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STAFF PAPER

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Project	Leases		
Paper topic	Lessee small-ticket leases		
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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. The phrase 'small-ticket leases' in this paper generally refers to high-volume, low-value leases.

2. This paper discusses the following alternatives that the boards could consider to provide cost relief for small-ticket leases held by a lessee, taking into account the feedback and suggestions received on the 2013 ED as well as the boards' discussion at the January 2014 joint board meeting:

   (a) Providing explicit materiality requirements within the leases guidance;

   (b) Permitting the leases guidance to be applied at a portfolio level; and

   (c) Providing an explicit recognition and measurement exemption for leases of small, non-specialised assets (a 'sub-set' of small-ticket leases).

   The boards could choose one or more of these alternatives to provide cost relief for small-ticket leases; they are not mutually exclusive.

3. This paper is very similar to Agenda Paper 3C/FASB Memo No. 264 that was discussed in the January 2014 joint board meeting. The most substantive differences between that paper and this one are as follows:

(a) This paper does not include a discussion of short-term leases. Short-term leases are discussed in Agenda Paper 3H/FASB Memo 275.

(b) This paper includes expanded analysis in the section on a recognition and measurement exemption for leases of small, non-specialised assets, taking into account suggestions made at, and additional analysis performed since, the January 2014 joint board meeting.

(c) This paper includes a discussion of disclosure requirements for any leases of small, non-specialised assets that would qualify for the proposed recognition and measurement exemption, if the boards choose to provide it.

(d) Appendix B of this paper includes staff analysis regarding a suggestion made in the January 2014 meeting to include a recognition and measurement exemption for entities with leases below a specified quantitative threshold.

(e) Appendix C includes the staff analysis of a combination small-ticket/noncore recognition and measurement exemption.

4. This paper does not discuss the application of the leases guidance to small-ticket leases held by a lessor, with the exception of permitting lessors to apply the leases guidance at a portfolio level. This is because some of the alternatives discussed in this paper may not be applicable to lessors, depending on which lessor model the boards adopt.

5. This paper is structured as follows:

(a) Summary of staff recommendations

(b) Background

(c) Feedback received on the 2013 ED

(d) Staff analysis

(i) Materiality guidance

(ii) Portfolio approach

(iii) Recognition and measurement exemption for small-ticket leases

(iv) Disclosure requirements

Summary of staff recommendations

6. The staff recommend that:

   (a) The leases guidance should not include specific requirements regarding materiality.

   (b) The leases guidance should be able to be applied at a portfolio level by lessees and lessors.

7. The staff are divided in their views on a recognition and measurement exemption for leases of small, non-specialised assets, under which a lessee would be permitted not to apply the recognition and measurement requirements to such leases:

   (a) Some staff support a recognition and measurement exemption for leases of small, non-specialised assets.

   (b) Other staff do not support any such recognition and measurement exemption. However, if the boards were to decide that they wish to provide additional cost relief for leases of small, non-specialised assets, these staff would recommend a measurement exemption only that would permit a lessee to measure the assets and liabilities arising from these leases on an undiscounted basis because this would require no incremental effort with respect to those leases than today, while still recognising these leases on the balance sheet.

8. If the boards decide to include a recognition and measurement exemption for leases of small, non-specialised assets, the staff recommend the following disclosures for these leases:

   (a) Qualitative disclosures, included as part of the qualitative disclosures required more generally for leases.

(b) The amount of expense recognised related to leases qualifying for the exemption in the current period.

9. If the boards decide to include a recognition and measurement exemption for leases of small, non-specialised assets, the staff have split views on whether a lessee should be required to disclose a maturity analysis of future lease payments for these leases.

Background

10. The 2013 ED did not include any specific recognition and measurement exemption or specific guidance for small-ticket leases.

11. IAS 17 *Leases* and Topic 840 *Leases* also do not have specific guidance for small-ticket leases. There are disclosure requirements for all operating leases which include:

(a) A maturity analysis,

(b) Disclosure of expense attributable to minimum lease payments, contingent rents, and sublease payments; and

(c) A general description of the lessee's significant leasing arrangements, including information about contingent rents and variable lease payments.

Feedback received on the 2013 ED

12. A full summary of the feedback received on the 2013 ED regarding small-ticket leases can be found in Agenda paper 3C/FASB Memo 264, discussed at the January 2014 joint board meeting. The following paragraphs give a high-level summary of the feedback received regarding small-ticket leases.

13. 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 generally 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) Cars.

14. 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. This is because these leases are not large-dollar-value leases and are not directly related to the lessee's overall business or operations.

15. Constituents offered various suggestions to address the issue of small-ticket leases. These suggestions included:

(a) To include explicit materiality guidance in the leases standard,

(b) To permit lessees to apply the leases guidance at a portfolio level, and

(c) To include an explicit recognition and measurement exemption for noncore or small-ticket leases.

Staff analysis

16. In the light of the feedback received with respect to small-ticket leases, the staff have explored different alternatives to provide cost relief for small-ticket leases held by a lessee. High volumes of small-value leases are likely to be the leases for which the costs to apply the leases proposals provide the least amount of corresponding benefit.

17. The following paragraphs analyse the advantages and disadvantages of each of the alternatives that the staff considered.

Materiality guidance

18. A number of constituents suggested that the boards should explicitly exclude immaterial leases from the scope of the leases guidance or provide further clarity about how the materiality provisions in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and Topic 105 *Generally Accepted Accounting Principles* apply to the leases guidance.

19. The staff do not recommend that the boards should consider providing an explicit recognition and measurement exemption for immaterial leases. Neither IFRS nor U.S. GAAP provide materiality requirements at a standards level, instead relying on the guidance in IAS 8 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.

20. 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).

21. The staff think that the existing materiality provisions would, in fact, mean that many small-ticket leases will be assessed as immaterial and a lessee would not need to account for these leases 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.

22. 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. Entities could 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.

23. At the January 2014 joint board meeting, some board members expressed interest in exploring a recognition and measurement exemption for entities with relatively insignificant leasing activity (for example, entities with leases that would represent less than 5% of the entity's noncurrent assets). The staff would not recommend such an exemption; the analysis supporting this recommendation is contained in Appendix B.

Question: Materiality guidance
Question #1 – Do the boards agree with the staff recommendation to not include any explicit materiality requirements in the leases guidance?

Portfolio approach

24. 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 included in the forthcoming revenue recognition standard. The latest draft of that standard has the following guidance:

> This IFRS specifies the accounting for an individual contract with a customer. However, as a practical expedient, an entity may apply this IFRS to a portfolio of contracts…with similar characteristics if the entity reasonably expects that the financial statement effects of applying this IFRS to the portfolio would not differ materially from applying this IFRS to the individual contracts…within that portfolio. When accounting for a portfolio, an entity shall use estimates and assumptions that represent the size and composition of the portfolio.

Advantages of a portfolio approach

25. The staff think that there are significant advantages in specifically permitting a lessee to apply the leases guidance at a portfolio level.

26. 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 could 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.

27. The cost relief offered by applying the leases guidance at a portfolio level need not be limited to simply grouping contracts together. The cost relief could also be particularly high for particular aspects of the leases guidance for which entities need to make judgements and estimates, such as determining the discount rate or the lease term. For example, rather than establishing a specific discount rate for a single leased asset, an entity might conclude that it could establish a single discount rate applied to all leased assets in a portfolio because using that discount rate would not result in a materially different answer from using a different discount rate for each individual lease.

28. 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 leases). 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 individual leases within the master lease agreement. Conversely, differences between individual leases within a master lease agreement would not preclude an entity from treating those leases as a single portfolio if those differences would not result in a material change from applying the leases guidance at an individual lease level.

29. In addition, the staff think the leases guidance could be applied at a portfolio level in instances other than master lease agreements for which an entity has large groups of similar individual leases. The staff think that judgement would 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.

30. 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 whether 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 a portfolio approach

31. The following paragraphs describe some concerns expressed about providing portfolio guidance. The staff note that the concerns described in this section are not disadvantages of including portfolio guidance. Rather, they identify possible areas of clarification or explain why the portfolio guidance would not remove all costs associated with applying the requirements to small-ticket leases. In the staff's view, the only disadvantage of including a statement explicitly allowing the leases guidance to be applied at a portfolio level is that including such an explicit statement may set a precedent for other standards or topics (that is, it might imply that such a statement would need to be included in every standard or topic within IFRS and U.S. GAAP going forward).

32. 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. This concern was also raised in the revenue recognition project. We

understand that the Basis for Conclusions for the revenue recognition guidance is expected to explain that the boards would expect that entities should be able to determine appropriate portfolios without needing to explicitly prove on a quantitative basis that there is no material difference. The boards could include a similar statement within the final leases guidance.

33. Reassessments may be challenging if the leases guidance is applied at a portfolio level and there are subsequent changes in some, but not all, leases within the portfolio. However, the staff think that other changes might be made to the reassessment proposals in areas like lease term and discount rate that would help mitigate these concerns. The staff think that it would be relatively uncommon for a lessee to conclude that it could apply the leases guidance to a portfolio of leases at lease commencement, but not also evaluate reassessment at the same portfolio level.

34. 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. This is because:

    (a) There are costs related 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 if there is a significant amount of judgement involved in determining the appropriate composition of portfolios.

    (c) Applying the leases guidance at a portfolio level may not be helpful for entities with 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 is very different from other leases.

35. Finally, some entities asked how impairment would be assessed if the leases guidance were to be applied at a portfolio level. If some, but not all, right-of-use

assets within a lease portfolio are impaired, it would be inappropriate to continue applying the leases guidance to the same portfolio if the impairment is material to the entity. In that case, the entity would need to split the original portfolio into smaller portfolios or apply the leases guidance at a contract level. This would be required to remove the material difference between application at a portfolio level and a contract level. This would ensure that the portfolio is not aggregated above the level that impairment is measured (that is, an asset group under U.S. GAAP or a cash-generating unit under IFRS).

Staff recommendation on applying a portfolio approach for lessees

36. The staff recommend that the leases guidance should include portfolio guidance similar to what will be included in the forthcoming revenue recognition guidance. That guidance should permit 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 guidance would provide potentially significant cost relief for entities applying the leases guidance with little, if any, reduction in the relevance of the information produced by such application.

37. The staff think that the actual portfolio guidance should be relatively brief, but that it might be helpful to include at least one example in the final standard and/or explanatory language in the Basis for Conclusion explaining how a lessee could apply the leases guidance at a portfolio level. The staff think this would be useful, but would want to ensure that any example or language included would not inappropriately limit the usefulness of the portfolio guidance.

Staff recommendation on a portfolio approach for lessors

38. The staff recommend that the boards also explicitly permit lessors to apply the leases guidance at a portfolio level, for many of the reasons explained above. In addition, the staff think that consistency with the revenue recognition guidance is especially important for lessors.

Question: Portfolio approach
Question #2—Do the boards agree with the staff recommendation to explicitly permit lessees and lessors to apply the leases guidance at a portfolio level?

Recognition and measurement exemption for small-ticket leases

39. Although the materiality provisions, short-term lease exemption (discussed in Agenda Paper 3H/FASB Memo 275), and portfolio guidance would provide potentially significant cost relief regarding small-ticket leases, the staff think that costs would remain.

40. If the boards wish to provide further cost relief for small-ticket leases, then the staff think the boards would need to consider providing an explicit recognition and measurement exemption for small-ticket leases.

41. This paper discusses two possible recognition and measurement exemptions:

    (a) A recognition and measurement exemption focussing on leases of small, non-specialised assets, discussed below.

    (b) A combined small-ticket/noncore recognition and measurement exemption, which was discussed in detail in Agenda Paper 3C/FASB Memo 264 during the January 2014 board meeting. This discussion is included in Appendix C to this paper.

Scope exclusion for leases of small, non-specialised assets

42. The staff have explored a recognition and measurement exemption for a 'sub-set' of what many constituents view as 'small-ticket' leases. Such an exemption would permit a lessee to account for leases that qualify for this exemption in the same manner as current operating leases. This exemption would apply to leases of underlying assets that are both:

    (a) Individually small in value (when new); and

    (b) Non-specialised (such that those assets would be used, without modification, by entities across a variety of industry sectors),

Appendix A contains the staff's proposed wording for this recognition and measurement exemption.

43. This recognition and measurement exemption would be intended to capture leases such as those of small IT equipment (for example, laptops, desktops, tablets, mobile phones and individual printers), as well as leases of office furniture. The staff think this is appropriate because these types of leases represent those for which many entities have a large volume of leases with individually small values. Accordingly, providing relief for these leases has the potential to provide significant cost relief whilst not losing a significant amount of useful information.

44. The staff considered 'raising' this proposed threshold for the recognition and measurement exemption to also capture leases of assets like cars or more sophisticated photocopiers (leases that were often described as 'small-ticket' in constituent comments). However, we decided not to do so because:

    (a) There is a greater chance that the costs of applying the leases proposals for these leases would not outweigh the benefits lost from their exclusion from the recognition and measurement requirements. This is because such assets are typically higher in value (and, therefore, the corresponding lease assets and liabilities are more likely to be higher in value).

    (b) Unlike assets such as individual IT equipment and office furniture, assets such as cars and photocopiers have a wide range in value. The staff think it would be difficult to distinguish, for example, between 'inexpensive' cars and 'expensive' cars in an operational way without introducing some sort of numerical threshold. This would increase the complexity of the recognition and measurement exemption, which would reduce the overall benefit thereof.

45. This recognition and measurement exemption would not function as guidance on how to apply materiality in the context of leases. It is an exemption that would be applied separately from the materiality assessment. The assessment of whether an underlying asset would qualify as 'small' would be done on an absolute basis and

not with reference to the size of the entity leasing that asset. This would mean, for example, that an entity could have leases that would not qualify for this recognition and measurement exemption and, yet, would not be accounted for according to the requirements because they would be immaterial. Conversely, an entity could have a number of leases of small assets that would be material in the aggregate and, yet, would not be accounted for according to the requirements because they would qualify for this recognition and measurement exemption.

46. When developing this recognition and measurement exemption, the staff thought that it was important to focus on developing an exemption that could be easily and consistently applied, with little opportunity for entities to change their leasing behaviours to achieve an accounting outcome. The staff think that the proposed recognition and measurement exemption would accomplish this objective. As the exclusion is based on a relatively straightforward assessment of the value of the underlying asset and whether that asset is specialised, the staff think it should be clear to most entities whether leases of particular classes of assets would qualify for the exclusion. The staff acknowledge that the criteria to qualify for the exclusion are qualitative, rather than quantitative, factors that some might argue would be difficult to assess. Therefore, the staff think it would be important to provide an example of how the recognition and measurement exemption would be applied in the final leases standard. The staff think this example should make clear what types of assets generally would and would not qualify for the exclusion (as illustrated in Appendix A to this paper).

47. The staff note that the proposed recognition and measurement exemption would focus on the nature of the underlying asset, rather than the right-of-use asset. The staff think this is appropriate because:

(a) It makes the recognition and measurement exemption more operational; an entity will only have to do one assessment for each class of underlying asset rather than each individual lease.

(b) It avoids leases of the same underlying asset having different on- or off-balance sheet treatment depending on the lease term.

(c) There is a link between the value of the underlying asset and the value of the right-of-use asset; if the value of the underlying asset is small, the value of the right-of-use asset will also be small.

Advantages of a recognition and measurement exemption for leases of small, non-specialised assets

48. The staff think an important benefit of a recognition and measurement exemption would be that it would directly address concerns about small-ticket leases by making it explicitly clear that entities would not have to apply the requirements to leases of particular classes of small assets. The staff think that such an exemption would capture many of the types of leases to which it could be costly to apply the proposals relative to the benefit that would be obtained from their inclusion in the requirements. This is because there is typically a high volume of these leases, while being individually small. The staff think that the proposed recognition and measurement exemption would eliminate the costs associated with applying the leases requirements to leases of small, non-specialised assets in two possible ways:

(a) If these leases are material in the aggregate, by removing the cost associated with applying the leases recognition and measurement requirements; or

(b) If these leases are immaterial in the aggregate, by eliminating the cost associated with proving that immateriality.

49. Consequently, this recognition and measurement exemption could result in potentially significant cost reductions. At the same time, the staff expect the exemption to result in only a correspondingly small decrease in the benefits of the information provided about an entity's leasing activities for most lessees. The staff think there is likely to be only a small decrease in benefits to users because the recognition and measurement exemption would be limited to only those leases for which the individual right-of-use asset and lease liability would be small. Consequently, it is likely that the aggregate of those leases will also be relatively small.

50. As discussed above, the staff think a recognition and measurement exemption for leases of small, non-specialised assets would be operational and relatively simple to apply. This is because we think that the guidance can be drafted so as to adequately illustrate which types of assets would qualify for the exclusion. The staff also think that there would be little incentive for entities to change their leasing behaviour to qualify for the recognition and measurement exemption. This is because the types of assets that would qualify for the recognition and measurement exemption will typically only be used for more administrative purposes. For example, the staff do not think entities would be likely or able to switch to leasing individual pieces of IT equipment as a substitute for leases of larger equipment in order to take advantage of the proposed exemption.

51. Finally, the staff note that, although the recognition and measurement exemption does not directly mention any core/noncore split, it would have the effect of mainly eliminating leases used for administrative, rather than revenue-generating, purposes from the scope of the requirements.

Disadvantages of a recognition and measurement exemption for leases of small, non-specialised assets

52. The above notwithstanding, the staff acknowledge that there are a number of disadvantages to introducing a recognition and measurement exemption for small, non-specialised assets:

   (a) A lessee could have many leases of small, non-specialised assets that, in the aggregate, could give rise to material assets and liabilities. The proposed recognition and measurement exemption would result in the lessee not recognising these material assets and liabilities on its balance sheet. One could argue that the objective of the leases project is to ensure a lessee recognises all material assets and liabilities arising from leases, and the type of underlying asset involved in a lease should not change the recognition decision.

   (b) The proposed recognition and measurement exemption would principally rely on examples to illustrate which classes of assets would and would not qualify as small-ticket. There is a risk that the values of the assets described would change in the future in a way that would make the examples meaningless. For example, if an example says that laptops are small in value and cars are large in value, that example would be rendered meaningless if the value of cars ever were to fall below the value of laptops. The staff note, however, that they think this risk should be relatively limited, given the types of assets the staff would intend to exempt from the guidance (refer to the draft example in Appendix A of this paper).

(c) A recognition and measurement exemption for leases of small, non-specialised assets would not capture all of the types of leases that were mentioned by constituents as 'small-ticket' leases. For example, leases of cars would not qualify for the recognition and measurement exemption. One could question the utility of such a recognition and measurement exemption if it does not address all high-volume, low-value leases.

(d) Any recognition and measurement exemption would further complicate the leases guidance by adding another judgemental assessment. Although the staff think that the proposed recognition and measurement exemption would be operational and narrowly tailored so as to reduce judgement, it would represent a judgement that entities would have to make if they wished to apply the recognition and measurement exemption.

(e) Given that the proposed recognition and measurement exemption would apply only to leases of assets with small values, one could argue that these leases would typically be immaterial, even in the aggregate. Because of this, one could question the utility of the proposed recognition and measurement exemption (that is, one could question whether there is any need to include the exemption if applying the existing materiality guidance in U.S. GAAP and IFRS would likely result in the same financial statement outcomes). Assuming that the boards agree with the staff recommendation regarding the portfolio guidance, one could argue that the boards have already provided significant relief for high-volume leases of low-value assets and any further recognition and measurement exemption is unnecessary.

(f) A recognition and measurement exemption of this nature is not provided for other types of assets and liabilities in IFRS and U.S. GAAP.

Staff recommendation on a recognition and measurement exemption for leases of small, non-specialised assets

53. Some staff members recommend that the boards reject any recognition and measurement exemption for leases of small, non-specialised assets. These staff members acknowledge that the cost benefit ratio for these types of leases is higher than for larger leases. However, the staff that oppose this exemption think it is inappropriate to ignore potentially significant lease assets and liabilities. They also disagree with providing a recognition and measurement exemption for *lease* assets and liabilities, which is not provided for other assets and liabilities (that is, they question why leases are 'special'). Those staff think that a lessee could apply existing materiality guidance under IFRS and U.S. GAAP effectively to leases, as it does to items of property, plant and equipment. In addition, these staff members think that the proposed portfolio guidance recommended in this paper would significantly reduce the costs of applying the requirements to small-ticket leases as compared to how many constituents have interpreted the magnitude of such costs based on the proposals in the 2013 ED. Consequently, these staff think that the proposed portfolio guidance provides a sufficient amount of cost relief and negates the need for any further recognition and measurement exemptions.

54. The staff members that oppose the recognition exemption think the boards could introduce *measurement* relief in the form of allowing entities to recognize these leases without considering the time value of money (that is, without discounting). Given that most small-ticket leases are in the 3-5 year range, the effect of discounting may not be significant. In any event, the difference in the financial

statements that would result from an undiscounted measurement would be considerably less than any difference in the financial statements that would result from not recognizing these leases of small, non-specialised assets. Relief from some of the more complex measurement requirements would provide additional relief to preparers. The staff note that a lessee is already required to track the information necessary to account for these leases on an undiscounted basis for disclosure purposes. In addition, in an undiscounted approach, a lessee's accounting would be the same regardless of lease classification; therefore, an undiscounted approach for these leases would eliminate the costs and complexity associated with lease classification. Consequently, if the boards think relief beyond that offered from the portfolio approach is warranted, this additional measurement exemption would further reduce the costs related to accounting for these leases of small, non-specialised assets to an amount no more than under existing guidance.

55. Other staff recommend that the boards introduce a recognition and measurement exemption for leases of small, non-specialised assets. Those staff are making this recommendation on cost-benefit grounds. Those staff think that the exemption has the potential to eliminate a significant amount of cost for entities applying the leases guidance with a relatively small decrease in the benefits of the information provided about a lessee's lease assets and liabilities.

56. Those staff also note that they think the proposed recognition and measurement exemption would be operational and relatively easy to apply. This is because those staff think the guidance can be drafted so as to eliminate a large proportion of the judgement entities would have to apply in determining which classes of assets qualify for the exemption. The staff supporting the exemption acknowledge that any recognition and measurement exemption would add a level of complexity to the guidance, but they think that this would be outweighed by the cost savings achieved.

Question: Recognition and measurement exemption for small-ticket leases
Question #3—Do the boards agree with introducing a recognition and measurement exemption for leases of small, non-specialised assets (a 'sub-set' of small-ticket leases?

Disclosure requirements

57. If the boards decide to permit a recognition and measurement exemption for any population of leases, the boards need to decide whether there should be disclosure requirements for leases qualifying for the exemption.

58. If the boards decide to grant a recognition and measurement exemption as a means of providing explicit materiality guidance (for example, the "5% proposal" outlined in Appendix B to this paper), the staff do not think it would be appropriate to require any further disclosures. The rationale behind such a recognition and measurement exemption would be to exclude immaterial leases. If leases are immaterial, there should be no need for an entity to provide disclosures about these leases.

59. If the boards decide to grant a recognition and measurement exemption for leases of small, non-specialised assets as a means of directly addressing issues related to small-ticket leases, the staff think there are more compelling arguments to include disclosure requirements for those leases. This is because the leases qualifying for the recognition and measurement exemption could be material in the aggregate.

60. The staff note that these leases of small, non-specialised assets are already included in the operating lease footnote disclosures under existing guidance. Accordingly, a lessee is already providing both qualitative and quantitative disclosures about these leases under existing IFRS and U.S. GAAP (assuming these leases are material).

61. The staff think the boards should consider the following disclosures for those leases that qualify for the proposed recognition and measurement exemption:

    (a) Qualitative disclosures, included as part of the qualitative disclosures required more generally for leases.

(b) The amount of expense related to leases qualifying for the exemption in the current period.

(c) A maturity analysis of future lease payments for leases qualifying for the exemption.

These disclosures would be relevant only if material.

62. The staff have provided analysis and recommendations on each of these alternative disclosures assuming that the boards would like to vote on disclosures at the same time as they vote on the recognition and measurement exemption. The boards may, however, prefer to wait and discuss disclosures more holistically as a package.

Qualitative disclosures

63. A lessee could be required to provide qualitative disclosures for those leases that qualify for a recognition and measurement exemption. This would be embedded within the general description of its leasing activities. Such disclosure would be useful because it would provide information about the terms and conditions of those leases of small, non-specialised assets. Moreover, the staff note that there would not be incremental costs to provide this disclosure because such qualitative disclosures are required under IAS 17 and Topic 840.

Disclosure of the lease expense

64. A lessee could be required to disclose the amount of expense related to leases of small, non-specialised assets to which the lessee elected the exemption in the current period. This would give an indication of the significance of those leases to the entity, particularly if users wish to estimate the assets and liabilities, or perform trend analysis, for those leases. The staff view this information as useful because those leases would not be recognised on the lessee's balance sheet.

65. Regarding the cost of providing this disclosure, the staff do not think that the incremental costs would be significant compared to today. A lessee is already required to include these leases in its operating lease expense disclosures under IAS 17 and Topic 840. Because this proposal would require disclosure of the

expense for leases qualifying for a recognition and measurement exemption separately from other leases, there may be a small amount of additional cost to effect that separation. However, the staff think that this cost would be minimal because the expense information relative to those leases is already within the lessee's general ledger or accounts payable system, and is already compiled as part of the existing operating lease expense disclosure requirement.

Disclosure of a maturity analysis of future lease payments

66. A lessee could be required to provide a maturity analysis of future lease payments for those leases that qualify for the proposed recognition and measurement exemption. Requiring a maturity analysis would result in the provision of information that users receive today about the amounts and timings of rental payments for lease commitments that are not capitalised on the balance sheet. This could be useful if users wish to estimate the lease liability for these leases.

67. Because the information is required today, the cost of providing this information should be relatively similar to today. Nonetheless, the operating lease maturity analysis required under existing guidance embeds this information within the maturity analysis provided for all existing operating leases. The staff think that there could be some incremental cost associated with segregating leases qualifying for a recognition and measurement exemption from all other leases. This is because existing leasing information likely does not contain information on the value of the underlying asset, and because entities do not have to track the maturity analysis associated with these lease payments separately from all other operating leases under existing requirements, as they would under this proposal. In addition, the systems used to gather the information for the operating lease maturity analysis may be less sophisticated than the system used for the lease expense disclosure (for example, this information does not necessarily come from the accounting general ledger system).

Staff recommendations on disclosures for small-ticket leases exempted from the recognition and measurement requirements

68. In summary, if the boards decide to include a recognition and measurement exemption for leases of small, no-specialised assets, the staff would recommend the following disclosures for those leases:

    (a) Qualitative disclosures, included as part of the qualitative disclosures required more generally for leases.

    (b) The amount of expense related to these leases in the current period.

69. The staff think that these disclosures would provide users with useful information with a minimum of cost, bearing in mind the operating lease disclosure requirements in IAS 17 and Topic 840. The staff note that these recommendations are the same as those for short-term leases, discussed in Agenda Paper 3F/FASB Memo 273.

70. The staff have split views regarding whether the boards should recommend a maturity analysis disclosure for the future lease payments relating to leases of small, non-specialised assets. Some staff members recommend requiring a maturity analysis. These staff members think that there should be a relatively small incremental cost to providing such a disclosure as these leases are included in the operating lease maturity analysis today. These staff members also think that a maturity analysis provides useful information about the timing and amounts of lease payments for which no asset or liability would be recognised on the balance sheet. These staff members note that such a maturity analysis will be required only if the lease payments relating to these leases are material.

71. Other staff members do not recommend requiring a maturity analysis for leases that qualify for a recognition and measurement exemption for those leases for the following reasons:

    (a) Although a maturity analysis could be useful if a user wishes to estimate the lease liability arising from these leases, outreach with users indicates that the majority of those users use the lease expense information to estimate liabilities, rather than the maturity analysis information.

(b) These staff think that the nature of leases of small, non-specialised assets is such that there are unlikely to be very significant changes in a lessee's activities in this respect—for example, if a lessee has a particular number of laptop leases, there is unlikely to be a very significant change in the number of those leases from one period to the next without a corresponding change in the lessee's overall business or a significant change in the lessee's buy versus lease strategy. Because of this, the staff think the expense information is sufficient to provide useful information about the future cash flows of the lessee in this respect.

(c) These staff think that there is at least some incremental cost associated with disclosing the maturity analysis for leases qualifying for a recognition and measurement exemption separately from other leases.

Question: Disclosure requirements
Question #4 – Do the boards wish to require any disclosures for leases qualifying for a recognition and measurement exemption? If so, which disclosures?

Appendix A: Draft wording for recognition and measurement exemption for leases of small, non-specialised assets with related illustrative example

A1. The following drafting represents the staff's draft proposed wording for a recognition and measurement exemption for leases of small, non-specialised assets and a related illustrative example. The illustrative example also contains a discussion of materiality and applying the leases guidance at a portfolio level, which would continue to be relevant even if the boards do not agree to a recognition and measurement exemption for leases of small, non-specialised assets.

Guidance in standard

A2. A lessee may elect, as an accounting policy, not to apply the requirements in paragraphs X-X to leases of underlying assets that have the following characteristics:

(a) The value of the asset (when new) is individually small.

(b) The asset is a non-specialised asset that would be used, without modification, by entities across industry sectors.

Illustrative example

A3. Company Z (a pharmaceutical manufacturing and distribution company) has the following leases:

(a) Leases of real estate (both office buildings and warehouses).

(b) Leases of manufacturing equipment.

(c) Leases of company cars, both for sales personnel and senior management.

(d) Leases of trucks and vans used for delivery purposes.

(e) Leases of IT equipment for use by individual employees (such as laptops, desktops, hand held computer devices and mobile phones).

(f) Leases of office equipment

 (i) Office furniture (such as chairs, desks and office partitions)

 (ii) Water dispensers

 (iii) High-capacity multifunction photocopier devices.

A4. Company Z determines that it has the following leases that qualify for the recognition and measurement exemption on the basis that the assets being leased have the characteristics listed in paragraph X:

(a) Leases of IT equipment for use by individual employees

(b) Leases of office furniture and water dispensers.

A5. Company Z elects not to apply the leases recognition and measurement requirements to those leases.

A6. Company Z determines that it can exclude its high-capacity multifunction photocopier leases from the leases requirements on the basis of the materiality guidance in IAS 8 [U.S. GAAP Topic 105].

A7. As a result, Company Z applies the leases requirements to its leases of real estate, manufacturing equipment, trucks and vans, and company cars. In doing so, Company Z groups its company cars, trucks and vans into portfolios.

A8. Company Z's company cars are leased under a series of master lease agreements. Company Z uses eight different types of company car, which vary by price and are assigned to staff based on seniority and territory. Company Z has a master lease agreement for each different type of company car. The individual leases within each master lease agreement are all similar, but the terms and conditions generally vary from master lease agreement to master lease agreement. Because the individual leases within each master lease agreement are similar to each other, Company Z reasonably expects that applying the leases requirements to each master lease agreement would not result in a materially different answer than applying the leases requirements to each individual lease within the master lease agreement. Therefore, Company Z concludes that it can apply the leases requirements to each master lease agreement as a portfolio. In addition, Company Z concludes that two of the eight master lease agreements cover substantially similar types of company cars in similar territories. Company Z concludes that the differences in terms and conditions between those two master lease agreements is not significant. It, therefore, concludes that it can further combine those two master lease agreements into a single lease portfolio.

A9. Company Z's trucks and vans are leased under individual lease agreements. There are 5,000 leases in total. All of the truck leases have similar terms, as do all of the van leases. The truck leases are generally for four years and involve similar models of truck. The van leases are generally for five years and involve equivalent models of van. Company Z determines that it would reasonably expect the result of applying the leases requirements to portfolios of truck and van leases, grouped by type of underlying asset, territory and the quarter of the year within which the lease was entered into, would not result in a materially different answer than applying the leases requirements to each individual truck or van lease. Therefore, Company Z applies the leases requirements to a total of 20 different portfolios of truck and van leases, rather than to 5,000 individual leases, with the composition of the portfolios dependent on the underlying asset, timing of the commencement of the lease, and territory within which the lease was entered into.

Appendix B: Staff analysis of a recognition and measurement exemption for entities with leases that are less than a particular quantitative threshold

B1. At the January 2014 joint board meeting, some board members expressed interest in exploring a recognition and measurement exemption for entities with leases that are less than a particular quantitative threshold (for example, entities with leases that are less than 5% of an entity's noncurrent assets). The staff think that this would, in effect, have the same impact as providing explicit materiality guidance; such a recognition and measurement exemption would effectively 'set' materiality for leases at the quantitative threshold. This exemption would also ensure that entities for which leasing is an insignificant component of their business would not be required to apply the new leases guidance.

B2. If the boards were to pursue such a recognition and measurement exemption, the staff think they would need to decide on a number of different factors:

(a) Which financial statement line item should be used as the benchmark against which a lease measurement number should be compared? The staff think that total assets, noncurrent assets, total liabilities, noncurrent liabilities, financial liabilities, equity, operating expense, or interest expense (or a combination of some of these) are all line items that could be relevant benchmarks.

(b) Should the financial statement line item(s) that serve as the benchmark(s) be based on finalised year-end numbers or a practical expedient based on, for example, financial statement line items from a particular quarter?

(c) Which number should serve as the quantitative threshold?

(d) Should the lease measurement number that is compared against the benchmark be calculated using the proposals in the leases guidance or using practical expedients (for example, using an undiscounted asset or liability measurement)?

(e) Should an entity reassess whether it continues to qualify for the recognition and measurement exemption? If so, how often?

B3. The staff think the main advantage of a recognition and measurement exemption for entities with leases that are, in aggregate, less than a particular quantitative threshold is that it is a clear way to provide cost relief for entities with an insignificant amount of leasing activities.

B4. However, the staff think there are a number of disadvantages of a recognition and measurement exemption for entities with leases that are less than a particular quantitative threshold. These disadvantages include:

(a) The general disadvantages of including materiality guidance in a specific standard in IFRSs or U.S. GAAP, discussed earlier in this paper. The staff think that these disadvantages would be intensified for a quantitative threshold such as the one discussed above, because there would be the risk that people would use such a threshold as the new materiality threshold for other accounting areas.

(b) Any recognition and measurement exemption for entities with leases below a quantitative threshold has the potential to capture not only small-ticket leases but any leases, including 'big-ticket' leases.

(c) Any recognition and measurement exemption for entities with leases below a quantitative threshold would reward or penalise certain entities depending on the nature of their business and their decisions regarding funding and capital allocation. For example, such a materiality threshold might reward larger entities in capital intensive industries, and penalise smaller, service-oriented entities. This would also raise comparability issues.

(d) Any number selected for the quantitative threshold would form a 'bright line' that would provide an incentive for entities to change their behaviour to qualify for the recognition and measurement exemption. Any number selected would also be arbitrary in the sense that it would be difficult for the boards to explain why amounts that are very slightly above or below the threshold would have such different accounting treatment.

(e) With regards to which benchmark (a year-end financial statement number or a simplified number) should be used, there would be disadvantages to either alternative. Requiring the entity to use finalised year-end numbers as a comparison would mean that an entity would not be able to determine whether it qualified for the recognition and measurement exemption until the year-end information is finalised, which might take weeks or months. Providing practical expedients to come up with the financial statement line item comparison number might result in answers that are inconsistent with performing the recognition and measurement exemption assessment using finalised year-end numbers and would further complicate the recognition and measurement exemption.

(f) With regards to which lease measurement number (a number calculated using the leases guidance or a simplified number) should be used, there would be disadvantages to either alternative. Requiring an entity to calculate its lease asset, liability or expense amounts under the leases guidance to perform the recognition and measurement exemption assessment would be removing much of the cost relief associated with the recognition and measurement exemption. Providing practical expedients to calculate lease asset, liability or expense amounts might result in answers that are inconsistent with performing the recognition and measurement exemption assessment using amounts calculated using the leases guidance and would further complicate the recognition and measurement exemption.

(g) There would be disadvantages to either requiring, or not requiring, that lessees reassess their qualification for the exemption. If the boards decide to prohibit reassessment, the staff think this will provide a large structuring incentive and would also not reflect changes in an entity's leasing activities. If the boards decide to require reassessment, there would be a possibility of large swings in lease assets and liabilities recognised from period to period when very little has changed in actual lease commitments. This could happen if, for example, the boards decide on a 5% of noncurrent assets threshold and an entity in one period has lease assets totalling 4.9% of noncurrent assets and in a subsequent period has lease assets totalling 5.1% of noncurrent assets. Additionally, the boards will have to develop additional guidance regarding matters like treatment of leases no longer qualifying for the recognition and measurement exemption which have commenced before the reporting period.

B5. Given the disadvantages discussed in the paragraph above, the staff would not recommend introducing a recognition and measurement exemption for entities with leases that fall below a particular quantitative threshold.

Appendix C: Staff analysis of a combination small-ticket/noncore recognition and measurement exemption

C1. At the January 2014 joint board meeting, the boards discussed the possibility of introducing a recognition and measurement exemption for small-ticket leases of noncore assets (that is, a combination small-ticket/noncore recognition and measurement exemption).

C2. A combination small-ticket/noncore recognition and measurement exemption would have two main elements:

(a) *Small-ticket element*: the recognition and measurement exemption 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 recognition and measurement exemption 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.

C3. The boards discussed this recognition and measurement exemption at the January 2014 board meeting and had various concerns, particularly about the operationality and consistent application of such a recognition and measurement exemption. The boards instructed the staff to further explore alternatives of operationalising such a recognition and measurement exemption, especially whether there could be a way of more objectively describing the noncore element by, for example, linking it to whether an entity classified an expense as part of cost of goods sold or general and administrative expenses.

C4. The staff also have significant reservations regarding the operationality and consistent application of a combined small-ticket/noncore recognition and measurement exemption. The staff think that any recognition and measurement exemption with a noncore element would be difficult to apply consistently because such an element would necessarily contain a significant degree of subjectivity.

C5. The staff explored whether the noncore element could be applied in a more objective way by linking the core/noncore assessment to how an entity classified its expenses (that is, by concluding that a lease would be revenue-generating if the entity classified the expenses associated with that lease as part of cost of goods sold, or that a lease would be administrative if the entity classified the expenses associated with that lease as part of general and administrative expenses). However, the staff have concerns with this approach. The staff think that this approach would not actually make the revenue-generating/administrative determination more objective for the following reasons:

(a) IFRSs and U.S. GAAP allow an entity to present its expenses by function or nature, so not all entities are required to present cost of goods sold or administrative expenses.

(b) In our view, guidance in either IFRSs or U.S. GAAP as to which expenses should be included within different expense categories is not appropriate for to creating objective criteria for core and non-core activities:

(i) Although there is some guidance on the types of expenses to include in cost of goods sold, that guidance is not very detailed and is not always definitive. Moreover, the guidance on cost of goods sold relates only to entities that sell goods; there is no guidance on what to include in cost of services provided for entities that provide services.

(ii) The concept of 'SG&A' (that is, sales, general and administrative expenses) is not formally defined in IFRSs or U.S. GAAP.

(c) The existing concepts of cost of goods sold and SG&A expenses would not perfectly align with the revenue-generating/administrative distinction. For example, the 'sales' portion of SG&A expenses should actually be included as a revenue-generating expense.

C6. The staff have looked at a variety of financial statements of entities in industries likely to be affected by the leases standard. There is a large variety in practice in terms of how entities present revenue-generating and administrative expenses, and in particular administrative expenses. On this basis, we do not think we could use the existing expense categories to help define administrative and revenue-generating activities.

C7. Given the concerns described above, the staff would not recommend that the boards pursue any recognition and measurement exemption containing a core/noncore distinction.