

SIC Interpretation 12

Consolidation—Special Purpose Entities

This version includes amendments resulting from IFRSs issued up to 31 December 2008.

SIC-12 *Consolidation—Special Purpose Entities* was developed by the Standing Interpretations Committee and issued in December 1998.

In April 2001 the International Accounting Standards Board resolved that all Standards and Interpretations issued under previous Constitutions continued to be applicable unless and until they were amended or withdrawn.

Since then, SIC-12 and its accompanying documents have been amended by the following IFRSs:

- IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (issued December 2003)
- IAS 27 *Consolidated and Separate Financial Statements* (issued December 2003)
- IFRIC Amendment to SIC-12 *Scope of SIC-12 Consolidation—Special Purpose Entities* (issued November 2004).

The following Interpretation refers to SIC-12:

- IFRIC 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* (issued December 2004).

SIC Interpretation 12 *Consolidation—Special Purpose Entities* (SIC-12) is set out in paragraphs 8–10. SIC-12 is accompanied by a Basis for Conclusions and an appendix illustrating the application of the Interpretation. The scope and authority of Interpretations are set out in paragraphs 2 and 7–17 of the *Preface to International Financial Reporting Standards*.

SIC Interpretation 12

Consolidation—Special Purpose Entities

References

- IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- IAS 19 *Employee Benefits*
- IAS 27 *Consolidated and Separate Financial Statements*
- IAS 32 *Financial Instruments: Presentation*
- IFRS 2 *Share-based Payment*

Issue

- 1 An entity may be created to accomplish a narrow and well-defined objective (eg to effect a lease, research and development activities or a securitisation of financial assets). Such a special purpose entity ('SPE') may take the form of a corporation, trust, partnership or unincorporated entity. SPEs often are created with legal arrangements that impose strict and sometimes permanent limits on the decision-making powers of their governing board, trustee or management over the operations of the SPE. Frequently, these provisions specify that the policy guiding the ongoing activities of the SPE cannot be modified, other than perhaps by its creator or sponsor (ie they operate on so-called 'autopilot').
- 2 The sponsor (or entity on whose behalf the SPE was created) frequently transfers assets to the SPE, obtains the right to use assets held by the SPE or performs services for the SPE, while other parties ('capital providers') may provide the funding to the SPE. An entity that engages in transactions with an SPE (frequently the creator or sponsor) may in substance control the SPE.
- 3 A beneficial interest in an SPE may, for example, take the form of a debt instrument, an equity instrument, a participation right, a residual interest or a lease. Some beneficial interests may simply provide the holder with a fixed or stated rate of return, while others give the holder rights or access to other future economic benefits of the SPE's activities. In most cases, the creator or sponsor (or the entity on whose behalf the SPE was created) retains a significant beneficial interest in the SPE's activities, even though it may own little or none of the SPE's equity.
- 4 IAS 27 requires the consolidation of entities that are controlled by the reporting entity. However, the Standard does not provide explicit guidance on the consolidation of SPEs.
- 5 The issue is under what circumstances an entity should consolidate an SPE.
- 6 This Interpretation does not apply to post-employment benefit plans or other long-term employee benefit plans to which IAS 19 applies.
- 7 A transfer of assets from an entity to an SPE may qualify as a sale by that entity. Even if the transfer does qualify as a sale, the provisions of IAS 27 and this Interpretation may mean that the entity should consolidate the SPE. This Interpretation does not address the circumstances in which sale treatment should apply for the entity or the elimination of the consequences of such a sale upon consolidation.

Consensus

- 8 An SPE shall be consolidated when the substance of the relationship between an entity and the SPE indicates that the SPE is controlled by that entity.
- 9 In the context of an SPE, control may arise through the predetermination of the activities of the SPE (operating on 'autopilot') or otherwise. IAS 27.13 indicates several circumstances which result in control even in cases where an entity owns one half or less of the voting power of another entity. Similarly, control may exist even in cases where an entity owns little or none of the SPE's equity. The application of the control concept requires, in each case, judgement in the context of all relevant factors.
- 10 In addition to the situations described in IAS 27.13, the following circumstances, for example, may indicate a relationship in which an entity controls an SPE and consequently should consolidate the SPE (additional guidance is provided in the Appendix to this Interpretation):

- (a) in substance, the activities of the SPE are being conducted on behalf of the entity according to its specific business needs so that the entity obtains benefits from the SPE's operation;
- (b) in substance, the entity has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an 'autopilot' mechanism, the entity has delegated these decision-making powers;
- (c) in substance, the entity has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incident to the activities of the SPE; or
- (d) in substance, the entity retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

11 [Deleted]

Basis for Conclusions

[The original text has been marked up to reflect the revision of IASs 1, 8 and 27 in 2003: new text is underlined and deleted text is struck through. Paragraphs 15A–15E were added by IFRIC Amendment to SIC-12 issued on 11 November 2004.]

- 12 IAS 27.1244 states that ~~'a parent which issues Consolidated financial statements shall include should consolidate all subsidiaries of the parent'~~. IAS 27.0406 defines a parent as 'an entity that has one or more subsidiaries', a subsidiary as 'an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent)', and control as 'the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.' Paragraph 35 of the *Framework* and IAS 8.10(b)(i) ~~1.20(b)(ii) (revised 1997)~~ require that transactions and other events are accounted for in accordance with their substance and economic reality, and not merely their legal form.
- 13 Control over another entity requires having the ability to direct or dominate its decision-making, regardless of whether this power is actually exercised. Under the definitions of IAS 27.0406, the ability to govern decision-making alone, however, is not sufficient to establish control. The ability to govern decision-making must be accompanied by the objective of obtaining benefits from the entity's activities.
- 14 SPEs frequently operate in a predetermined way so that no entity has explicit decision-making authority over the SPE's ongoing activities after its formation (ie they operate on 'autopilot'). Virtually all rights, obligations, and aspects of activities that could be controlled are predefined and limited by contractual provisions specified or scheduled at inception. In these circumstances, control may exist for the sponsoring party or others with a beneficial interest, even though it may be particularly difficult to assess, because virtually all activities are predetermined. However, the predetermination of the activities of the SPE through an 'autopilot' mechanism often provides evidence that the ability to control has been exercised by the party making the predetermination for its own benefit at the formation of the SPE and is being perpetuated.
- ~~15 IAS 27.13(b) indicates that a subsidiary should be excluded from consolidation when it 'operates under severe long term restrictions which significantly impair its ability to transfer funds to the parent.' Predetermination of the activities of an SPE by an enterprise (the sponsor or other party with a beneficial interest) is often a demonstration of control over ongoing activities as determined by that enterprise and would not represent the type of restrictions referred to in IAS 27.13(b).~~
- 15A In 2004, the IFRIC amended the scope of SIC-12. That Amendment is effective for annual periods beginning on or after 1 January 2005, unless an entity applied IFRS 2 for an earlier period, in which case the Amendment is effective for that earlier period. Before that Amendment, SIC-12 excluded from its scope equity compensation plans and post-employment benefit plans. Paragraphs 15B–15E summarise the IFRIC's considerations in reaching its consensus to amend the scope of SIC-12. Individual IFRIC members gave greater weight to some factors than to others.
- 15B The IFRIC was asked by the IASB to consider whether the scope exclusion in SIC-12 for equity compensation plans should be removed when IFRS 2 becomes effective. Equity compensation plans were excluded from the scope of SIC-12 because they were within the scope of IAS 19 and that Standard did not specify recognition and measurement requirements for equity compensation benefits. However, once IFRS 2 became effective, IAS 19 would no longer apply to equity compensation plans. IFRS 2 specifies recognition and measurement requirements for equity compensation benefits.
- 15C Also, IFRS 2 amended IAS 32, to state that paragraphs 33 and 34, which relate to the treatment of treasury shares, should be applied to treasury shares purchased, sold, issued or cancelled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements. However, in some cases, those shares might be held by an employee benefit trust (or similar entity) set up by the entity for the purposes of its share-based payment arrangements. Removing the scope exclusion in SIC-12 would require

an entity that controls such a trust to consolidate the trust and, in so doing, to apply the requirements of IAS 32 to treasury shares held by the trust.

- 15D The IFRIC therefore concluded that, to ensure consistency with IFRS 2 and IAS 32, the scope of SIC-12 should be amended by removing the exclusion of equity compensation plans.
- 15E At the same time, the IFRIC discussed the scope exclusion in SIC-12 for post-employment benefit plans. The IFRIC noted that, although SIC-12 did not exclude other long-term employee benefit plans from its scope, IAS 19 nevertheless requires those plans to be accounted for in a manner similar to the accounting for post-employment benefit plans. The IFRIC therefore concluded that, to ensure consistency with IAS 19, the scope exclusion in SIC-12 should also apply to other long-term employee benefit plans.

Date of consensus

June 1998

Effective date

This Interpretation becomes effective for annual financial periods beginning on or after 1 July 1999; earlier application is encouraged. Changes in accounting policies shall be accounted in accordance with IAS 8.

An entity shall apply the amendment in paragraph 6 for annual periods beginning on or after 1 January 2005. If an entity applies IFRS 2 for an earlier period, this amendment shall be applied for that earlier period.

Appendix to SIC-12

This appendix accompanies, but is not part of, SIC-12.

Indicators of control over an SPE

The examples in paragraph 10 of this Interpretation are intended to indicate types of circumstances that should be considered in evaluating a particular arrangement in light of the substance-over-form principle. The guidance provided in the Interpretation and in this Appendix is not intended to be used as ‘a comprehensive checklist’ of conditions that must be met cumulatively in order to require consolidation of an SPE.

(a) *Activities*

The activities of the SPE, in substance, are being conducted on behalf of the reporting entity, which directly or indirectly created the SPE according to its specific business needs.

Examples are:

- the SPE is principally engaged in providing a source of long-term capital to an entity or funding to support an entity’s ongoing major or central operations; or
- the SPE provides a supply of goods or services that is consistent with an entity’s ongoing major or central operations which, without the existence of the SPE, would have to be provided by the entity itself.

Economic dependence of an entity on the reporting entity (such as relations of suppliers to a significant customer) does not, by itself, lead to control.

(b) *Decision-making*

The reporting entity, in substance, has the decision-making powers to control or to obtain control of the SPE or its assets, including certain decision-making powers coming into existence after the formation of the SPE. Such decision-making powers may have been delegated by establishing an ‘autopilot’ mechanism.

Examples are:

- power to unilaterally dissolve an SPE;
- power to change the SPE’s charter or bylaws; or
- power to veto proposed changes of the SPE’s charter or bylaws.

(c) *Benefits*

The reporting entity, in substance, has rights to obtain a majority of the benefits of the SPE’s activities through a statute, contract, agreement, or trust deed, or any other scheme, arrangement or device. Such rights to benefits in the SPE may be indicators of control when they are specified in favour of an entity that is engaged in transactions with an SPE and that entity stands to gain those benefits from the financial performance of the SPE.

Examples are:

- rights to a majority of any economic benefits distributed by an entity in the form of future net cash flows, earnings, net assets, or other economic benefits; or
- rights to majority residual interests in scheduled residual distributions or in a liquidation of the SPE.

(d) *Risks*

An indication of control may be obtained by evaluating the risks of each party engaging in transactions with an SPE. Frequently, the reporting entity guarantees a return or credit protection directly or indirectly through the SPE to outside investors who provide substantially all of the capital to the SPE.

As a result of the guarantee, the entity retains residual or ownership risks and the investors are, in substance, only lenders because their exposure to gains and losses is limited.

Examples are:

- the capital providers do not have a significant interest in the underlying net assets of the SPE;
- the capital providers do not have rights to the future economic benefits of the SPE;
- the capital providers are not substantively exposed to the inherent risks of the underlying net assets or operations of the SPE; or
- in substance, the capital providers receive mainly consideration equivalent to a lender's return through a debt or equity interest.