different aspects to consider when applying the existing materiality guidance (for example, the presence of the lease liability and complex lease terms).
35. Moreover, the staff think that the existing materiality provisions would, in fact, mean that many small-ticket leases will be immaterial and would not need to be accounted for under the new leases requirements. The staff have talked to some preparers who have confirmed that they expect some (or even all) of their small-ticket leases to be viewed as immaterial. It appears that leases of small IT equipment, photocopiers, and printers are the most likely to be considered to be immaterial.
36. However, the staff do not think that relying on materiality would mean that all small-ticket leases are excluded from the scope of the leases requirements. Many entities will have small-ticket leases that will be material to the entity in the aggregate. Consequently, without further guidance, an entity would have to account for those leases according to the leases requirements.

Short-term lease exemption

Confirmation of exemption

37. As discussed above, the boards have received requests to expand the short-term recognition and measurement exemption for lessees in order to capture more small-ticket leases. However, before the boards discuss expanding the short-term exemption, the staff think the boards first need to confirm that they would like to include an exemption for a lessee's short-term leases in the final leases guidance.
38. As discussed previously, general support was expressed for the recognition and measurement exemption for short-term leases proposed in the 2013 ED. The staff think that the feedback confirmed the boards' expectation that the short-term lease exemption provides relief for preparers without a large reduction in the usefulness of lease information for users.
39. Consequently, the staff's view is that a lessee should be permitted, as an accounting policy election, to not apply the recognition and measurement requirements to short-term leases and instead recognise lease payments in profit or loss, typically on a straight-line basis.

Expansion of exemption

40. The staff think there are two ways in which the boards could consider amending the short-term recognition and measurement exemption to further address the concerns about small-ticket leases:
 - (a) increase the short-term threshold beyond one year; or
 - (b) change the definition of a short-term lease to be consistent with the definition of the lease term.

Increase the short-term threshold

41. The staff think that there is a range of upper limits that the boards could consider for increasing the short-term threshold. Constituents suggested that the threshold should be increased to be anywhere from eighteen months to five years.
42. An increase in the short-term threshold would exclude more small-ticket leases from the scope of the leases guidance and, thus, reduce the costs associated with

applying the leases guidance to small-ticket leases. In saying that, the staff understand that the majority of small-ticket leases have lease terms of three to five years. This understanding has been verified by information obtained from European and U.S. leasing associations as well as from comment letters and from field work participants. Consequently, the staff think that the boards would have to increase the threshold to at least three years to exclude a significantly larger amount of small-ticket leases than for a one-year short-term exemption.

43. Such an increase could potentially exclude from the scope of the leases guidance not only small-ticket leases, but also many ‘non-small-ticket’ leases. For example, the staff are aware that there are many leases of property, construction equipment, manufacturing equipment, and mining equipment, among other types of non-small-ticket leases, with lease terms that are between three to five years.
44. Moreover, the staff think that extending the short-term threshold beyond one or two years could give rise to a significant incentive to change leasing behaviour to achieve short-term lease classification. The staff think that this incentive is relatively limited if the short-term threshold remains at one year, because there is a significant economic difference between entering into a one-year lease versus a five-year lease. However, the staff think there is much less of an economic difference in entering into a three-year lease versus a five-year lease.
45. For these reasons, the staff do not think that the boards should extend the short-term lease exemption to be longer than 12 months, at least not in isolation. The boards could, however, consider extending it in combination with other criteria, as discussed in paragraph 72 of this paper.

Change the definition of ‘short-term’

46. Another way to expand the short-term lease recognition and measurement exemption would be to change the definition of a short-term lease to include leases with extension options, assessed in the same way as lease term would normally be determined (that is, using the significant economic incentive assessment test if the boards confirm the lease term proposals in the 2013 ED).
47. The main benefit of doing so would be to address the concerns raised about daily rentals and month-to-month leases, which may not meet the definition of a

short-term lease proposed in the 2013 ED. The staff think it is appropriate that month-to-month leases with a non-cancellable period of less than 12 months would meet the definition of short-term. Additionally, it would introduce more consistency into the leases guidance because entities would have to perform only one assessment of the options in a lease for the purposes of determining the lease term and for determining whether the lease is a short-term lease.

48. However, the staff have similar concerns about changing the definition of short-term to include options as are expressed in paragraphs 43 and 44 of this paper. Changing the definition of short-term to include options would potentially exclude more non-small-ticket leases from the scope of the leases guidance. Changing the definition of short-term to include options would also make it easier for entities to change their behaviour to achieve an accounting outcome (for example, change a ten-year lease to a one-year lease with nine one-year extension options, with no significant economic incentive for a lessee to exercise those options, in order to have that lease qualify as a short-term lease).
49. On balance, the staff's preliminary view is that the boards should change the definition of a short-term lease so that it is assessed consistently with the assessment of lease term. Accordingly, the staff's view is that a one-year lease with an extension option, in which the lessee does not have a significant economic incentive to exercise that option, should qualify as a short-term lease. The staff think there are significant benefits to this change, as described in paragraph 47 of this paper. Although the staff acknowledge that there are disadvantages to changing the definition, we think these are relatively limited. The staff do not think that this change would introduce a significantly larger motivation to structure leases to obtain a short-term lease classification than the 2013 ED.

Summary of staff views on short-term lease exemption

50. The staff think that the boards should:
- (a) confirm a recognition and measurement exemption for a lessee's short-term leases;
 - (b) confirm that the short-term lease threshold is 12 months; and

- (c) change the definition of ‘short-term lease’ so that it is assessed consistently with the definition of ‘lease term’.

Unit of account

51. As discussed above, many constituents asked the boards to permit a lessee to apply the leases guidance at a portfolio level. The staff think this could be accomplished by providing guidance similar to that in the 2011 Exposure Draft *Revenue from Contracts with Customers*, which stated:

This [draft] IFRS specifies the accounting for an individual contract with a customer. However, as a practical expedient, an entity may apply this [draft] IFRS to a portfolio of contracts...with similar characteristics if the entity reasonably expects that the result of doing so would not differ materially from the result of applying this [draft] IFRS to the individual contracts (...).

Advantages of permitting the leases guidance to be applied at a portfolio level

52. The staff think that there are significant advantages in specifically permitting a lessee to apply the leases guidance at a portfolio level.
53. The overarching complaint about the costs associated with applying the leases guidance to small-ticket leases relates to the high volume of these leases. Applying the leases guidance at a portfolio level would significantly reduce this volume in terms of the number of units to which a lessee would apply the leases guidance. Accordingly, it would reduce the costs of applying the leases guidance for many entities with small-ticket leases. The cost relief could be particularly high for particular aspects of the leases guidance, such as determining the discount rate or separating lease and non-lease components.
54. The staff understand that many small-ticket leases, particularly IT equipment leases and vehicle leases, are part of master lease agreements (that is, a master umbrella contract containing as many as 1,000 individual lease contracts). The staff have talked to entities who engage in master lease agreements that would

prefer the unit of account to be at the master lease level. For example, the staff talked with one entity that has master lease agreements in place for all of its 10,000 small-ticket leases. The staff think that these master lease agreements represent an example of contracts for which the leases guidance could be applied at a portfolio level. However, an entity may need to identify more than one portfolio within a master lease agreement, if, for example, there are different underlying assets, or significantly different start and end dates for the different individual lease contracts within the master lease agreement.

55. In addition, the staff think the leases guidance could be applied at a portfolio level in other instances for which an entity has large groups of similar individual lease contracts. The staff think that judgement will be involved in determining portfolios in these cases. Nonetheless, the staff think that entities should be able to determine appropriate portfolios. Conversations with preparers and auditors have reinforced this view.
56. The staff acknowledge that the 2013 ED did not explicitly prohibit an entity from applying the leases guidance at a portfolio level. However, many entities noted that the revenue recognition proposals explicitly provided portfolio guidance. They asked if the 2013 ED's lack of guidance on this subject meant that an entity would not be permitted to apply the proposals at a portfolio level. Consequently, if the boards decide that an entity should be permitted to apply the leases guidance at a portfolio level, the staff think that this should be explicitly included within the final Standard.

Concerns about permitting the leases guidance to be applied at a portfolio level

57. Although many entities specifically requested guidance about applying the leases proposals at a portfolio level and confirmed that such guidance would offer significant cost relief, there were some concerns expressed about providing such guidance.
58. The staff think that some could interpret the proposed portfolio wording as requiring an entity to apply the leases guidance at an individual contract level in order to prove that there is no reasonable expectation of a material difference

between applying the leases guidance at a portfolio level and a contract level. This could negate any cost relief associated with permitting the leases guidance to be applied at a portfolio level.

59. The staff note that the concern about the work involved in proving that applying the leases guidance at a portfolio level is not materially different from applying the leases guidance at a contract level was also raised in the revenue recognition project. We understand that the boards expect to include a statement in the Basis for Conclusions for the revenue recognition guidance explaining that, although judgement would be required in selecting portfolios so that the entity would reasonably expect that the results do not differ materially from applying the requirements at a contract level, the boards would expect that entities should be able to determine appropriate portfolios without needing to explicitly prove that there is no material difference. The boards could include a similar statement within the final leases guidance.
60. The staff also note that reassessment may be challenging if the leases guidance is applied at a portfolio level and there are subsequently changes in some, but not all, leases within the portfolio.
61. The staff further note that permitting the leases guidance to be applied at a portfolio level would not provide relief for all of the costs associated with applying the proposals in the 2013 ED to small-ticket leases, for the following reasons:
 - (a) Much of the cost relates to the initial gathering of the information required to apply the leases guidance. This information would still be required, even if the leases guidance is applied to portfolios of leases.
 - (b) There may be costs associated with grouping contracts into portfolios.
 - (c) Applying the leases guidance at a portfolio level may not be helpful for entities with very decentralised operations. This is because grouping contracts in different reporting units into portfolios might not conform to how the entity operates its business.
 - (d) It may not be possible to group leases into portfolios if each individual lease contract is very different from the other lease contracts.

62. Finally, some entities asked how impairment would be assessed if the leases guidance was applied at a portfolio level. If, following the guidance in U.S. GAAP or IFRS, there is evidence that some, but not all, right-of-use assets within a lease portfolio may be impaired, it may be inappropriate to continue applying the leases guidance to the same portfolio. In such an impairment scenario, an entity would need to determine if there is a reasonable expectation that there would be a material difference between applying the leases guidance at the original portfolio level and at an individual contract level. If there is a reasonable expectation of a material difference, then the entity may need to split the original portfolio into smaller portfolios or apply the leases guidance at a contract level to remove that difference and ensure that the portfolio is not aggregated above the level that impairment would need to be measured (that is, an asset group under U.S. GAAP or a cash-generating unit under IFRS).

Staff views on unit of account

63. The staff's view is that the leases guidance should include a provision similar to the provision in the forthcoming revenue recognition guidance, permitting a lessee to apply the leases guidance at a portfolio level if the lessee has a reasonable expectation that doing so would not result in a material difference from applying the leases guidance at a contract level. The staff think that such a provision will provide significant cost relief for entities applying the leases guidance with very little, if any, reduction in the relevance of the information produced by such application.
64. The staff think that the actual guidance on unit of account should be relatively brief, but that it might be helpful to include one example within the Illustrative Examples explaining how an entity could apply the leases guidance at a portfolio level.
65. The staff note the concerns expressed about the need to apply the leases guidance at a contract level in order to prove there is no reasonable expectation of a material difference, described in paragraph 58 of this paper. The staff agree with the approach that the revenue recognition project has taken on the issue and think that the boards should do the same for leases. However, if the boards think that is

inappropriate, the leases guidance could include more detail on the composition of an appropriate portfolio (for example, all individual leases within a portfolio should have the same underlying asset, similar lease terms and similar other contractual terms) rather than a statement that an entity must have a reasonable expectation that applying the leases guidance at a portfolio level is not materially different from applying the leases guidance at a contract level.

Scope exclusion: small-ticket leases and leases of noncore assets

- 66. Although the materiality provisions, short-term lease exemption, and unit of account guidance would all provide some cost relief regarding small-ticket leases, the staff think that costs would remain.
- 67. If the boards wish to remove almost all of the cost associated with applying the leases guidance to small-ticket leases, then the staff think the boards would need to consider providing an explicit scope exclusion as was suggested by constituents.
- 68. The staff think that such a scope exclusion could have two main elements:
 - (a) *Small-ticket element*: the scope exclusion should only be available to leases for which:
 - (i) there is a large group of similar underlying assets, and
 - (ii) each lease is individually insignificant.
 - (b) *Noncore element*: the scope exclusion should only apply to leases of assets that are not ‘core’ to an entity’s operations. The staff think that the most appropriate and operational way to distinguish between core and noncore assets would be to distinguish between assets that are used to generate revenue and those that are used for administrative purposes.
- 69. Examples of how this scope exclusion could apply to different types of leases are provided in Appendix A.
- 70. The staff think it is important to include the small-ticket element in a scope exclusion because it focuses the exclusion on the problem identified. The scope exclusion would be designed to capture scenarios for which the cost of applying

the leases guidance is particularly high because of a large volume of leases, and the benefits are lower because each individual lease is insignificant. However, the staff do not think the scope exclusion could rely solely on the small-ticket element, because it may lead to scope exclusions for leases that are very important to an entity's operations, such as store leases for a retailer or trucks for a distribution company.

71. Accordingly, the staff think it is important to include the noncore element in a scope exclusion, because it is important that any such scope exclusion would *not* capture leases that are directly related to an entity's revenue-generating operations. Moreover, the types of leases that are most commonly mentioned as small-ticket leases are those that are used in an administrative or support capacity, such as IT equipment, office furniture, or occasionally vehicles.
72. The staff also think the boards could consider adding a *time* element to the scope exclusion. The staff think that, if the boards were to add a time element, it should be that the lease have a lease term of no longer than five years. The staff think that a time element would provide more rigour around the scope exclusion assessment. In addition, the staff understand that most small-ticket leases have a lease term of five years or less, so the staff do not think that a time element would inappropriately remove any leases from the scope exclusion.
73. The staff note that some entities asked for property leases to be treated as leases of noncore assets and qualify for a scope exclusion. However, we do not think that property leases would qualify under the scope exclusion described above. In many cases, property leases are used for revenue-generating purposes (for example, leases of store locations). Even if the property lease is not used for a revenue-generating purpose (for example, a head office), the staff do not think there would be many, if any, groups of property leases that could be described as 'large groups of similar underlying assets'. This is because the location of a property lease is unique to each lease and has a large impact on that underlying asset's value. Property leases also tend to have terms and conditions that are unique to that lease.

Advantages of a small-ticket/noncore scope exclusion

74. The staff think an important benefit of such a scope exclusion would be that it would most directly address the concerns about small-ticket leases. This scope exclusion could result in significant cost reductions and, at the same time (and if applied properly—and consistently), result in only a correspondingly small decrease in the benefits of the information provided about an entity’s leasing activities.
75. The staff acknowledge that a scope exclusion could be difficult to apply consistently, as discussed in further detail below. However, the staff think that the provision of examples of leases that would qualify for the scope exclusion would be very helpful in terms of clarifying the types of leases to which the boards think the scope exclusion should apply.

Disadvantages of a small-ticket/noncore scope exclusion

76. However, the staff acknowledge that there are a number of disadvantages to introducing a scope exclusion for noncore assets:
- (a) Any scope exclusion based on the small-ticket and noncore concepts would be difficult to apply consistently because it would be based on qualitative concepts. The specific scope exclusion proposed above would be difficult to apply consistently because it would introduce subjective terminology (for example, ‘insignificant’, ‘administrative’, and ‘revenue-generating’). The scope exclusion proposed above would also be difficult to apply consistently if an asset is being used for both a revenue-generating and administrative purpose, or if an entity has two similar underlying assets that are being used for two different purposes.
 - (b) Any scope exclusion would introduce an incentive for entities to modify their leases to obtain off-balance-sheet accounting treatment.
 - (c) Any scope exclusion would further complicate the leases guidance by adding another judgemental assessment that entities must make.

- (d) The scope exclusion proposed would not capture all of the leases that entities consider to be small-ticket leases (for example, forklifts used as part of a distribution business).
- (e) A noncore scope exclusion would be inconsistent with the way that other types of assets and liabilities are capitalised in IFRS and U.S. GAAP.
- (f) Leases of noncore assets could still give rise to material assets and liabilities.

77. Finally, the staff also considered providing a list of assets that would qualify as noncore assets rather than providing a definition of noncore. This list would be likely to focus on office equipment and other information technology equipment. However, the staff is concerned that such a list might not capture all small-ticket leases, would create structuring opportunities, and would put too much stress on the definition of those types of assets. Moreover, such a scope exclusion would need to have some sort of exception for revenue-generating assets if the boards would wish to include assets such as photocopiers within the scope of the leases guidance if those assets are used for revenue-generating purposes (for example, in the case of a document production or reproduction company).

Staff views on a small-ticket/noncore scope exclusion

78. Although the staff are attracted to the idea of providing a scope exclusion for small-ticket leases and leases of noncore assets, the staff think the disadvantages described in paragraph 76 and 77 outweigh the advantages. The staff are particularly concerned that the scope exclusion would be difficult to apply, add complexity to the final leases guidance, and result in similar leases being accounted for differently.
79. In addition, if the boards agree with the staff views earlier in this paper, the staff think that the materiality provisions, short-term lease recognition and measurement exemption, and unit of account guidance will offer substantive cost relief for small-ticket leases.

Summary of staff views

80. The staff think that:
- (a) No specific requirements regarding materiality should be included in the leases guidance.
 - (b) The one-year short-term recognition and measurement exemption for lessees should be retained (and not expanded beyond 12 months). The definition of ‘short-term’ should be changed to be consistent with the definition of ‘lease term’.
 - (c) The leases guidance should be able to be applied at a portfolio level.
 - (d) There should not be any additional scope exclusions for small-ticket leases or leases of noncore assets.

Questions: Lessee small-ticket leases

Question #1 – Do the boards have any questions on the proposed alternatives to providing cost relief for small-ticket leases?

Question #2 – Are there any other alternatives to providing cost relief for small-ticket leases that the boards think the staff should explore?

Appendix A: Examples of possible application of a small-ticket/noncore scope exclusion

Example	Qualifies for scope exclusion?	Why?
Photocopiers, used by a clothing retailer's IT, finance, and administrative staff in back offices	Yes	<i>Small-ticket element</i> —the group of photocopiers are all similar assets that are individually insignificant. <i>Noncore element</i> —the photocopiers are used for administrative purposes. The retailer's revenue-generating activities are selling clothing. The photocopiers are not directly involved in selling that clothing.
Aircraft, used by an airline	No	<i>Small-ticket element</i> —the aircraft is not individually insignificant. <i>Noncore element</i> —the airline's revenue-generating activities are the provision of flight services. The aircraft is directly involved in providing those flight services.
Trucks, used by a grocery store retailer	No	<i>Small-ticket element</i> —the group of trucks are all similar assets that are individually insignificant. <i>Noncore element</i> —the retailer's revenue-generating activities are selling food. The trucks are directly involved in selling that food by transporting it to customers.
IT equipment, used by a clothing retailer for individual stores to order clothing from a central warehouse	No	<i>Small-ticket element</i> —the IT equipment is made up of a group of similar assets that are individually insignificant. <i>Noncore element</i> —the retailer's revenue-generating activities are selling clothes. The IT equipment is directly involved in selling those clothes by instigating the ordering process.

Example	Qualifies for scope exclusion?	Why?
Corporate jet, used by the CFO of a conglomerate	No	<p><i>Small-ticket element</i>—the corporate jet is not individually insignificant.</p> <p><i>Noncore element</i>—the corporate jet is not directly used for revenue-generating activities; instead, it is used for administrative purposes, for the use of an employee that is not directly related to revenue-generating activities.</p>
Cars, used by a construction and manufacturing company	Some yes, some no	<p><i>Small-ticket element</i>—the group of cars are all similar assets that are individually insignificant.</p> <p><i>Noncore element</i>—some of the cars are used by the company’s sales department, while others are used by the finance department. The cars used by the sales department are directly involved in the company’s revenue-generating activities, while the cars used by the finance department are used in administrative activities. The qualification would depend on the purpose for which an individual car (or portfolio of cars) is being used.</p>
Laptops, used by an engineering company	Yes/No	<p><i>Small-ticket element</i>—the group of laptops are all similar assets that are individually insignificant.</p> <p><i>Noncore element</i>—the laptops are used by engineers, partly for revenue-generating purposes (developing the technology sold to customers), and partly for administrative purposes (completing time/expense reporting).</p>