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Basis for Conclusions

[The original text has been marked up to reflect the revision of IAS 39 in 2003 and subsequently the issue of IFRS 4: new text is underlined and deleted text is struck through]

12 Paragraph 9 of IAS 11 *Construction Contracts* requires a group of contracts to be treated as a single contract when the group of contracts is negotiated as a single package, the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin, and the contracts are performed concurrently or in a continuous sequence. In such a situation, a series of transactions that involve the legal form of a lease are linked and accounted for as one transaction, because the overall economic effect cannot be understood without reference to the series of transactions as a whole.

13 An agreement is accounted for as a lease in accordance with IAS 17 when it conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time. For information to represent faithfully the transactions it purports to represent, paragraph 35 of the *Framework*[1] indicates that it is necessary that transactions are accounted for and presented in accordance with their substance and economic reality, not merely their legal form.

14 When an Entity does not control the assets that will be used to satisfy the lease payment obligations, and is not obligated to pay the lease payments, it does not recognise the assets and lease payment obligations, because the definitions of an asset and a liability have not been met. This is different from the circumstance when an Entity controls the assets, is obligated to pay the lease payments, and then later transfers assets to a third party (including a trust). In that circumstance, the transfer of assets (sometimes called an 'in-substance' defeasance) does not by itself relieve the Entity of its primary obligation, in the absence of legal release. A financial asset and a financial liability, or a portion of either, are derecognised only when the requirements of ~~IAS 39.35–65~~ paragraphs 15–37, 39–42, AG36–AG52 and AG57–AG63 of IAS 39 are met.

15 ~~In addition to addressing the general requirements for recognition of a provision, IAS 37 IAS 39~~ IFRS 4 provides guidance for recognising and measuring financial guarantees and similar instruments that provide for payments to be made if the debtor fails to make payments when due, if that contract transfers significant insurance risk to the issuer. ~~IAS 37 also provides guidance when disclosure of a contingent liability is required.~~ Financial guarantee contracts that provide for payments to be made in response to changes in relation to a variable (sometimes referred to as an 'underlying') are subject to IAS 39.

16 IAS 18 addresses the accounting treatment of revenue. Paragraph 75 of the *Framework*[2] indicates that gains are no different in nature from revenue. Therefore, the requirements of IAS 18 apply by analogy or otherwise. Example 14(c) in the Appendix of IAS 18 states that a fee earned on the execution of a significant act, which is much more significant than any other act, is recognised as income when the significant act has been completed. The example also indicates that it is necessary to distinguish between fees earned on completion of a significant act and fees related to future performance or risks retained.

Date of consensus

February 2000

[1] superseded by Chapter 3 of the *Conceptual Framework*. References to the *Framework* are to IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting.*

[2] now paragraph 4.30 of the *Conceptual Framework*

Appendix A
Linked transactions

This appendix accompanies, but is not part of, SIC-27.

A1 The Interpretation requires consideration of whether a series of transactions that involve the legal form of a lease are linked to determine whether the transactions are accounted for as one transaction.

A2 Extreme examples of transactions that are viewed as a whole and accounted for as single transactions, include:

(a) An Entity leases an asset to an Investor (the headlease) and leases the same asset back for a shorter period of time (the sublease). At the end of the sublease period, the Entity has the right to buy back the rights of the Investor under a purchase option. If the Entity does not exercise its purchase option, the Investor has options available to it under each of which the Investor receives a minimum return on its investment in the headlease—the Investor may put the underlying asset back to the Entity, or require the Entity to provide a return on the Investor's investment in the headlease.

The predominant purpose of the arrangement is to achieve a tax advantage for the Investor, which is shared with the Entity in the form of a fee, and not to convey the right to use an asset. The Investor pays the fee and prepays the lease payment obligations under the headlease. The agreement requires the amount prepaid to be invested in risk-free assets and, as a requirement of finalising the execution of the legally binding arrangement, placed into a separate investment account held by a Trustee outside of the control of the Entity. The fee is retained by the Entity.

Over the term of the sublease, the sublease payment obligations are satisfied with funds of an equal amount withdrawn from the separate investment account. The Entity guarantees the sublease payment obligations, and will be required to satisfy the guarantee should the separate investment account have insufficient funds. The Entity, but not the Investor, has the right to terminate the sublease early under certain circumstances (eg a change in local or international tax law causes the Investor to lose part or all of the tax benefits, or the Entity decides to dispose of (eg replace, sell or deplete) the underlying asset) and upon payment of a termination value to the Investor. If the Entity chooses early termination, then it would pay the termination value from funds withdrawn from the separate investment account, and if the amount remaining in the separate investment account is insufficient, the difference would be paid by the Entity. The underlying asset is a specialised asset that the Entity requires to conduct its business.

(b) An entity leases an asset to another entity for its entire economic life and leases the same asset back under the same terms and conditions as the original lease. The two entities have a legally enforceable right to set off the amounts owing to one another, and an intention to settle these amounts on a net basis.

(c) An entity (Entity A) leases an asset to another entity (Entity B), and obtains a non-recourse loan from a financier (by using the lease rentals and the asset as collateral). Entity A sells the asset subject to the lease and the loan to a trustee, and leases the same asset back. Entity A also concurrently agrees to repurchase the asset at the end of the lease for an amount equal to the sale price. The financier legally releases Entity A from the primary responsibility for the loan, and Entity A guarantees repayment of the non-recourse loan if Entity B defaults on the payments under the original lease. Entity B's credit rating is assessed as AAA and the amounts of the payments under each of the leases are equal. Entity A has a legally enforceable right to set off the amounts owing under each of the leases, and an intention to settle the rights and obligations under the leases on a net basis.

(d) An entity (Entity A) legally sells an asset to another entity (Entity B) and leases the same asset back. Entity B is obligated to put the asset back to Entity A at the end of the lease period at an amount that has the overall practical effect, when also considering the lease payments to be received, of providing Entity B with a yield of LIBOR plus 2 per cent per year on the purchase price.

Appendix B
The substance of an arrangement

This appendix accompanies, but is not part of, SIC-27.

B1 The Interpretation requires consideration of the substance of an arrangement to determine whether it includes the conveyance of the right to use an asset for an agreed period of time.

B2 In each of the examples described in Appendix A, the arrangement does not, in substance, involve a lease under IAS 17 for the following reasons:

(a) in the example described in paragraph A2(a), the arrangement is designed predominantly to generate tax benefits that are shared between the two entities. Even though the periods of the headlease and sublease are different, the options available to each of the entities at the end of the sublease period are structured such that the Investor assumes only an insignificant amount of asset risk during the headlease period. The substance of the arrangement is that the Entity receives a fee for executing the agreements, and retains the risks and rewards incident to ownership of the underlying asset.

(b) in the example described in paragraph A2(b), the terms and conditions and period of each of the leases are the same. Therefore, the risks and rewards incident to ownership of the underlying asset are the same as before the arrangement. Further, the amounts owing are offset against one another, and so there is no retained credit risk. The substance of the arrangement is that no transaction has occurred.

(c) in the example described in paragraph A2(c), Entity A retains the risks and rewards incident to ownership of the underlying asset, and the risk of payment under the guarantee is only remote (due to the AAA credit rating). The substance of the arrangement is that Entity A borrows cash, secured by the underlying asset.

(d) in the example described in paragraph A2(d), Entity A's risks and rewards incident to owning the underlying asset do not substantively change. The substance of the arrangement is that Entity A borrows cash, secured by the underlying asset and repayable in instalments over the lease period and in a final lump sum at the end of the lease period. The terms of the option preclude recognition of a sale. Normally, in a sale and leaseback transaction, the risks and rewards incident to owning the underlying asset sold are retained by the seller only during the period of the lease.