STAFF PAPER

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REG IASB Meeting

Project	**Leases**		
Paper topic	Leases of Small Assets		
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Objective

1. The objective of this paper is to provide the IASB with a summary of the outreach performed and feedback received relating to the recognition and measurement exemption for leases of small assets. In the light of this information, the IASB can decide whether it wishes to revisit the tentative decision made in March 2014 relating to the exemption for leases of small assets.

2. This topic was initially discussed by the IASB during the January 2014 board meeting (Agenda Paper 3C) and at the March 2014 board meeting (Agenda Paper 3F). This paper does not revisit the analysis presented by the staff at those meetings. Instead, as previously requested, it is intended to provide the IASB with a factual update of the results of the outreach performed and to highlight any new information identified and feedback received beyond that previously presented.

3. This paper is structured as follows:

   (a) Summary of staff recommendations and conclusions

   (b) Background

   (c) Outreach performed

   (d) Summary of responses

   (e) Other feedback received

   (f) Summary and questions for the IASB

(g) Appendix A – Proposed drafting of small asset lease exemption

(h) Appendix B – Lessee questions

(i) Appendix C – Lessor questions

(j) Appendix D – Alternatives considered but rejected: Recognition of small asset leases on an undiscounted basis

Summary of Staff Recommendations and Conclusions

4. The results of the outreach performed have not changed the staff recommendation as presented at the March 2014 board meeting. The staff continue to be divided in their views as to whether a recognition and measurement exemption for leases of small assets should be included in the final leases standard. Nonetheless, the staff think that the following key pieces of information identified by the outreach should be noted by the IASB when determining whether to reconsider the tentative decision reached in the March 2014 board meeting:

   (a) Outreach confirmed that drafting the potential leases of small asset exemption in a clear and operational way is challenging. Accordingly, lessees are unlikely to interpret the exemption consistently without a quantitative threshold being mentioned in the standard or the Basis for Conclusions.

   (b) Notwithstanding the above concern, the quantitative feedback received indicates that, in cases for which the exemption is applied in the intended manner, the effect on reported financial information is not expected to be significant. This is because, for the outreach population, leased assets captured by a small asset exemption would typically already be excluded from a lessee's balance sheet due to either the existing materiality provisions of IFRS or the short-term lease exemption.

   (c) There are some potential unintended consequences of permitting an exemption that, based on the outreach population, can arise in particular situations. These are:

(i) assets being captured by the exemption which are currently capitalised on the balance sheet under existing accounting for finance leases (IAS 17 *Leases*);

(ii) the potential to exclude large assets (such as IT storage systems) from the balance sheet that are built up over time by combining a number of individually small leases.

5. The staff recommend that, if a recognition and measurement exemption for small assets is included in the new leases standard, the drafting of this exemption should be based on that discussed in Agenda Paper 3F as presented in the March 2014 joint board meeting (see Appendix A to this paper). However, in the light of information identified by the outreach, we also recommend that the IASB consider including the following elements in the small asset exemption:

(a) a requirement that the small asset exemption should apply *only* to leases of assets that are not dependent on, or highly interrelated with, other leased assets;

(b) in the Basis for Conclusions, a discussion of the quantitative threshold that the IASB had in mind at the time of deliberating the exemption. When preparing the draft wording of the exemption in Appendix A to this paper, the staff had in mind a threshold of, roughly, $5,000 as the value of the underlying asset when new; and

(c) in the Basis for Conclusions, a statement that the small asset lease exemption would be a particular focus of the post implementation review.

6. The staff have also considered a measurement only exemption for small asset leases that was suggested at the March 2014 board meeting. Under that exemption, a lessee would recognise small leased assets on an undiscounted basis as an alternative to a recognition and measurement exemption. Accordingly, the amount recognised on the balance sheet in respect of leases of small assets would be the same as the amount currently disclosed under existing operating lease disclosure requirements. However, the staff do not recommend such a measurement only exemption. This is because, if the IASB would like to include a small asset exemption in the final standard, the staff think this would need to be an exemption from both recognition *and* measurement in order to provide a

sufficient level of cost relief to justify including the exemption. The staff analysis relating to the recognition of small asset leases on an undiscounted basis is presented in Appendix D to this paper.

Background

7. During the March 2014 board meeting, the IASB discussed providing an explicit recognition and measurement exemption for leases of small assets. Such an exemption would permit a lessee to account for leases that qualify for this exemption in the same manner as existing operating leases. However, unlike current requirements for operating leases, detailed disclosures would not be provided about these leases. Instead, a lessee would be required to disclose only the income statement expense relating to small asset leases (if material enough to warrant disclosure).

8. The 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. These types of leases were identified as those for which many entities have a large volume of leases with individually small values. Accordingly, providing relief for large volume, small value leases has the potential to provide significant cost relief while not losing a significant amount of useful information. Refer to Appendix A for the proposed drafting relating to the exemption.

9. The IASB tentatively decided to provide the recognition and measurement exemption for leases of small assets. However, the staff were asked to conduct further outreach in order to better understand the implications of such an exemption. In particular, the staff were asked to obtain more information to better assess whether the scope of the exemption would be clear and whether it is likely to result in leases that are material in the aggregate being exempt from the new leases standard.

Outreach Performed

10. Since the March 2014 meeting, the staff have performed outreach activities to better understand the potential effect of a recognition and measurement exemption for leases of small assets. The staff selected a global sample of 31 lessees and 21 lessors. Most participants submitted comment letters for the 2013 ED, and the staff selected the companies based on industry, and whether leases of small assets could be relevant to that particular entity. Some additional entities (that did not specifically comment on small asset leases) were also selected to help ensure the population included a diverse group of industries. The sample included many different industries, including the following: shipping, consumer goods, travel, insurance, retail, banking, telecommunications, financial services, technology and hotels. Although the exemption relates only to lessees, the staff thought it would be helpful to also perform outreach with lessors to obtain information about their customers.

11. For each participant, the staff sent a cover email describing the outreach activity and a copy of the draft wording for the exemption that was included in Agenda Paper 3F at the March 2014 board meeting (see Appendix A to this paper).

12. The staff also sent a detailed list of questions to each participant, which were different for lessees and lessors. The questions for lessees focused primarily on what types of leases would be considered to be leases of small assets. More specifically, the staff requested information about the classes of assets, contract volumes, dollar amounts, existing lease classifications, and lease duration. As noted above, the questions for lessors focused primarily on the lessor’s customers.

13. Refer to Appendix B for the questions distributed to lessees and Appendix C for the questions distributed to lessors.

Summary of Responses

Overview

14. The staff received the following responses to the outreach performed:

	Number of entities included in outreach	Number of responses received	Number of quantifiable responses received*
Lessees			
*Before March 2014 joint board meeting***	5	5	4
After March 2014 joint board meeting	26	20	13†
Total Lessees	**31**	**25**	**17**
Lessors	**21**	**17**	**N/A**

*Considered quantifiable if the staff could establish an estimate of small leased assets as a % of operating lease commitments and as a % of total non-current assets. These estimates were based on information provided by respondents together with their reported financial information.

†Of the 17 lessees that provided quantifiable data for small asset leases, 6 of these did so only *after* being provided with a quantitative threshold to use in identifying small asset leases.

**These lessees were not provided with the questionnaire in Appendix B. Instead, meetings were held with each lessee to discuss their small asset leasing arrangements

15. The responses received varied greatly, both in terms of the level of detail provided and the opinions expressed. A wide range of feedback was received in respect of both the operationality of the proposed drafting (as shown in Appendix A) and the cost-benefit effect of the potential exemption.

16. In order to provide the boards with a high level summary of the information received, the staff have organised the responses as follows:

(a) Operationality of the exemption

(b) Quantitative threshold

(c) Potential effect of the exemption

(d) Effect of the exemption compared to the use of existing materiality guidance

(e) Industry specific considerations

(f) Potential unintended consequences

(i) Inclusion of existing finance leases

(ii) IT equipment

Operationality of the Exemption

17. When asked about the operationality of the proposed exemption, the majority of respondents fell into two broad categories:

(a) Respondents who did not consider the guidance to be operational. These respondents struggled to understand the scope of the exemption and identified a number of specific types of assets for which they were unable to determine whether these assets would be captured by the proposed exemption. These assets included: LAN/servers, DSD storage devices, telecommunications equipment, mainframes, mailroom equipment, aircraft parts, tools, containers and mid-range printers.

Two such respondents stated:

"We do not believe that the guidance as proposed would be operational as the criteria to determine whether or not the leased asset met the exemption is too ambiguous (e.g. furniture is expressly exempted whereas multi-functional copiers are expressly excluded from the exemption even though the relative value of these assets could be similar) for the number of leases and the number of people involved in the leasing process. The examples given in the proposed draft are a small subset of the types of assets that could be leased and do not necessarily provide a clear set of guidelines as to which leased assets would fall under the exemption."

"For example, printers are not just desktop or high capacity multi-function printers. There are a multitude of printers that fall between these two categories….. Our opinion is that it will be too laborious for the boards to define the type of equipment, as well as the parameters related to the equipment, that may qualify for this exemption"

(b) Respondents who considered the guidance to be operational in that they would be able to make an assessment of which assets would be captured. Some of these respondents, however, had concerns about the level of subjectivity that would be involved in this assessment. One such respondent stated:

"We believe that we could identify which assets qualify for the exemption based on our interpretation. However, the guidance is inherently subjective and, as a result, we are concerned that the likelihood that our interpretation would be consistent with other market participants and auditors is low. Specifically, the guidance uses the term small, which will be difficult to apply and will likely result in inconsistencies among companies."

18. Approximately half of the lessee respondents stated that they would plan to establish an internal quantitative threshold. The size of the threshold suggested by respondents based on the guidance provided in Appendix A ranged from $1,000 to $500,000-$1million.

19. A number of US lessor respondents stated that they would interpret the small asset exemption guidance (as shown in Appendix A) as capturing underlying assets with a value below the existing "small ticket" terminology, which is currently used and defined in industry specific guidance for the US equipment leasing industry. In the industry guidance, "small ticket" refers to below $250,000 and "micro ticket" refers to below $25,000.

20. Many respondents suggested an alternative basis for the exemption that they would consider to be more operational. These included the following:

    (a) A threshold based on "small" leased assets as a percentage of total assets, or based on lease expense as a percentage of operating results. A small number of respondents noted that such a definition could, however, cause problems if the results of such quantitative assessments were to change over time such that previously exempt leases ceased to classify for the exemption in a subsequent year;

    (b) A threshold based on lease length – for example, increasing the short term exemption to capture all leases with a lease term of less than 36 months;

    (c) A threshold based on whether the lease term is a significant component of economic life of the underlying asset;

    (d) An exemption for "non-core" (ie non-revenue generating) assets;

(e) An exemption based on existing capitalisation thresholds for Property, Plant and Equipment.

The staff note that the suggestions in bullets (a), (b), (c) and (d) were considered and rejected by the IASB at the March 2014 board meeting. For alternative (e), the staff note that there is no existing capitalisation thresholds within existing IFRS literature, so there would be no existing guidance on which to base this exemption.

Quantitative Threshold

21. A number of respondents to the outreach did not initially provide any quantifiable feedback about the effect of the potential exemption. In some cases this was because the information would be time consuming or costly to provide. In other cases this was because respondents had difficulties in interpreting which assets would be captured by the exemption.

22. In the light of this feedback, the staff introduced a quantitative threshold, where necessary, for participants to use in identifying the leased assets that might be captured by the proposed exemption. The threshold provided by the staff during this exercise was roughly $5,000 in terms of the value of the underlying asset when new. This is the amount that the staff had in mind when writing Agenda Paper 3F for the March 2014 board meeting and is an approximation for the types of assets we envisage being high in volume but low in value.

Potential Effect of the Exemption

23. Responses to the outreach were received from 25 lessees. 17 of these responses contained sufficient data to enable the staff to establish an estimate of "small" leased assets as a percentage of total non-current assets and liabilities, and as a percentage of existing operating lease commitments. These estimates were based on information provided by respondents together with their reported financial information. This data is summarised below:

		Value of Small Leased Assets as a % of Total Non-Current Assets**	Value of Small Leased Assets as a % of Total Non-Current Liabilities**	Value of Small Leased Assets as a % of Reported Operating Lease Commitments
1		3.02%	4.41%	4.87%
2		0.04%	0.13%	1.20%
3		0.03%	0.04%	1.00%
4		0.35%	0.29%	0.69%
5		0.03%	0.11%	1.79%
6†	‡	0.16%	0.41%	55.02%
6(a)†	*	0.00%	0.00%	0.17%
7		0.05%	0.09%	0.49%
8		0.53%	2.20%	14.40%
9	‡	0.39%	0.88%	30.00%
10	‡	0.57%	0.99%	9.84%
11	‡	0.01%	0.02%	22.78%
12		0.05%	0.09%	0.38%
13	*	0.01%	0.01%	0.30%
14	*	0.00%	0.00%	0.00%
15	*	0.01%	0.01%	1.00%
16	*	0.06%	0.14%	5.00%
17	*	0.00%	0.00%	0.00%

* Feedback based on underlying asset value of $5,000 or less
**Total non-current assets and liabilities are as reported, plus an estimate of discounted operating lease commitments
† Note that 6 and 6(a) show data from the same respondent. Initially, high capacity multi function printers were included in the assessment of small assets shown in line 6. Line 6a shows the result for this respondent using a $5,000 threshold
‡ These respondents included items such as vehicles and high capacity multi function printers in their assessment of small assets

24. Four of the respondents (denoted by ‡ in the table) confirmed in their response that they had included particular items (such as cars and high capacity multi-function printers (HCMFPs)) in their assessment of small assets. These had been included despite being explicitly excluded from the exemption by the proposed guidance (Appendix A). One of these respondents stated:

"Based upon the proposed guidance, high capacity multi-function printers (HCMFPs) and vehicles would be excluded from the scope of "small" assets. Given the use of such assets is so pervasive, we favor an exclusion of HCMFPs and vehicles from the scope of "small" assets. We believe the costs of

implementing software and systems to track these assets to determine whether capitalization exclusion applies would far outweigh any benefits incremental financial disclosures could provide to investors. Even if HCMFPs and vehicles are not scoped out in the final lease accounting standard, we anticipate that industry practice will eventually evolve to exclude these items."

25. The majority of the remaining respondents – ie those who interpreted the guidance in the manner intended by the staff - indicated that application of the small asset exemption, as proposed, would give rise to an exemption of a value of leased assets of less than 5% of their existing operating lease commitments. For these respondents, the value of leased assets and lease liabilities exempted was generally less than 1% of total non-current assets and liabilities. The outreach population indicates that application of the small asset lease exemption as intended does not give rise to the omission of material assets and liabilities from the balance sheet. However, it is not possible to conclude based on this limited sample that the assets and liabilities captured by the exemption will *never* be material.

26. For these respondents, the volume of leased assets that would be captured by the proposed small asset lease exemption ranged from 70 to 315,000.

Effect of the Exemption Compared to Existing Materiality Guidance

27. Lessee respondents were asked to estimate the proportion of their small asset leases that, regardless of any small asset lease exemption, would be considered immaterial under the existing materiality guidance in IFRS.

28. Approximately half of the lessee respondents explicitly confirmed that all of the identified small assets would be considered immaterial. Consequently, the proposed exemption would not have any effect on their reported figures. Some of these respondents noted, however, that because immateriality needs to be "proved", the exemption would still provide cost relief.

29. Several of the respondents that did *not* provide any quantitative data said that they considered all of the assets that could potentially be captured by the exemption to be immaterial and did not see any value in assessing such assets against the exemption criteria. These respondents typically were large entities for which

materiality is likely to be assessed at a significantly higher level than the effect of a small asset exemption. One such respondent stated:

"We do not find it necessary to have an exemption on small assets, because the materiality principle can easily be applied to all contracts, regardless of the type of asset. In this respect, we will use the same capitalisation thresholds as for capitalisation of property, plant and equipment. Our main interest in the new lease standard is that it becomes as simple as possible to apply. We only think it adds to complexity to include principles on small assets, even if the IASB specify which small assets may be exempted."

30. Most of the remaining respondents noted that at least some of the small assets identified would either be considered to be immaterial or captured by the short term lease exemption, although these statements were generally not quantified.

31. A number of respondents suggested that, for the exemption to provide a worthwhile level of cost relief, the exemption would need to capture leases of vehicles and/or high capacity multi-function printers. These respondents generally considered the inclusion of these asset types within the scope of the exemption to be appropriate because such assets are (a) not core to the operating activities of their businesses; and (b) often leased in high volumes. One respondent noted that whilst the small asset exemption, as proposed, is *"…unlikely to reduce preparers' workload very significantly"*, inclusion of vehicles within the scope of the exemption *"…would enable a much greater reduction in preparers' workload – increasing the benefit of the exemption to preparers by a factor of three or four times"*.

Industry Specific Considerations

32. As part of the outreach performed, the staff were specifically asked to consider whether there are any particular industries within which there is a greater prevalence of small asset leasing.

33. This was approached in three ways:

    (a) Firstly, the staff asked all lessor respondents whether they are aware of any variation by industry in the level of small asset leasing – ie whether customers of small asset leases were more likely to come from particular industries.

(b) Secondly, the staff ensured that the outreach sample contained a number of industry sectors for which there would be likely to be more leases of small assets, by including lessees operating in the services or financial sectors. Given the nature of their businesses, it is considered likely that these lessees may have a higher proportion of small leased assets (such as individual computers and office equipment) in their lease portfolios than those in other industries such as manufacturing and retail.

(c) Finally, companies operating within the shipping container industry were represented in both the lessee and lessor outreach sample. This industry was identified as containing a potentially significant proportion of small asset leases in their lease portfolios via a review of comment letters received in response to the 2013 ED.

Lessor feedback

34. Virtually all of the lessor respondents (other than those operating as a lessor to only one specific industry) reported that they are not aware of any variations in the level of small asset leasing by industry. Many lessors stated that factors that affect the level of small asset leasing for their customers tend to be the size of the business or number of employees rather than the industry in which they operate.

Service and Financial Sectors

35. Lessee participants included a number of lessees from the service or financial sectors that the staff think may have a relatively high proportion of small asset leases in their lease portfolios. The industries represented within this category are: professional services, asset managers, investment managers, insurance, banking and technology (software or storage).

36. The feedback provided by these lessees on the extent of their small asset leasing was mixed. Some of these lessees stated that they typically purchase small assets. Others noted that their small asset leases are already considered to be immaterial and they do not anticipate that changing under the new leases standard.

	Industry	Value of Small Leased Assets as a % of Total Non-Current Assets	Value of Small Leased Assets as a % of Total Non-Current Liabilities	Additional Comments
1	Professional Services	Not quantified	Not quantified	Leasing activities include property and vehicles - small assets considered to be a small proportion of that
2	Asset Managers	0.01%	0.01%	
3	Insurance	Not quantified	Not quantified	Without including high capacity multi-function printers (HCMFPs) or vehicles, the exemption does not meet the cost/benefit test for insurers
4	Investment Managers	0.01%	0.02%	HCMFPs included in this assessment of small assets
5	Banking	0.53%	2.20%	
6	Banking	0.03%	0.11%	
7	Technology (storage)	initially: 0.16% threshold: 0.00%	initially: 0.41% threshold: 0.00%	HCMFPs and vehicles included in initial assessment of small assets - use of $5,000 quantitative threshold eliminated these items
8	Technology (software)	Not quantified	Not quantified	Small assets tend to be purchased rather than leased. Cost of identifying small leased assets considered significant compared to the effect on financial statements

Shipping Container Industry

37. Both the lessor and lessee outreach samples contained participants from the shipping container industry. Generally, these participants commented that it was not clear from the guidance provided whether shipping containers would be within the scope of the small asset exemption. These participants indicated that, at individual container level, underlying asset values would generally be below $5,000, with the largest shipping companies potentially contracting over 1,000,000 containers at one time during peak seasons.

38. We note that contracts for the supply of shipping containers take a number of different forms that, in some cases, would not meet the definition of a lease. However, based on the feedback received, we think that there will be some circumstances in which a lessee of high volumes of shipping containers could judge these leases to be captured by the small asset exemption.

Potential Unintended Consequences

39. Some specific unintended consequences of a small asset exemption were identified in the outreach population. These are summarised below.

Inclusion of existing finance leases

40. Respondents were asked to comment on whether the proposed exemption would capture any existing finance leases. Most respondents confirmed that the vast majority of assets captured by the exemption are currently classified as operating leases.

41. However, one lessee respondent indicated that the majority of their existing small asset leases are currently classified as finance leases. These assets comprised point of sale systems, scanners, other retail store equipment and individual IT equipment. A small asset exemption would mean that these assets would no longer be recognised on the balance sheet. For this respondent, total finance leases recognised on the balance sheet represent less than 0.5% of reported non-current assets and liabilities.

IT Equipment

42. One of the respondents was a large lessor of IT equipment. This lessor provided information about the nature of their leases, noting that all of their lease contracts are based on the smallest component parts of the leased equipment. This means, for example, that a large high value storage system can be made up of a large number of component parts, which are leased individually and added to the system over time, all of which would individually meet the criteria for a small asset lease exemption. This lessor indicated that all of their IT equipment leases would be likely to meet the small asset lease exemption for lessees.

43. In such a case, because the various individual lease contracts would not all have the same start date or lease term and because they are not negotiated as a package with the lessor, the staff do not think that these component parts would be subject to contract combination or separating lease components guidance. It is therefore possible that large pieces of IT equipment made up of component parts could be captured by the small asset lease exemption (and that leases could potentially be

restructured to achieve this, although that risk is somewhat mitigated by the contract combination guidance).

Other Feedback Received

44. Since the March 2014 board meeting, in addition to the outreach exercise summarised above, the staff have received feedback relating to the small asset lease exemption from a number of other constituents. This has included meetings with preparers in Japan and Europe, discussions with investors and analysts and additional comment letters received since the March 2014 board meeting.

Fieldwork Meetings with Preparers and Preparer Groups

45. Participants at these meetings were asked about the potential cost relief of a recognition and measurement exemption for leases of small assets. They were generally supportive of the proposal.

46. Constituents noted that the exemption is expected to be most beneficial for smaller entities, in particular because it would eliminate the need to ‘prove’ immateriality. Some noted that, in their view, it would be easier to apply the small asset lease exemption than go through the process of demonstrating that all of these leases would be immaterial in the aggregate. Others noted that some small asset leases also include service components that are difficult to separate from the lease components.

Feedback from Investors and Analysts

47. The staff have discussed the potential small asset exemption with a few investors and analysts since the March 2014 board meeting. These investors and analysts noted that they are generally not concerned about the exemption of lease assets and liabilities relating to the types of asset that the IASB consider “small”.

48. These investors and analysts noted that the only entities for which small assets are likely to be a significant proportion of non-current assets are companies that are not capital-intensive. Analysts of such companies are generally unlikely to be interested in information about their leased assets. One such analyst observed that

if a lessee has small leased assets that are material to Property, Plant and Equipment (PPE), then PPE is unlikely to be material to the financial statements as a whole.

49. In contrast, the staff note that the US Investor Advisory Committee (IAC) have reported concerns about the potential small asset lease exemption:

> "We believe that a small-ticket exemption could result in potentially material lease obligations being omitted from the lease measurement. The IAC believes a picture of a company's obligations would be deficient if many individually immaterial assets could be exempted regardless of the aggregate amount of leases." ***(IAC comment letter, November 2014)***

Additional Comment Letters Received

50. A number of unsolicited comment letters have been received since the March 2014 board meeting. Two of these commented on the small asset lease exemption. One reported differing views on the cost benefit and operationality of the potential exemption based on a sample of eight preparers and preparer groups. The other, from a preparer industry group, disagreed with the exemption, noting that it might result in the exemption of material ROU assets and obligations.

Summary and Questions for the IASB

51. Notwithstanding the feedback received regarding operationality, alternative approaches to drafting a recognition and measurement exemption for leases of small assets that were discussed in the Appendices to the March 2014 Agenda Paper 3F have not been revisited in this paper. This is because the staff think that the feedback received has *not* identified any new approaches to defining the exemption that have not previously been considered by the IASB. Furthermore, the staff think that the reasons for rejecting the alternative approaches to drafting the exemption remain relevant. Therefore, the staff continue to think that *if* a recognition and measurement exemption for small assets is included in the new leases standard, the drafting of this exemption should be on the basis that was

discussed in Agenda Paper 3F as presented in the March 2014 joint board meeting (see Appendix A to this paper).

52. In addition, this paper does not revisit the analysis presented by the staff in March 2014 Agenda Paper 3F with regard to the advantages and disadvantages of a recognition and measurement exemption for leases of small assets. Consistent with the recommendation in that paper, the staff continue to be divided in their views as to whether a recognition and measurement exemption for leases of small assets should be permitted in the new leases standard. Those staff that support the exemption do so because they think that it will provide potentially significant cost relief to lessees by not having to demonstrate that small asset leases are immaterial in the aggregate. Those staff that do not support the exemption think that it could lead to assets and liabilities that are material in the aggregate being excluded from some lessees' balance sheets.

53. The staff think that if the IASB decide to include a recognition and measurement exemption for small assets in the new leases standard, some additional elements to the exemption should be considered in order to mitigate some of the concerns identified in the outreach work. These are:

(a) including a requirement that the small asset exemption should apply *only* to leases of assets that are not dependent on, or highly interrelated with, other leased assets. This would be intended to prevent large assets made up of small individual component leases being captured by the exemption;

(b) including in the Basis for Conclusions a discussion of the quantitative threshold that the IASB had in mind when deliberating the exemption. When preparing the draft wording of the exemption in Appendix A to this paper, the staff had in mind a threshold of, roughly, $5,000 in terms of the value of the underlying asset when new. The staff think that, in applying the requirements of the new leases standard, many entities will establish a capitalisation threshold, similar to those used in practice today for PPE. Indicating a threshold for a small asset leases exemption would differ from a capitalisation threshold in that it would be unrelated to materiality. This means that a quantitative threshold for small asset leases would effectively set a minimum lease capitalisation threshold.

The staff are making this suggestion in order to address some of the operationality concerns raised by outreach participants. We think that this discussion should be included in the Basis for Conclusions (rather than in the standard) because it is intended to provide context for the IASB's decision at the time that it was made. We do not think that the figure itself can be authoritative in the longer term because factors such as inflation and currency exchange would be likely to impact the threshold over time; and

(c) including in the Basis for Conclusions a statement that the small asset lease exemption would be a particular focus of the post implementation review of the new standard. This would reflect the intention that typically the effect of the exemption would be immaterial but with a reduced 'burden of proof'. Thus the post implementation review would be intended to identify the extent to which assets and liabilities which are in fact material in the aggregate are excluded from the balance sheet by virtue of the small asset exemption.

Questions: Recognition and measurement exemption for leases of small assets

1. Would the IASB like to retain their tentative decision to include a recognition and measurement exemption for leases of small assets in the new leases standard?
2. If the IASB would like to include a recognition and measurement exemption for leases of small assets in the final leases standard, would they also like to:
   (a) include a requirement that the small asset exemption should apply only to leases of assets that are not dependent on, or highly interrelated with, other leased assets;
   (b) include in the Basis for Conclusions a discussion of the quantitative threshold that the IASB had in mind when deliberating the exemption; and
   (c) include in the Basis for Conclusions a statement that the small asset lease exemption would be a particular focus of the post implementation review of the new standard?

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

A1. The following drafting represents the staff's current thoughts on proposed wording for a recognition and measurement exemption for leases of small assets related application guidance. We have highlighted (blue) those elements of the drafting that have been amended since the version included in March 2014 Agenda Paper 3F in the light of feedback received during the outreach work as described in this paper. In addition, we have noted (*[…]*) those elements of the drafting which are particularly subject to change because detailed consideration of definitions appearing in the new leases standard and/or translation considerations will need to be made as part of the drafting process.

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 when ~~the value of~~ the underlying asset ~~(when new)~~ is individually small (see paragraph A3).

Application guidance

A3. The assessment of whether an underlying asset qualifies as small *[for the purposes of the small asset exemption]* is based *only* on the characteristics of the underlying asset and is not affected by the size, nature or circumstances of the entity making the assessment. Underlying assets which are dependent on, or highly interrelated with, other underlying assets are not small.

A4. Assets captured by the exemption are those which are individually small, including being of low value. The assessment of whether an underlying asset qualifies as small is based on the value of the asset when it is new. The assessment is not made on the basis of materiality and is performed on an absolute basis. Different entities are expected to reach the same conclusion about whether a particular asset is individually small, because the conclusion is unrelated to the entity making the assessment.

A5.

Application example

A6. 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 and *[of varying quality, specification and value]*.

(d) Leases of trucks and vans used for delivery purposes, of varying size and value.

(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.

A7. 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~~ the value of the underlying assets when new are individually small:

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

(b) Leases of office furniture and water dispensers

A8. Company Z elects ~~not~~ to apply the ~~leases recognition and measurement requirements~~ *[small asset lease exemption]* to those leases.

A9. 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 *Accounting Policies, Changes in Accounting Estimates and Errors.*

A10. As a result, Company Z applies the leases requirements to its leases of real estate, manufacturing equipment, trucks and vans, and all of its company cars. In doing so, Company Z groups its company cars, trucks and vans into portfolios.

A11. 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.

A12. 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: Lessee Questions

B1. What is the approximate volume and value of lease contracts, by type of asset, that might qualify for an exemption for leases of small assets?

B2. Would the attached guidance on assets covered by the exemption be operational (that is, would this guidance enable you to identify whether certain assets qualify for the exemption)? Would you establish a quantitative threshold for assets to qualify for this exemption? If so, what would that threshold be?

B3. Are any of your lease agreements that might qualify for this exemption for leases of small assets covered by master lease agreements? If so, approximately what volume is covered by master lease agreements?

B4. Irrespective of whether an exemption for leases of small assets is included in the final leases standard, we anticipate that the existing materiality guidance in IFRS and U.S. GAAP would mean that at least some leases of small assets would be immaterial, even when considered in aggregate. What proportion of your leases of small assets would you consider to be immaterial? What types of asset do these leases relate to? Would the assets that might qualify for this exemption be below your current PP&E capitalization threshold(s)?

B5. What is the approximate range of lease terms for your leases of small assets? Do lease terms differ by type of underlying asset?

B6. Are any of your leases of small assets currently classified as finance leases in accordance with IAS 17 (IFRS) or capital leases in accordance with Topic 840 (U.S. GAAP)?

Appendix C: Lessor Questions

C1. What types of leased assets do you think might qualify for a lessee exemption for leases of small assets? What is the typical volume of these leases for an individual customer?

C2. Are you aware of any variation in the volume of leases of small assets by industry? That is, are your customers with leases of small assets likely to come from particular industries?

C3. Are your lease agreements that might qualify for this exemption covered by master lease agreements? What is the typical volume of assets covered by one master lease agreement?

C4. What is the approximate range of lease terms offered for leases of small assets? Is there any notable variation across industries or types of underlying assets in the typical lease terms?

C5. For your leases of small assets, are you aware whether any of these would currently be classified by the lessee as finance leases in accordance with IAS 17 (IFRS) or capital leases in accordance with Topic 840 (U.S. GAAP)?

C6. If an exemption for leases of small assets were to be permitted for lessees under the final leases standard, would you anticipate your customers looking to alter contractual terms in an attempt to qualify for the exemption? (For example, leasing several “small” assets rather than one “large” one?)

Appendix D: Staff analysis of the recognition of small asset leases on an undiscounted basis

D1. At the March 2014 joint board meeting, the boards discussed the possibility of a measurement-only exemption for leases of small assets as an alternative to a recognition and measurement exemption. This would mean that a lessee would recognise small asset leases on its balance sheet on an undiscounted basis. Under this exemption, the amount recognised on the balance sheet in respect of leases of small assets would be the same as the amount currently disclosed under existing operating lease disclosure requirements.

D2. A measurement only exemption would have two main advantages:

(a) Compared to applying the recognition and measurement requirements as otherwise prescribed, the difference in the reported financial statements that would result from an undiscounted measurement would be considerably less than the difference resulting from not recognising leases of small assets;

(b) A measurement only exemption is likely to be "self-policing" in terms of operationality. This is because, if small assets were of a sufficiently aggregated value that discounting would have a material effect on the reported balance sheet, preparers would be unlikely to take the exemption because of the resulting increase in lease liabilities that would occur.

D3. However, while less information would be lost, the staff do not think that a measurement only exemption would provide a worthwhile level of cost relief. This is because the primary advantage of a recognition and measurement exemption is that information about small asset lease payments would not need to be tracked and monitored within an entity's accounting system. Information would need to be gathered for disclosure purposes (ie to disclose the small asset lease expense in the period), but we think this information could be obtained with relative ease by lessees and would not require them to track future small asset payments. In other words, a recognition and measurement exemption requires relatively little additional preparer cost to be incurred beyond that required to identify which assets are captured. The same is not true of a measurement only exemption which would necessitate:

(a) all small asset leases (including future lease payments) being input into a preparers accounting system;

(b) a *different* system set-up being established for these small asset leases to eliminate the effect of discounting that would be applied to all other leases.

D4. The staff do not therefore think that an exemption on a measurement only basis would achieve substantial cost relief for preparers, which is the primary objective of any small asset lease exemption.

D5. The staff also note that, in the 2010 Exposure Draft *Leases*, the boards proposed a measurement only exemption for short term leases. The feedback from respondents to that ED indicated that preparers/respondents did not view a measurement-only exemption as providing any significant relief.