

STAFF PAPER

May 2015

IFRS Interpretations Committee Meeting

Project	IFRS 10– Control of a structured entity involving a single lessee and a single asset		
Paper topic	Revised tentative agenda decision		
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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 (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 whether an entity controls the SE.
3. At its November 2014 meeting the Interpretations Committee tentatively decided not to add these topics to its agenda. The relevant Agenda Papers (12A and 12B) are available on our website:

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

<http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2014/November/AP12B%20-%20IFRS%2010%20Control%20of%20a%20structured%20entity%20by%20a%20junior%20lender.pdf>

4. The comment letters received on the tentative agenda decisions were discussed at the March 2015 Interpretations Committee meeting. The comment letter analysis notes that two respondents disagreed with the Interpretations Committee decision not to add this topic to its agenda. In particular, one respondent thought that the November 2014 tentative agenda decision was incomplete because it did not:
 - (a) include all of the points that were discussed by the Interpretations Committee; and
 - (b) answer the question of whether the use of the leased asset by the lessee is a relevant activity of the SE and, therefore, whether the lessee has power over the SE.
5. The Interpretations Committee agreed that it would be helpful to include more information in the agenda decision and asked the staff to prepare a revised tentative agenda decision to include a fuller analysis of the points discussed.
6. The purpose of this paper is to set out the form of that revised tentative agenda decision prior to its re-exposure for comment in the *IFRIC Update*.

Paper structure

7. The paper is organised as follows:
 - (a) discussions at the March 2015 meeting;
 - (b) summary and staff recommendation;
 - (c) Appendix A—tentative agenda decision, revised for re-exposure;
 - (d) Appendix B—original November 2014 tentative agenda decision; and
 - (e) Appendix C—extract from the *IFRIC Update* March 2015.

Discussion at the March 2015 meeting

8. The Interpretations Committee discussed the comment letters received on its November 2014 tentative agenda decision at its March 2015 meeting.
9. It considered the respondent's comment that the tentative agenda decision was incomplete and agreed that it would be helpful to include a fuller summary of its November 2014 discussions in a revised tentative agenda decision. In particular,

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the Interpretations Committee asked that the discussion points contained in paragraph 15 of the March 2015 Agenda Paper be incorporated into the agenda decisions. These points are 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 the 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 can lease an asset from a subsidiary. When the parent owns 51 per cent 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 was uncomfortable with using the 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.
- (d) Interpretations Committee members 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 that 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.

10. Agenda Paper 5 from the March 2015 meeting is available on the website.¹
11. At the March 2015 meeting, the Interpretations Committee also confirmed its November 2014 decision not to take this issue onto its agenda. However, it noted that a comment letter respondent had reported significant diversity in practice with respect to these types of transactions in its jurisdiction. Accordingly, it asked the staff to remove the reference in the November 2104 tentative agenda decision to the lack of significant diversity in practice.
12. Consequently, the Interpretations Committee tentatively decided not to take this topic onto 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; and
 - (c) the Interpretations Committee concluded that the principles established within IFRS 10 would enable a determination to be made when all required information is known.
13. For convenience, the summary of the March 2015 discussions, published in the *IFRIC Update*, is included as Appendix C of this paper.

Summary and staff recommendation

14. The Interpretations Committee asked the staff to redraft the November 2014 tentative agenda decision to include a fuller record of its discussion and remove the reference to the lack of diversity in practice. The revised tentative agenda decision will be published in the *IFRIC Update* for comment.
15. Appendix A of this paper contains the revised tentative agenda decision. We have revised the November 2014 agenda decision in three respects:

¹ The relevant paper can be found at:
<http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2015/March/AP05%20-%20IFRS%2010-%20Single%20lessee%20single%20asset.pdf>.

- (a) we have combined the discussions on the two submissions because many members of the Interpretations Committee think that the arguments apply equally to both sets of circumstances;
- (b) we have included a fuller description of the points discussed by the Interpretations Committee, as summarised in paragraph 9 of this Agenda Paper; and
- (c) we have also removed the reference to an expected lack of diversity in practice from the tentative agenda decision.

Question for the Interpretations Committee

Do you have any comments or suggestions on the revised wording of the tentative agenda decision included as Appendix A to this paper?

Appendix A

Tentative agenda decision, revised for re-exposure

IFRS 10 *Consolidated Financial Statements*—Revised tentative agenda decision (Agenda Paper X)

The Interpretations Committee received two requests for clarification about the interaction of IFRS 10 *Consolidated Financial Statements* and IAS 17 *Leases*. In both examples, a structured entity (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. 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 whether the entity controls the SE. In particular, the submitters asked whether the lessee's use of the leased asset is a relevant activity of the SE when assessing power over the SE.

In discussing this issue the Interpretations Committee noted that:

- (a) It was of the view that 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, even when the lessor's only asset is the underlying asset. Without any additional rights, it is unlikely that a lessee would control the entity that legally owns an underlying asset that it is leasing.
- (b) However, it noted that 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 can lease an asset from a subsidiary. For example, when an entity (that is the lessee) holds 51 per cent of the voting rights of the lessor (an entity controlled via voting rights), the lessee is likely to control the lessor in accordance with IFRS 10.
- (c) It also noted 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 that go beyond simply providing the lessee with the right to use the asset.

The Interpretations Committee concluded that it did not have sufficient information about the specific fact patterns in either submission to make an assessment about which entity would consolidate the SE. It also noted that it is not the Interpretations Committee's practice to give case-by-case advice on individual fact patterns.

As a result of its discussions, however, the Interpretations Committee concluded that the principles and guidance within IFRS 10 would enable such a determination to be made when all of the relevant facts and circumstances were known.

Consequently, the Interpretations Committee thought that neither an Interpretation of, nor an amendment to, a Standard is required and [decided] not to add these issues to its agenda.

Appendix B

Original November 2014 tentative agenda decision

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.

Appendix C

Extract from IFRIC *Update* March 2015

IFRS 10 Consolidated Financial Statements—Single-asset, single lessee lease vehicles and the assessment of control—control of a structured entity involving an operating lease and control of a structured entity by a junior lender (Agenda Papers 5 and 5A)

The Interpretations Committee discussed two tentative agenda decisions recorded at its November 2014 meeting. In each submission, a structured entity (the 'SE') had been 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. The submitter whose example related to an operating lease asked whether the lessee should consolidate the SE; the submitter of the finance lease example asked whether the junior lender should consolidate the SE. In both cases that decision would be based on an assessment of which entity has power over the relevant activities of the SE. In particular, the submitters asked whether the lessee's use of the leased asset is a relevant activity of the SE.

In November 2014, the Interpretations Committee tentatively decided not to add this topic to the agenda. In its meeting on 24 March 2015, the Interpretations Committee discussed the comment letters received on the two tentative agenda decisions.

The Interpretations Committee noted that two of the comment letters received on the tentative agenda decisions had highlighted concerns about diversity in practice on this issue. Some members of the Interpretations Committee suggested that it would be helpful to expand the wording of the tentative agenda decisions to include some of the discussion included in paragraph 15 of Agenda Paper 5 about the assessment required in such circumstances when making conclusions about control.

Accordingly, the Interpretations Committee asked the staff to bring a revised tentative agenda decision for discussion and public re-exposure to a future meeting.