Appendix B—Comment letters received

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Wayne Upton
Chairman of the
IFRS Interpretations Committee
30 Cannon Street
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United Kingdom

Berlin, 20 January 2015

Dear Wayne,

IFRS IC's tentative agenda decisions in its November 2014 meeting

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on the IFRS IC's tentative agenda decisions regarding several issues of IFRS 11 *Joint Arrangements* and two issues of IFRS 10 *Consolidated Financial Statements*, published in the November 2014 *IFRIC Update*. Please find our detailed comments in the appendix to this letter.

If you would like to discuss our views further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr

President

Appendix – Comments on recent tentative agenda decisions

IFRS 11 – Several issues

We appreciate and support the substance of the IFRS IC's tentative agenda decisions and the clarifications they comprise. However, we have concerns about not developing any formal clarification of the standard, but declaring that sufficient guidance would exist and neither a clarification nor an interpretation is needed.

In our view, the IFRS IC’s tentative agenda decisions are an important clarification of the underlying principles of IFRS 11 and are crucial to the application of IFRS 11. Therefore, we believe that merely publishing these clarifications as (tentative) agenda decisions would not be appropriate to the importance of these clarifications.

Thus, we urge the IFRS IC to hold onto its views, but to revise the tentative agenda decision by proposing a narrow-scope amendment which would add guidance to IFRS 11, based on the wording of the current tentative agenda decisions. Only if this is not deemed feasible, we would encourage the IFRS IC to publish the clarifications as agenda decisions, but in this case to also earmark these issues for future due process steps, i.e. the post-implementation review of IFRS 11.

***IFRS 10 – Control of a structured entity by an operating lessee* and**
IFRS 10 – Control of a structured entity by a junior lender

The November 2014 *IFRIC Update* states that the IFRS IC had not received any evidence that there was diversity in the application of IFRS 10 on these issues.

As communicated to the technical staff in their outreach on these issues, we observed that these transactions are common in Germany and that we see diversity in practice. As we think that IFRS 10 is lacking clarity, we would welcome additional guidance and would therefore appreciate further elaboration of these issues.

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20 January 2015

Dear Mr Upton

Tentative agenda decision - IFRS 10 *Consolidated Financial Statements*: Control of a structured entity by a junior lender

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the November IFRIC Update of the tentative decision not to take onto the Committee's agenda a request for guidance on whether a structured entity created to lease a single asset under finance lease should be consolidated by a junior lender to the entity.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader

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Our ref MV/288
Contact Mark Vaessen

20 January 2015

Dear Mr Upton

Tentative agenda decisions: IFRS 10 – Control of a structured entity by an operating lease and IFRS 10 – Control of a structured entity by a junior lender

We appreciate the opportunity to comment on the IFRS Interpretations Committee's tentative agenda decisions, named above and set out in IFRIC Update of November 2014. We have consulted with, and this letter represents the views of, the KPMG network.

We do not agree with the reasons for rejection provided in the tentative agenda decisions because they provide no comment on the issue of principle on which those two items turn, i.e. whether use of the asset is or is not a relevant activity. The issue is significant and principle-based. On the basis of the draft we expect that lessees and lenders would take different views and, consequently, that no party would consolidate such vehicles.

The two draft agenda decisions are dealing with essentially the same issue: does the lessee or the lender (or junior lender) consolidate a single-asset leasing vehicle? One of the key judgements in making this assessment is whether the relevant activities – the key innovation in IFRS 10 for structured entities – are only those related to management of credit risk of the lessee (the lender's decision); or whether use of the asset (the lessee's decision, unless the lease is short, which would not be typical in 'big ticket' structured transactions) is also a relevant activity.

The context for the application of the definition of relevant activities is the purpose and design of the vehicle (IFRS 10.B5, BC79) and the risks that it was designed to pass to the parties (B8). This extends to activities occurring outside of the vehicle if they are integral to the overall transaction (B52, Example 11, BC80). This leads to two views.

1) **The purpose and design is to pass risk of the asset amongst the parties.**

   Here the lease is merely the means of passing some of the asset risk to one party. So although it happens outside of the vehicle, the use of the asset – managing the asset to make more or less profitable use of its service potential – is a relevant activity. The lessee has power over this and in practice it would almost certainly be more significant than managing credit risk (i.e. leases are not set up with the expectation of default, and so credit management is a less significant activity than asset use), so the lessee would consolidate. After all, the vehicle owns the asset but, like all structured entities, some of the asset's variability – in this case most of it (its value during the lease term, being anything up to about 90% of its full value) – is absorbed by one party, which also makes decisions about that variability; so use of the asset is a relevant activity notwithstanding arrangements to make its absorption and decision-making occur outside the vehicle.

2) The purpose and design is to be exposed to the credit risk of the lessee and pass this on to the lender(s).

Here the purpose and design is solely about credit risk exposure to the stream of lease payments (from slow payment through to default). The lease creates the variability that the vehicle is designed to pass on. It does not absorb variability (BC66). Therefore the use of the asset is not a relevant activity. That leaves the management of the various aspects of credit risk as the only activity of the vehicle, and hence that is its relevant activity. Since the lender (or junior lender) has power over that activity, then the lender (or junior lender) consolidates.

So a decision on that question – whether or not the use of the asset is *one of* the relevant activities from among which a subsequent judgement must be made as to the most significant – makes a significant difference to the subsequent analysis. This isn't a matter of the particular facts of any leasing vehicle – i.e. it does not depend on further factual information – but is a question of principle relevant to a whole class of big ticket, structured leasing transactions. As the draft stands, lender(s) and lessees involved in any particular leasing vehicle would be justified in taking opposite views, with the result that neither the lender nor the lessee would consolidate the vehicle or (much less likely) both parties would.

In the appendix to this letter we have illustrated a few of our concerns regarding papers 12A and 12B from the November IFRIC meeting.

Finally, we note that US GAAP needed a specific rule to address the situation (ASC 810 - 10 - 55 - 39), providing that an operating lease is a creator not an absorber of variability. This, we understand, is to prevent the consolidation standard from over-turning the result of the leasing standard.

Please contact Mark Vaessen or Mike Metcalf +44 (0)20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

Copy: Reinhard Dotzlaw

Appendix – selected comments on papers 12A and 12B of November 2014

- In paragraphs 43 and 48 of paper 12A, it is said that the lessee has few risks and rewards of the asset, seemingly as a step towards concluding that it has no power. This is reminiscent of a SIC-12 risks-and-rewards analysis, whereas IFRS 10 fundamentally changed to a model focused on power over relevant activities. So under IFRS 10 it is possible to have a small exposure to the risks and rewards but still control a vehicle. In any case, an operating lessee may have very significant risks and rewards – enjoying anything less than substantially all of the value of the asset, typically taken to be something approaching 90%. Further, the paper also refers the lease classification model's being a risk-and-rewards based model and that the IFRS 10 analysis should not contradict this (paragraphs 43 and 56). However, the IFRS 10 model is not a risk-and-reward model and is therefore different from the IAS 17 model; as a an unintended consequence different conclusions could be reached, albeit that we believe that is an unattractive outcome.

- Paragraph 54 of paper 12A, addressing the second part of the control test, states that a lessee would not be exposed to variable returns. However, returns are defined broadly by IFRS 10, which also has a very low threshold requiring an exposure merely to some returns. In particular the returns do not have to relate directly to the financial returns generated by the vehicle (e.g. IFRS 10.B57). Therefore, the lessee's benefit of using the asset (or its tax advantages from the structure) are returns for IFRS 10.

- Paragraphs 48 and 54 of paper 12A dismiss variability apportioned or agreed at inception – here, risk and reward of asset ownership – as not relevant under IFRS 10. If correct, that would be very important to settling the issue at hand, and yet no depth of explanation is provided. Moreover, in any structured entity specific streams of variability are pre-allocated to specific parties – e.g. at inception a vehicle holding financial assets will issue instruments transferring types and slices of financial risk (variability) to the participants – and these are the subject of the IFRS 10 analysis.

- Paragraphs 26 and 38 of paper 12B seem doubtful about the extent of the junior lender's exposure to variability, apparently regarding the proceeds of the asset's sale as the junior lender's directly and not that of the vehicle. This view, more widely applied, could have a major effect on the application of IFRS 10, and yet there is no explanation as to why it is not considered to be variability of the vehicle to which the junior lender is exposed through its involvement (and hence is variability over which it has power). After all, a junior lender to a structure is, by its very nature, the most exposed lender to the structure.