IFRS

STAFF PAPER

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IFRS® Interpretations Committee Meeting

Project	**IAS 28 *Investments in Associates and Joint Ventures***
Paper topic	Fund manager's significant influence over a fund

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Introduction

1. The IFRS Interpretations Committee (the Interpretations Committee) received a request to clarify whether, and how, a fund manager assesses if it has significant influence over a fund that it manages and in which it has a direct investment.

2. The Interpretations Committee discussed this issue previously in 2014 and 2015, but decided to:

   (a) put it on hold;

   (b) monitor if the International Accounting Standards Board's (the Board) research project on the equity method of accounting (the Research Project) addresses this issue; and

   (c) revisit the issue if the Research Project did not address the issue.

3. The objective of this paper is to:

   (a) update the Interpretations Committee and provide it with a summary of the issue and our analysis; and

   (b) ask the Interpretations Committee if it agrees with the staff recommendation not to add this issue to its agenda.

Structure of the paper

4. This paper includes:

   (a) background information;

   (b) staff analysis;

   (c) assessment against the Interpretations Committee's agenda criteria;

   (d) staff recommendation;

   (e) questions for the Interpretations Committee;

   (f) Appendix A—proposed wording of the tentative agenda decision; and

   (g) Appendix B—original submission.

Background information

The submission

5. The submitter describes a scenario in which a fund manager has a direct investment in a fund that it manages. The fund manager has decision-making rights and applies IFRS 10 *Consolidated Financial Statements* to assess whether it controls the fund. The fund manager concludes that it is an agent applying paragraphs B58-B72 of IFRS 10, and thus that it does not control the fund. The facts are such that the fund manager also does not have joint control of the fund applying IFRS 11 *Joint Arrangements*.

6. The submitter requests clarity as to whether, and how, the fund manager assesses if it has significant influence over the fund. The requirements in IFRS 10 that specifically address how a decision maker determines whether it controls an investee (and which did not exist before IFRS 10 was issued) appear to have given more prominence to this question about significant influence.

7. The submission notes the effect of the fund manager concluding that it has, or does not have, significant influence over the fund. The fund manager's conclusion does not affect whether a fund manager recognises its direct investment in the fund. Rather, it might affect how the fund manager measures that investment and the disclosures that it provides. If the fund manager concludes that it has significant influence over the fund, it applies the requirements in IAS 28 *Investments in Associates and Joint Ventures*—this will result in measuring the investment using the equity method or, if the fund manager is a venture capital organisation, or a mutual fund, unit trust or a similar entity, at fair value through profit or loss (if the fund manager elects to do so). If it does not have significant influence, the fund manager applies the requirements in IFRS 9 *Financial Instruments* to its investment. The disclosure requirements in IFRS 12 *Disclosure of Interests in Other Entities* for investments in associates are different from those in IFRS 7 *Financial Instruments: Disclosures* for investments accounted for applying IFRS 9.

Previous discussions of the Interpretations Committee

8. The Interpretations Committee first discussed this issue at its meeting in September 2014[1] and issued a tentative agenda decision. It noted that a fund manager applies IAS 28 to assess whether it has significant influence over a fund if it does not have control or joint control of the fund. However, it also noted that IAS 28 does not address whether, in assessing significant influence, the fund manager includes its right to participate in the financial and operating policy decisions that it undertakes on behalf of others (agency rights). The Interpretations Committee concluded that this issue is better addressed as part of the Research Project, and tentatively decided not to add the issue to its agenda.

[1] Please see agenda paper 10 from the Interpretations Committee's meeting in September 2014 for further information.

9. The Interpretations Committee discussed the comments received on its tentative agenda decision at its meeting in January 2015[2]. At that meeting, the Interpretations Committee confirmed its previous decisions. However, it decided not to finalise the agenda decision but instead to place this issue on hold and monitor how the Research Project progresses.[3]

10. We have revisited this issue because we do not see any benefit in keeping this issue on hold until further progress is made on the Research Project, which is now part of the Board's research pipeline. The following paragraphs outline our analysis of the issue, together with the rationale for our recommendation.

Staff analysis

Do the requirements in IFRS 10 affect a fund manager's assessment of significant influence?

11. The submission referred to the principal versus agent requirements in IFRS 10, and thus we think it is helpful to first discuss whether those requirements affect a fund manager's assessment of significant influence.

12. Paragraph 3 of IAS 28 defines significant influence as follows:

> *Significant influence* is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

13. We agree with the Interpretations Committee's previous observation that a fund manager applies the requirements of the relevant IFRS Standard in assessing whether it has control of, joint control of, or significant influence over a fund that it manages. If the fund manager does not have control or joint control of the fund, it applies IAS

[2] Please see agenda paper 7 from the Interpretations Committee's meeting in January 2005 for further information, including a copy of the comment letters received.

[3] Please see IFRIC Update from the Interpretations Committee's meeting in January 2015 for further information.

28 to assess if it has significant influence over that fund. The issuance of IFRS 10 did not change this requirement.

14. IFRS 10 contains specific requirements that a fund manager applies in assessing whether it is a principal or an agent (and accordingly, whether it controls a fund that it manages). Paragraph B58 of IFRS 10 states:

> When an investor with decision-making rights (a decision maker) assesses whether it controls an investee, it shall determine whether it is a principal or an agent…An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)) and therefore does not control the investee when it exercises its decision-making authority.

15. Paragraphs B59-B72 then go on to discuss the factors that a decision maker considers in assessing whether it is primarily engaged to act on behalf and for the benefit of others (and thus is an agent) or alternatively is a principal. These factors include the scope of its decision-making authority, the rights held by other parties, the remuneration to which the decision maker is entitled and the decision maker's exposure to variability of returns from any other interests in the investee.

16. If a decision maker concludes that it is an agent applying paragraphs B58-B72 in IFRS 10, then it does not control the investee and does not consolidate it. If a decision maker concludes that it is a principal and controls the investee applying the requirements in IFRS 10, then it consolidates the investee. As a consequence, the requirements in paragraphs B58-B72 of IFRS 10 link directly to the definition of control in IFRS 10, and are an integral part of the application guidance on that definition. The Board developed those requirements solely in the context of a decision maker's assessment of whether it controls an investee, as control is defined in IFRS 10.

17. For this reason, the Board did not change the definition of significant influence in IAS 28 when it issued IFRS 10, nor did it change the requirements (now in paragraphs 5-9

of IAS 28) regarding the assessment of significant influence. This is confirmed in the Basis for Conclusions on IAS 28. At the time of developing IFRS 10, some had suggested that the Board change the requirements in IAS 28 on the assessment of significant influence (specifically relating to potential voting rights), because of changes made to the assessment of control within IFRS 10. In response, the Board noted in paragraph BC16 of IAS 28 that 'it had not considered the definition of significant influence when it amended IAS 28 [in 2011, at the same time that it developed the definition of control in IFRS 10] and concluded that it would not be appropriate to change one element of significant influence in isolation. Any such consideration should be done as part of a wider review of the accounting for associates'.

18. Because the Board did not change the definition of significant influence in IAS 28 when it issued IFRS 10, IFRS 10 did not require any change to how a fund manager assesses whether it has significant influence over a fund. The requirements in IFRS 10 do not apply to a fund manager's assessment of significant influence.

19. In saying that, IFRS 10 influences whether a fund manager assesses significant influence over a fund that it manages. This is because a fund manager will assess whether it has significant influence only if it has concluded that it does not control or have joint control of the fund.

Should the Interpretations Committee undertake a project to develop requirements for decision makers in assessing significant influence?

20. As discussed above, IFRS 10 contains specific requirements that a fund manager applies in assessing whether it controls a fund—those requirements are designed to help assess whether a fund manager is primarily engaged to act on behalf and for the benefit of others. IAS 28 does not contain any similar requirements regarding the assessment of significant influence, although arguably such requirements would also be helpful to fund managers when making that assessment.

21. The question then to ask is whether the Interpretations Committee (or the Board) should undertake a narrow-scope project to develop requirements in this respect.

22. In our view, such a project would not be a narrow-scope project. This is because we think that such requirements could not be developed in isolation of a comprehensive review of the definition of significant influence in IAS 28. The principal versus agent requirements in IFRS 10 were developed as an integral part of developing a new definition of control that applies to all investees.

23. We think it would not be an easy task to develop requirements for decision makers when assessing significant influence. When the existing definition of significant influence was developed by the Board's predecessor, the International Accounting Standards Committee (IASC), some considerable time ago, it would appear that the IASC did not give any consideration to how that definition might be applied by a decision maker who has decision-making authority delegated to it. In addition, it is highly likely that any such project would also involve consideration of the scope of application of the equity method, on the grounds that the main effect of concluding that an entity has significant influence is often to require measurement of any investment using the equity method rather than at fair value.

24. We have assessed this issue against the Interpretations Committee's agenda criteria in the following section.

Assessment against the Interpretations Committee's agenda criteria

25. Our assessment of the Interpretations Committee's agenda criteria is as follows:[4]

Paragraph 5.16 of the Due Process Handbook states that the Interpretations Committee should address issues:	Agenda criteria satisfied?
that have widespread effect and have, or are expected to have, a material effect on those affected;	**Met.** We understand that fund managers often hold an investment in funds that they manage, including those that they do not control.
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and	**Met.** The effect of concluding whether a fund manager has significant influence over a fund does not affect whether a fund manager recognises its investment in the fund, but might affect how the investment is measured and the disclosures provided. We understand that fund managers reach differing conclusions about whether they have significant influence in the absence of requirements that specifically address decision makers.
that can be resolved efficiently within the confines of existing IFRS Standards and the *Conceptual Framework for Financial Reporting*.	**Not met.** We think that a project to develop requirements for decision makers in assessing significant influence would not be a narrow-scope project. This is because we suggest that such a project could not be undertaken in isolation of a more comprehensive review of the definition of significant influence and the scope of the equity method more generally.
In addition:	
Can the Interpretations Committee address this issue in an efficient manner (paragraph 5.17)?	Not applicable.

4 These criteria can be found in the *IFRS Foundation Due Process Handbook* .

Paragraph 5.16 of the Due Process Handbook states that the Interpretations Committee should address issues:	Agenda criteria satisfied?
The solution developed should be effective for a reasonable time period (paragraph 5.21).	Not applicable.

Staff recommendation

26. On the basis of our analysis, we suggest that it is not possible for the Interpretations Committee to efficiently resolve this issue within the confines of existing IFRS Standards and the *Conceptual Framework for Financial Reporting*. On the basis of our assessment of the Interpretations Committee's agenda criteria, we recommend that the Interpretations Committee does not add this issue to its agenda.

27. The Board and the project team responsible for the Research Project are already aware of the issue. The next stage of the Research Project is to perform outreach as part of the Post-implementation Review of IFRSs 10, 11 and 12 to understand the information needs of users. The Board and the project team will consider the information obtained from the outreach when setting the scope of the Research Project.

28. The Interpretations Committee has previously issued a tentative agenda decision and obtained feedback on the issue. However, given the time period that has elapsed since the Interpretations Committee last discussed this issue in January 2015, we recommend publishing another tentative agenda decision. Appendix A to this paper outlines the proposed wording of the tentative agenda decision.

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff recommendation not to add this issue to its agenda?   2. Does the Interpretations Committee agree with the staff recommendation to publish another tentative agenda decision on this issue? If yes, does the Interpretations Committee have any comments on the proposed wording of the tentative agenda decision outlined in Appendix A to this paper?

Appendix A—Proposed wording for tentative agenda decision

IAS 28 *Investments in Associates and Joint Ventures*—Fund manager's assessment of significant influence

The IFRS Interpretations Committee (the Interpretations Committee) received a request to clarify whether, and how, a fund manager assesses significant influence over a fund that it manages and in which it has an investment. In the scenario described in the submission, the fund manager applies IFRS 10 *Consolidated Financial Statements* and determines that it is an agent, and thus does not control the fund. In addition, the fund manager has also concluded that it does not have joint control of the fund.

The Interpretations Committee observed that a fund manager assesses whether it has control, joint control or significant influence over a fund that it manages applying the relevant IFRS Standard, which in the case of significant influence is IAS 28 *Investments in Associates and Joint Ventures*.

The Interpretations Committee noted that, unlike IFRS 10, IAS 28 does not contain any requirements that specifically address how an entity that has decision-making authority delegated to it (such as a fund manager) assesses whether it has significant influence. However, developing any such requirements could not be undertaken in isolation of a comprehensive review of the definition of significant influence in IAS 28.

The Interpretations Committee concluded that this issue cannot be resolved efficiently within the confines of existing IFRS Standards. Consequently, it [decided] not to add the issue to its agenda.

Appendix B—Submission[5]

IFRS IC Potential Agenda Item

The issue

What factors might indicate a fund manager has significant influence over a fund which it manages and has a direct holding in?

IFRS 10 para B58 requires that a party with decision making rights assesses whether it is acting as a principal or an agent. IFRS 10 paras B60-B72 set out a number of factors to consider in making such an assessment that are supported by a series of examples (examples 13-16). Some of these examples specifically consider when a fund manager is acting as principal or agent and hence will have control of a fund. Examples 14A and C explicitly conclude that the fund manager does not control the fund in the scenario presented.

We have generally understood the examples to demonstrate that if power of the fund manager is sufficiently constrained, (e.g. by substantive removal rights as in Example 14C) or if the fund manager's exposure to variable returns is sufficiently low (as in Example 14A) the fund manager is acting as an agent on behalf of the investors in the fund. None of the examples further considers the relationship of the fund manager to the fund once the fund manager is judged to be acting as an agent. Although IFRS 10 paras B60-B72 provide guidance on whether a decision maker is an agent or a principal, they do not comment on whether an agent would be considered to have significant influence.

Should the fund manager consider if it has significant influence over the fund? If so, how should it make that assessment? IAS 28 defines significant influence as "*the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies*." A fund manager who has decision-making rights over relevant activities but not control of a fund might be viewed as meeting this definition.

Fund managers will often have a direct investment in the funds they manage. Should they have a direct holding and be considered to have significant influence, this would require the following:

- The investment of the fund manager would meet the definition of an associate, and IAS 28 would require that the equity method of accounting be used for that investment (unless the exemption in para 1 of IAS 28 applies).
- The investment in an associate would also be within the scope of the disclosure requirements for an associate in IFRS 12.

Should a fund manager be considered not to have significant influence, they would account for their investment

[5] We have deleted details that could identify the submitter of the request.

as an 'Available-for-sale' financial asset under IAS 39 (unless the fair value option is applied) or an equity investment under IFRS 9, and be within the scope of the disclosure requirements of IFRS 7.

For a fund manager which has a direct investment in a fund they manage, the decision as to whether they have significant influence would result in differences in the location in which changes in the carrying amount are recorded in the income statement and in disclosure requirements:

	Significant influence - associate	**No significant influence - 'Available-for-sale' financial asset/equity investment**
Changes in carrying amount	Share of profit/loss through profit or loss	Change in fair value through other comprehensive income
Disclosure	IFRS 12, including summarised financial information for individually material associates and in aggregate for all other associates	IFRS 7, with no requirement for summarised financial information

The activities performed by a fund manager would seem to indicate the power to participate in financial and operating decisions of an investee. However, there other indicators provided by IAS 28 as to whether there is significant influence. If the power of the fund manager is constrained such that it is acting as an agent for others, this may preclude significant influence. It would be helpful if the Interpretations Committee could provide guidance as to how these various factors should be assessed in making a final decision.

Current practice

We have seen diversity in practice among fund managers and other financial institutions in accounting for investments in funds which they manage but do not control.

Prior to the clarifications and additional 'guidance provided by IFRS 10, some concluded that treatment as an "available-for-sale" financial asset was appropriate. In some cases, this approach would not appear to have been revisited following the introduction of IFRS 10.

We believe this diversity might apply not only to funds, but also other types of "structured entity" as defined by IFRS 12. There are specific requirements around the assessment of control and disclosure for these types of arrangement provided by IFRS 10 and 12. A service provider who has an interest in a structured entity will perform an assessment of control for that interest. However, should they conclude they do not have control, some might not be aware of the factors to be considered as to whether they have significant influence.