

STAFF PAPER

March 2015

IFRS Interpretations Committee Meeting

Project	Single lessee; single asset		
Paper topic	Tentative agenda decision comment letter analysis		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

Purpose of this paper

1. The IFRS Interpretations Committee ('the Interpretations Committee') received two requests for clarification about the interaction of IFRS 10 *Consolidated Financial Statements* and IAS 17 *Leases*. In each submitter's example, a structured entity ('the SE') is created to lease a single asset to a single lessee. In one submission the lease is an operating lease; in the other it is a finance lease.
2. The submitter whose example related to an operating lease asked whether the operating lessee should consolidate the SE. The submitter whose example related to a finance lease asked whether the lender should consolidate the SE. In both examples, the consolidation decision would be based on an assessment of which entity has power over the relevant activities of the SE.
3. Our analysis of this issue was discussed in Agenda Papers 12A and 12B of the Interpretations Committee's November 2014 meeting. Those papers are available on our web site:

<http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2014/November/AP12A%20-%20%20IFRS%2010%20Single%20asset%20held%20under%20an%20operating%20lease.pdf>

<http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2014/November/AP12B%20-%20%20IFRS%2010%20Control%20of%20a%20structured%20entity%20by%20a%20junior%20lender.pdf>
4. At its November 2014 meeting the Interpretations Committee tentatively decided not to add these topics to its agenda because:

- (a) in making an assessment of power in accordance with IFRS 10, it is necessary to make a careful assessment of the facts and circumstances;
 - (b) it is not the Interpretations Committee's practice to give case-by-case advice on these types of individual fact patterns;
 - (c) it did not expect significant diversity in the application of IFRS 10 to arise following the implementation of the Standard; and
 - (d) the Interpretations Committee concluded that the principles established within IFRS 10 would enable a determination to be made when all required information is known.
5. For convenience, the tentative agenda decision, published in the November 2014 *IFRIC Update*, is included as Appendix A to this paper.

Paper structure

6. The paper is organised as follows:
- (a) comment letter summary;
 - (b) summary and staff recommendation; and
 - (c) Appendix A—agenda decision.
7. The comment letters received on the tentative Agenda Decision published in *IFRIC Update* in November 2014 are attached as a separate Agenda Paper 5A, Appendix B—Comment letters received.

Comment letter summary

Analysis of respondents

8. We received three comment letters on the tentative agenda decision:

Nature of respondent	Number
Standard-setters	1
Accounting firms	2
Total	3

Geographical location of respondent	Number
Europe	1
Global	2
Total	3

9. One respondent, Deloitte, agreed with the decision not to take the issue onto the Interpretation Committee's agenda for the reasons given in the tentative agenda decision.
10. A second respondent, the Accounting Standards Committee of Germany, thought that the issue should be taken onto the Interpretations Committee's agenda because it thinks that IFRS 10 lacks clarity and that these transactions are common in its jurisdiction.
11. The third respondent, KPMG, raises a number of points of detail to explain why it disagrees with the reasons given for rejection.

Matters raised by the third respondent

12. The third respondent thinks that the tentative agenda decision is unsatisfactory because it does not answer the question of whether, in the fact pattern submitted, use of the asset by the lessee is a relevant activity in accordance with IFRS 10, which could subsequently be judged to significantly affect the returns of the SE.
13. In their response, the respondent considers in detail the effect that purpose and design might have on such an assessment, by reference to paragraphs B5, B8 and BC 79 of IFRS 10.
14. The respondent also makes detailed comments about a number of points in the November 2014 Agenda Papers in the appendix to their letter:
- (a) the distinction between IAS 17 and IFRS 10—the first based on an assessment of risks and rewards and the second on control—and the

tension that this causes in any assessment involving those two Standards;

- (b) the assessment of returns, which includes non-financial returns, such as the lessee's benefit in using the asset or any benefit the lessee derives from the structure; and
- (c) the uncertainty about the degree of variability in the fact patterns presented and the effect that an assessment of that variability would have on the consolidation decision.

15. The staff think that a number of the points raised in the letter were discussed by the Interpretations Committee at its meeting in November 2014. Those discussions included the following:

- (a) Having the right to use an asset for a period of time in and of itself would not be expected to give a lessee decision making rights that would provide power over the lessor (the entity that legally owns the underlying asset being leased), even when the lessor's only asset is the underlying asset. Accordingly, without any additional rights (other than the right to use the underlying asset), it is unlikely that a lessee would control the entity that legally owns an underlying asset that it is leasing.
- (b) However, this conclusion does not mean that a lessee can never control the entity that legally owns an underlying asset that it is leasing. A parent (the lessee) can lease an asset from a subsidiary (the lessor). When the parent owns 51% of the voting rights of the subsidiary (that is controlled via voting rights), the lessee would control the lessor in accordance with IFRS 10.
- (c) A majority of the Interpretations Committee were uncomfortable with using criteria in IAS 17 as an indicator of control in IFRS 10. They considered that an assessment of the classification of a lease between operating and finance was a different assessment from the control decision in accordance with IFRS 10. Consequently they requested that the following sentence be removed from the tentative agenda decision included in Agenda Paper 12A:

It also concluded that if the lease is an operating lease, as defined by IAS 17, the lease would be unlikely to transfer sufficient rights to the lessee to grant the lessee power over the SE, assessed in accordance with IFRS 10.

- (d) All Interpretation Committee members were agreed that in assessing control, an entity would consider all of the rights that it has in relation to the investee to determine whether it has power over the investee.

This would include rights in contractual arrangements other than the lease contract, as well as rights that may be included within the lease contract but go beyond simply providing the lessee with the right to use the asset.

- (e) The Interpretations Committee noted that it had inadequate information about the specific fact patterns in the submissions to come to a conclusion about the relevant activities of the SE. Consequently, the Interpretations Committee concluded that it did not have sufficient information in either submission to make an assessment about which entity would consolidate the SE.
 - (f) As a result of its discussions, however, the Interpretations Committee concluded that the principles established within IFRS 10 would enable such a determination to be made when all required information was known.
16. In the staff view, the further arguments presented by the third respondent are a continuation of themes raised in the November 2014 Agenda Papers and considered by the Interpretations Committee in their discussions. Consequently, the staff do not think that these further arguments affect the Interpretations Committee's tentative agenda decision.

Summary and staff recommendation

17. In the staff view, the third respondent does not raise new questions or arguments that would warrant a further discussion of the issue by the Interpretations Committee.
18. Consequently, we think that the Interpretations Committee's conclusions at its November 2014 meeting on this topic are still valid and are unchanged by the comment letters received:
- (a) in an assessment of power made in accordance with IFRS 10, it is necessary to make a careful assessment of all relevant facts and circumstances;
 - (b) it is not the Interpretations Committee's practice to give case-by-case advice on individual fact patterns;
 - (c) we do not expect significant diversity in the application of IFRS 10 to arise following the implementation of the Standard in this respect; and

(d) the Interpretations Committee concluded in November 2014 that the principles established within IFRS 10 would enable a determination to be made when all required information is known.

19. We recommend that the Interpretations Committee should finalise the tentative agenda decision as it was originally worded in *IFRIC Update*, included for convenience in Appendix A.

Question for the Interpretations Committee

Do you agree with the staff recommendation to finalise the tentative agenda decision as worded in the November 2014 edition of *IFRIC Update*?

Appendix A Agenda decision marked up with recommended changes

IFRS 10 Consolidated Financial Statements—Control of a structured entity by an operating lessee (Agenda Paper 12A)

The Interpretations Committee received a request for clarification about the interaction of IFRS 10 and IAS 17 *Leases*. In the submitter's example, a structured entity ('the SE') is created to lease a single asset to a single lessee. The submitter asks whether the lessee controls the SE and whether the lessee should consolidate the SE. The lease is an operating lease as defined by IAS 17.

The Interpretations Committee noted that, in assessing the effect of a lease on an assessment of power made in accordance with IFRS 10, it is necessary to make a careful assessment of the facts and circumstances. It also noted that it is not the Interpretations Committee's practice to give case-by-case advice on individual fact patterns. It concluded, however, that the principles established within IFRS 10 would enable a determination to be made when all required information is known.

The Interpretations Committee further concluded that it did not expect significant diversity in the application of IFRS 10 to arise following the implementation of the Standard.

Consequently, the Interpretations Committee thought that neither an Interpretation nor an amendment to a Standard is required and decided not to add this issue to its agenda.

IFRS 10 Consolidated Financial Statements—Control of a structured entity by a junior lender (Agenda Paper 12B)

The Interpretations Committee received a request for guidance related to assessing whether a particular party controls a structured entity ('the SE') that is created to lease a single asset to a single lessee and is financed by a senior and a junior lender. The submitter asked whether the junior lender controls the SE and whether that lender should consolidate the SE. The lease is a finance lease as defined by IAS 17.

The Interpretations Committee noted that, in assessing the effect of a lease on an assessment of power made in accordance with IFRS 10, it is necessary to make a careful assessment of the facts and circumstances. It also noted that it is not the Interpretations Committee's practice to give case-by-case advice on individual fact patterns.

It concluded, however, that the principles and guidance in IFRS 10 would be sufficient to enable a determination to be made when all required information is known. It also noted that it had not received any evidence that there was diversity in the application of IFRS 10 on this issue.

Consequently, the Interpretations Committee thought that neither an interpretation nor an amendment to the Standard was required and ~~decided~~ not to add this issue to its agenda.