

30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
E-mail: iasb@iasb.org Website: www.iasb.org

International
Accounting Standards
Board

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards. These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: 23 July 2008, London
Project: Consolidation
Subject: Illustrative case 4 (Agenda paper 14B(4))

Case title

Cruise liner lease

FACT PATTERN

Cruise liner

1. Constructor, an international shipbuilding company, built a world class cruise liner and sold it to CruiseLease, a separate legal entity established by Constructor. The value of the cruise liner on the day of purchase was CU500 million. CruiseLease is the legal owner of the cruise liner.

Lease agreement

2. CruiseLease entered into a lease agreement with a cruise operating company (Operator). The lease agreement is for a period of 15 years that constitutes less than majority of the cruise liner's useful life. At the end of the lease, provided that all lease requirements are fulfilled, Operator becomes the legal owner of the cruise liner.

3. The lease contract provides Operator with exclusive rights to use and manage the cruise liner for its own benefit and in accordance with its needs. During the period of the lease, Operator cannot dispose of the cruise liner. Operator has the following rights and responsibilities relating to the use of the cruise liner:
 1. Maintaining and carrying out necessary repairs to the cruise liner;
 2. Making improvements and additions to the cruise liner after consulting an administrator of CruiseLease;
 3. Ability to sublease or rent the cruise liner to the third party subject to the consent of the administrator of CruiseLease;
 4. Liability for damages or third party injuries caused by the use of the cruise liner.

Bank loan and guarantee

4. CruiseLease financed the purchase of the cruise liner with a bank loan of CU450 million secured on the cruise liner. The remaining balance of CU50 million was paid in initially by Operator. Constructor received all proceeds from the sale of the cruise liner of CU500 million. The total interest on the bank loan is CU200 million.
5. The bank loan is repaid from the lease instalments paid by Operator. The amounts and dates of the interest and principal payments made by Operator on the lease are equal to and aligned with those on the bank loan. CruiseLease is obliged to remit all amounts received from Operator to the bank as soon as received.
6. Constructor provided assistance to Operator in financing the purchase of the cruise liner in the form of a guarantee given to the bank of CU450 million (equal to the amount of the loan). In the event of Operator default or bankruptcy, the bank has a right to call the guarantee provided by Constructor with recourse to all of its assets. Default occurs when the lease payment is 3 months overdue. The risk of Operator's default or bankruptcy is very low.
7. Once the guarantee is exercised, Constructor has rights to terminate the lease contract, repossess the cruise liner and decide whether to sell, retain or lease the cruise liner to another party. Constructor has no claims to other assets of Operator because of the guarantee.
8. Operator transferred CU15 million to CruiseLease that will be only used to compensate the bank's loss of interest income on Operator's default or early termination of the loan. The amount is deposited on a separate

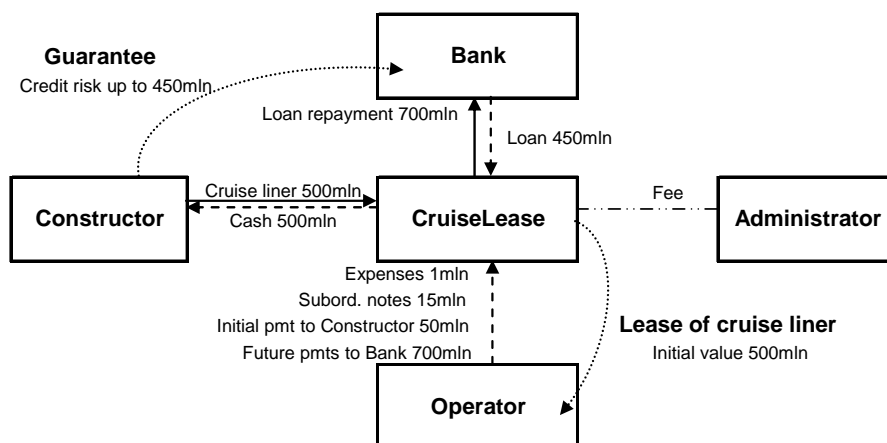
bank account and Operator is entitled to receive any interest earned. Operator will receive back the remaining balance after it fulfils all lease obligations.

Administrator

9. A third party administrator manages the activities of CruiseLease for a fixed fee at market rates. It ensures that the value of the cruise liner is preserved and Operator adheres to the contractual requirements of the lease. In addition, it has the following responsibilities:
 1. To collect payments from Operator and transfer to the bank;
 2. To contact Operator if payments are delinquent and modify the terms of lease payments (subject to the bank and Constructor agreement);
 3. To administer and maintain accounts of CruiseLease.
10. The administrator is selected by Constructor and the bank and can be replaced only on its default or bankruptcy.

CruiseLease activities

11. Operator set up a fund of CU1 million that finances operating expenses of CruiseLease. The fund will cover all expenses of CruiseLease incurred over the period of the lease. At the end of the end of the lease, any remaining amounts on the fund will be returned to Operator.
12. The activities of CruiseLease are restricted to service the existing lease and loan arrangements to the extent described in paragraph 9. This means that, CruiseLease cannot enter into new lease or borrowing agreements or take up other activities. Any necessary changes to structural features of CruiseLease or terms of the agreements can be made only with the consent of the bank and Constructor. After the repayment of the lease obligations, CruiseLease would be dissolved automatically.
13. The structure of the transaction and flow of resources is summarised in the diagram:



ANALYSIS IN ACCORDANCE WITH THE PROPOSED EDX

14. CruiseLease facilitates financing the purchase of the cruise liner by Operator through the lease arrangement. It also enabled Constructor to receive upfront all cash proceeds from the sale that it can use to finance its business operations. CruiseLease's objective is to ensure that the obligations toward the bank are repaid on time and in full rather than to generate profits.
15. Before the parties to the transaction make an assessment of control over CruiseLease's activities, they should identify the assets and liabilities of CruiseLease. This means that, the parties should first analyse the transaction whether it qualifies for true sale and how the lease should be classified. Then, each party should assess whether they have sufficient power to control the activities of CruiseLease, and effectively benefit from its assets and liabilities.

[Paragraphs 16-46 omitted from observer note.]