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AUTORITÉ DES NORMES COMPTABLES

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PDC n° 39

Mrs Sue Lloyd
Chair of the IFRS Interpretations Committee
7 Westferry Circus, Canary Wharf
London, E14 4HD
United Kingdom

Subject: Tentative Agenda Decision – Sale and Leaseback of an Asset in Single-Asset Entity (IFRS 10 and IFRS 16)

Dear Mrs Lloyd,

I am writing to you on behalf of the Autorité des Normes Comptables (ANC) to express our views on the IFRS Interpretations Committee's (Committee) Tentative Agenda Decision (TAD) published in September 2020 regarding the applicability of the sale and leaseback requirements in IFRS 16 *Leases* to a transaction in which an entity sells its equity interest in a subsidiary that holds one asset and leases that asset back.

We agree with the Committee's conclusion that, in the very specific fact pattern described in the submission, the gain that the entity recognises reflects the requirements in paragraph 100(a) of IFRS 16. Nonetheless, we disagree with the Committee's tentative analysis of the requirements in IFRS Standards. In our view, this analysis is incomplete because it disregards some relevant requirements in IFRS 10 *Consolidated Financial Statements* and thus, insufficiently explains how those requirements interplay with the requirements in IFRS 16. We think the Committee's tentative analysis results in the requirements in IFRS 16 overriding those in IFRS 10 without providing any evidence of any such hierarchy between IFRS Standards. Furthermore, we think the Committee should consider whether its analysis is consistent with the requirements in other IFRS Standards and the approach the Committee previously retained to similar fact patterns. We are usually supportive of the Committee outlining the applicable requirements in IFRS Standards and then considering whether those requirements result in information that is useful. However, in the case of this TAD, we think the Committee may wish to reach a conclusion that provides a faithful representation of the transaction at the expense of a fair and comprehensive reading of the existing requirements. Accordingly, we think the Committee should revise its analysis and, if it were unable to do so, assess whether it should recommend standard-setting to the IASB (Board).

We also question the helpfulness of publishing an agenda decision considering a fact pattern that, in our view, is not widespread. We are aware of the prevalence of fact patterns that have much more complex features than the transaction described in the submission. We think the Committee's tentative analysis is unlikely to help entities understand how the principles and requirements in IFRS Standards would apply in those circumstances—we think that applying the thought process underpinning the TAD to less narrowly-defined fact patterns may be difficult. We acknowledge that the Committee limited its analysis to the fact pattern described in the submission but think the Committee should consider undertaking outreach to understand the transactions that do, or are expected to, occur in practice and assess whether its analysis could have unintended consequences on how entities account for those transactions.

- **The Committee's technical analysis**

We appreciate the Committee's objective to conclude that the gain that the entity recognises on the transaction as described in the submission reflects the requirements in paragraph 100(a) of IFRS 16—this is consistent with the Board's observations in paragraph BC261 of IFRS 16. However we think that the Committee's analysis of existing requirements as outlined in the TAD is insufficient to reach that conclusion.

  - ***The Committee's analysis does not consider all relevant requirements in IFRS Standards***

We note that the TAD itself skirts around relevant requirements in IFRS Standards. The TAD specifies that '*the entity applies paragraphs 25 and B97–B99 of IFRS 10 to account for the loss of control of the subsidiary—in particular, paragraph B98 of IFRS 10 requires the entity to derecognise the building held by the subsidiary and recognise the fair value of the consideration received*'. We agree with the Committee's analysis but note that the Committee did not outline that paragraph B98(d) (and paragraph 25(c)) also requires to recognise '*any resulting difference* [having applied the requirements in paragraphs B98(a)–(c)] *as a gain or loss in profit or loss attributable to the parent'*. In our view, the TAD ignores the existence of this gain or loss. The Committee's analysis seems to rely on the assumption that *all* the requirements in IFRS 16 for sale and leaseback transactions apply to the fact pattern whereas only *some* of the requirements in IFRS 10 for the loss of control of the subsidiary apply—in other words the TAD seems to 'cherry pick' the requirements in IFRS 10 that are compatible with those in IFRS 16. In our view, this approach undermines the robustness of the Committee's analysis and results in an unconvincing conclusion.

We disagree with the analysis developed in Agenda Paper 2 for the September 2020 Committee's meeting but think it had the merits of clearly outlining the approach that, in reality, underpins the TAD, ie that the entity (a) first applies the requirements in IFRS 10 and then (b) those in IFRS 16 and, by doing so, 'overrides' the gain or loss initially recognised applying IFRS 10 so as to recognise a gain that reflects the requirements in paragraph 100(a) of IFRS 16. We acknowledge that presenting the thought process in this way might not have been consensual but we think this would clearly have articulated how the Committee had reached its conclusion.

In addition, we think that the TAD cannot be read in isolation, ie ignoring the drafting of some other requirements that apply to similar transactions. The TAD concludes that the gain the entity recognises on the transaction reflects the requirements in IFRS 16—in other words, the entity recognises a gain that does *not* reflect the requirements in IFRS 10. We note that for some sale and lease back transactions, the requirements in relevant IFRS Standards explicitly state that IFRS 16 takes precedence with regard to the recognition of the gain or loss over any other requirement. In contrast, IFRS 10 does not include any such reference to IFRS 16 when the entity initially controls the asset through a subsidiary. For example, we note that:

- paragraph 68 of IAS 16 *Property, Plant and Equipement* states that '*the gain or loss arising from the derecognition of an item of property, plant and equipment shall be included in profit or loss when the item is derecognised (unless IFRS 16 Leases requires otherwise on a sale and leaseback)*…' (emphasis added)
- paragraph 69 of IAS 40 *Investment Property* states that '*gains or losses arising from the retirement or disposal of investment property shall be determined as the difference between the net disposal proceeds and the carrying amount of the asset and shall be recognised in profit or loss (unless IFRS 16 requires otherwise on a sale and leaseback) in the period of the retirement or disposal'* (emphasis added).

Having in mind these specific requirements in IAS 16 and IAS 40 and the lack of similar requirements in IFRS 10, we question the robustness of the Committee's conclusion.

  - ***The Committee's analysis is inconsistent with the analysis applied to similar transactions***

In September 2014, the Board published the amendments to IFRS 10 and IAS *28 Investments in Associates and Joint Ventures* '*Sale or contribution of assets between an investor and its associate or joint venture*'[1]. As explained

[1] The Board deferred the effective date of those amendments in December 2015.

in paragraphs BC190A–190C of those amendments, the Board decided to undertake standard-setting further to a request to the Committee seeking clarifications about how an entity applies IFRS Standards when it contributes business (through a subsidiary) to a joint-venture or an associate in exchange for an equity interest in that joint venture or associate. The Committee and the Board noted the conflicting requirements between IFRS 10 and IAS 28[2] . This is because, applying the requirements in IAS 28, the gain or loss recognised resulting from the contribution of a non-monetary asset to a joint venture or an associate in exchange for an equity interest in that joint venture or associate is restricted to the extent of the interests attributable to the unrelated investors in the joint venture or associate. However, IFRS 10 requires a full gain or loss recognition on the loss of control of the subsidiary.

We note similarities between the fact pattern that the Committee and the Board considered in 2014 and the fact pattern described in the TAD—ie the entity loses control of a subsidiary and receives, in exchange, non-cash consideration (right of use in the TAD and equity instruments in the fact pattern above) with two differing sets of requirements applying to the gain or loss the entity recognises as a result of that exchange. Absent any explicit indication about which requirements should prevail for the transaction described in the submission, we do not understand why the Committee would conclude that the requirements in IFRS 16 apply in the fact pattern described in the TAD whereas it concluded, along with the Board, that there was a conflict between IFRS 10 and IAS 28 when accounting for a sale or contribution of assets between an investor and its associate or joint venture. Should the Committee decide to confirm its analysis, we recommend the Committee explain how it could reach different conclusions on a matter that is *in substance* alike.

We also note that the Committee considered a similar transaction at its September 2017 and January 2018 meetings. In its Agenda Decision, the Committee considered how an entity accounts for a transaction in which it contributes property, plant and equipment to a newly formed associate in exchange for shares in the associate. In question C in this Agenda Decision, the Committee was asked how an investor determines the gain or loss on contributing PPE—this is because paragraphs 68 of IAS 16 and paragraph 28 of IAS 28 have differing requirements in relation to how an entity determines that gain or loss. We understand that the Committee did not conclude on which requirements an entity applies in those circumstances.

In the light of the above, we are surprised to read that the Committee could reach a conclusion for the sale and lease back transaction described in the submission whereas it was unable to reach any such conclusion for similar fact patterns. Accordingly, we recommend that the Committee consider how its conclusion reconcile with the approach retained for the matters described above.

Pending standard-setting, we think that an alternative analysis may consist in acknowledging there are conflicting requirements in IFRS 10 and IFRS 16 applying to the gain that the entity recognises. In those circumstances, an entity would apply the requirements in paragraphs 10–12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and use its judgement in developing and applying an accounting policy that results in information that is relevant and reliable as described in paragraphs 10(a) and 10(b) of IAS 8. *In the very specific case described in the submission*, we think an entity would conclude that applying the requirements in paragraph 100(a) in IFRS 16 to the gain is *the* accounting policy that results in information that is relevant and reliable—in particular because these requirements would result in information that reflects the substance of the transaction as described in paragraph 10(b)(ii) of IAS 8.

- **The fact pattern that the Committee considered**

The question submitted to the Committee refers to a very narrow and, to the best of our knowledge, unusual fact pattern. Such sale and leaseback transactions involving a corporate wrapper do occur but we are unaware of any transaction that would present the characteristics described in the TAD. According to our constituents, similar transactions that already occurred, or are currently under consideration, are significantly more complex. We also understand that a growing number of entities contemplate entering such transactions in the context of asset-

[2] The submission initially referred to an inconsistency between IAS 27 (as revised in 2008) and SIC-13 *Jointly Controlled Entities—Non-Monetary Contributions by Venturers*. However, IFRS 10 replaced IAS 27 (as revised in 2008) and the relevant requirements in SIC-13 were incorporated into paragraphs 28 and 30 of IAS 28 (as amended in 2011). Accordingly, the Board decided to amend only IFRS 10 and IAS 28 (as amended in 2011).

optimisation strategies. Those transactions have one or several of the following variations:

- the entity does not own 100% of the equity in the subsidiary prior to the loss of control—ie there are non-controlling interests before the transaction,
- the entity retains a non-controlling interest in the subsidiary after the transaction,
- the subsidiary holds several assets and only some of those assets are leased back to the entity,
- the subsidiary is already the party to a lease arrangement with other entities in the consolidation group,
- the subsidiary has recognised deferred and current tax assets or liabilities, and
- the subsidiary has liabilities to external parties, in particular financing related to the acquisition of the real estate asset.

In contrast, in the fact pattern described in TAD:

- the entity owns 100% of the equity in the subsidiary and sells all its equity interest to a third party, and
- the subsidiary owns a single asset and has incurred no liabilities.

The TAD does not provide any insight into how the requirements in IFRS 10 and IFRS 16 would apply or not apply in the more complex circumstances described above.

We note that the Committee did not request the staff to perform any outreach. We think such outreach would help assess whether the transaction described in the submission is prevalent and thus, whether the publication of an agenda decision would be helpful and, from a due process perspective, necessary. This would also help the Committee assess whether the analysis applied to the fact pattern described in the submission could have unintended consequences on the way entities account for other similar, but more complex, transactions. Accordingly, we recommend outreach be performed before finalising the TAD.

Should you need any further information, please do not hesitate to contact me.

Yours sincerely,

Patrick de Cambourg