IFRS 16: Guidance on “Low-value” Leases

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Based on the recognition exemption in paragraph 5 of IFRS 16 *Leases*, a lessee can elect not to recognize a right-of-use asset and a lease liability for leases for which the underlying asset is of low value. The value of an underlying asset is based on the value of the asset when it is new, regardless of the age of the asset being leased. This election can be made on a lease-by-lease basis. If a lessee applies the recognition exemption, the lease payments are recognized as an expense on either a straight-line basis over the lease term or another systematic basis.

Paragraphs B3-B8 of IFRS 16 provide application guidance for this recognition exemption, including examples of underlying assets of low value, such as tablets and personal computers, small items of office furniture and telephones. However, the application guidance does not explicitly quantify what is meant by a “low value” asset. Instead, paragraph B5 of IFRS 16 states:

> “An underlying asset can be of low value only if:
>
> (a) the lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee; and
>
> (b) the underlying asset is not highly dependent on, or highly interrelated with, other assets.”

Paragraph BC100 in the Basis for Conclusions on IFRS 16 does indicate that when the IASB decided on the exemption, it had in mind leases of underlying assets with a value, when new, in the order of magnitude of US$5,000 or less.

The Group discussed the following fact pattern to highlight factors to consider when assessing whether a leased asset may qualify for the low-value recognition exemption.

Fact Pattern

An entity has the following leases:

- Leases of buildings;
- Leases of vehicles (each individual asset is worth significantly more than US$5,000 when new);
- Leases of office furniture (each individual asset is worth CAD$7,000 (US$5,300) when new); and
- Leases of IT equipment such as a lease arrangement for 100 laptops (each individual laptop is worth CAD$1,000 when new, for a total lease value of CAD$100,000).

Issue: Which leased assets qualify for the low-value exemption?

View A – Leases of office furniture and IT equipment.

Proponents of this view note that IFRS 16 does not provide an explicit quantification for what is a low-value asset. Although the Basis for Conclusions on IFRS 16 mentions that the IASB had in mind a magnitude of US$5,000 or less, this amount is not considered a bright-line test. Therefore, the leases of office furniture are considered to be of sufficient low-value to qualify for the exemption despite the value of each asset being above US$5,000.

Proponents of this view also note that the recognition exemption can be applied on a lease-by-lease basis, subject to the interdependence condition in paragraph B5 of IFRS 16. An entity is not required to aggregate the leases to determine if the overall effect is material. In the case of the leases of IT equipment, while the total assets under the lease arrangement are worth CAD$100,000 when new, each laptop is worth only CAD$1,000 when new, and therefore, qualifies for the low-value lease exemption.

For the leases of buildings and leases of vehicles, those underlying assets, when new, are significantly above US$5,000. As a result, the recognition and measurement requirements of IFRS 16 apply.

View B – Leases of IT equipment only.

This view is similar to View A, except for the perspective on whether US$5,000 is considered a bright-line test.

Proponents of this view think that while IFRS 16 does not provide an explicit quantification of what is considered a low-value asset, paragraph BC100 in the Basis for Conclusions implies a threshold, or a bright-line test, of US$5,000 or less. Therefore, the leases of office furniture would not qualify for the recognition exemption on the basis that the underlying assets, when new, are individually over the threshold of US$5,000 at the inception of the lease.

View C – Leases of office furniture only.

This view is similar to View A, except for the perspective of how the “lease-by-lease basis” guidance is applied.

Proponents of this view acknowledge that the recognition exemption can be applied on a lease-by-lease basis and is subject to the interdependence requirement in paragraph B5 of IFRS 16. However, in the case of the leases of IT equipment, each leased asset is part of an overall lease arrangement. The total assets under that one lease arrangement are worth CAD$100,000 when new and would not be considered to qualify for the low-value lease recognition exemption.

View D – No leases qualify for the exemption.

Proponents of this view share the same perspective outlined in View A for the leases of buildings and vehicles, View B for leases of office furniture, and View C for leases of IT equipment.

The Group’s Discussion

A substantial majority of the Group members supported the view that leases of office furniture and IT equipment would qualify for the low-value exemption in IFRS 16 (View A).

Group members noted that the amount of US$5,000 referred to in paragraph BC100 in the Basis for Conclusions on IFRS 16 is not intended to be a bright-line test. Entities are required to apply judgment when applying the recognition exemption to leases for which the underlying asset is of low value. Group members also noted that while the recognition exemption is not a materiality assessment, materiality may come into play when applying this exemption in IFRS 16.

Some Group members observed that in practice, entities leverage their existing asset capitalization policy in determining what constitutes low-value leased assets. However, a point was made that by not recognizing a leased asset, there is also a potential for understating the entity’s liabilities as well. This effect on the entity’s financial position is different compared to the decision for not capitalizing items of property, plant and equipment. Therefore, entities should make sure the effect of not recognizing low-value leased assets is considered from both asset and liability perspectives as there could be covenant and financial liquidity implications.

In addition, entities are required to disclose the expense relating to leases of low-value assets, so it is important to have a system in place to track this data. A representative of the Canadian Securities Administrators noted that this disclosure is an important indicator as to how judgment is applied in determining what the entity considers to be low value.

The Group’s discussion raises awareness about the judgments involved when applying the recognition exemption to leases for which the underlying asset is of low value. No further action was recommended to the AcSB.

(For a full understanding of the discussions and views expressed, listen to the audio clip).