

**30 Cannon Street, London EC4M 6XH, United Kingdom**  
**Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411**  
**E-mail: [iasb@iasb.org](mailto:iasb@iasb.org) Website: [www.iasb.org](http://www.iasb.org)**

**International  
Accounting Standards  
Board**

*This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.*

*These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.*

## **INFORMATION FOR OBSERVERS**

**Board Meeting:** November 2008, London

**Project:** Consolidation

**Subject:** Consolidation: Sweep Issues—Parties acting in the role of a principal and agent (Agenda paper 16B)

---

### **Introduction**

1 When assessing control, a reporting entity considers whether it acts as an agent for another party or parties. Sometimes a reporting entity might act simultaneously as a principal and agent. For example, a reporting entity might invest in a fund and simultaneously act as manager of that fund. The staff draft presented to the Board at its October meeting contained the following requirement for parties that act simultaneously in the role of a principal and agent:

This [*draft*] IFRS presumes that a reporting entity that acts both as a principal and as an agent uses the powers available to it in its role as agent for its own benefit and not that of other parties, unless it can demonstrate that it is obliged to act in the best interests of other parties, or has policies and procedures in place that ensure the independence of the decision making in its role as an agent from that in its role as a principal.

2 The staff recommends deleting this paragraph. We think that the guidance in the staff draft relating to control without the majority of the voting rights and on principal-agent relationships is sufficient for a reporting entity acting in a dual role to assess whether it

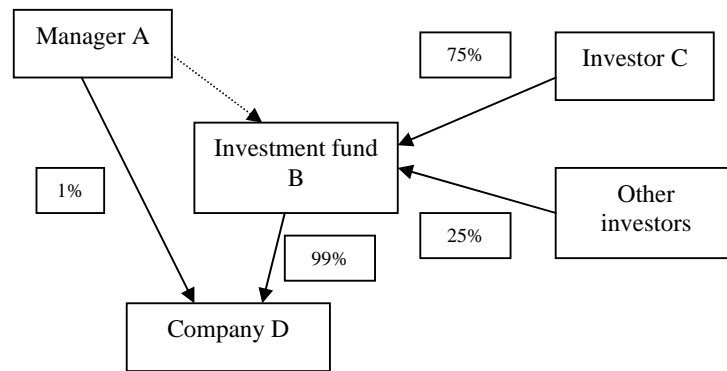
controls another entity. The wording in that paragraph (ie the paragraph we propose deleting) also creates opportunities for structuring.

### **Staff Analysis**

- 3 IAS 27 does not address the assessment of control when the reporting entity acts as an agent for other parties. As a consequence, IAS 27 does not contain requirements for reporting entities acting in a dual role as a principal and agent. The lack of guidance has created divergence in practice with accounting firms applying different rules to reporting entities acting in a dual role.
- 4 In June 2004 the staff presented to the Board three alternative treatments of reporting entities that act in a dual role. The alternatives discussed were:
  - a *Alternative 1*: always to require the reporting entity to assess its power in aggregate when it has a dual role; ie the reporting entity must always conclude that it uses the powers available to it in its role as agent for its own benefit and not for the benefit of other parties.
  - b *Alternative 2*: to adopt a rebuttable presumption that the reporting entity should assess its power in aggregate when it has a dual role; ie the reporting entity is *presumed* to use the powers available to it in its role as agent for its own benefit and not for the benefit of other parties unless it can demonstrate otherwise.
  - c *Alternative 3*: to allow the reporting entity to assess its power excluding its influence arising as fiduciary, but require disclosure of supplementary information about the investee; ie the reporting entity would always conclude that it uses the powers available to it in its role as agent for the benefit of other parties.
- 5 The Board tentatively decided, at that time, that the staff should pursue Alternative 2 and develop suggested criteria for the rebuttable presumption for the Board's consideration. The Board also noted that if suitable criteria for the rebuttable presumption could not be developed, Alternative 1 would be preferable to

Alternative 3.<sup>1</sup> As the project developed the Board became increasingly inclined towards Alternative 1 because they could not identify any factors that were suitable criteria for rebutting the presumption.

- 6 In developing the staff draft in 2008, we decided that we should try to implement the Board's preferred approach (Alternative 1) rather than the fall-back position reflected in Alternative 2. We think that Alternative 1 is a rule rather than a principle and that, like every rule, Alternative 1 is therefore inevitably open to structuring opportunities. We are concerned that Alternative 1 might create off-balance sheet structuring opportunities and might cause a reporting entity to consolidate entities that it does not control and not to consolidate entities that it controls.
- 7 To illustrate, assume that manager *A* manages an investment fund *B* as an agent for investor *C*. Investor *C* holds 75% of the investments in *B*. Investor *C* can remove manager *A* as manager of investment fund *B* without cause. Investment fund *B* has a 99% interest in company *D*, which carry 99% of the voting rights. Manager *A* has the remaining 1% interest, and voting rights, in company *D*.



- 8 We are concerned that requiring manager *A* to assess its power in aggregate might lead manager *A* to conclude that it has power over, and therefore controls, company *D*. Control is not shared. Therefore investor *C* would not control company *D*.
- 9 To implement Alternative 2, previous versions of the staff draft of the ED included the following criteria. These criteria, if demonstrated, would rebut the presumption that a

---

<sup>1</sup> Update, June 2004.

reporting entity acting in a dual role uses the powers available to it in its role as agent for its own benefit and not that of other parties:

- a the reporting entity demonstrates that it is obliged to act in the best interests of other parties;
  - b the reporting entity demonstrates that it has policies and procedures in place that ensure the independence of the decision making in its role as an agent from that in its role as a principal.
- 10 On reflection, we are concerned that neither criteria are suitable. In most jurisdictions an agent is legally or contractually obliged to act in the best interest of other parties. Therefore, the first criterion automatically rebuts the presumption by operation of law.
- 11 Regarding the second criterion, we understand from constituents that in virtually all situations in which a reporting entity acts in a dual role, it would be possible to demonstrate that some policies and procedures are in place to ensure the independence of the decision making in its role as an agent from that as a principal. As a consequence, the second criterion could also be used to rebut the presumption in most situations.
- 12 We think that neither Alternative 1 nor Alternative 3 result in the right conclusions in terms of control in all situations. We know that it is difficult to differentiate between an agency relationship and one where voting interests have been transferred to another party. The problem is that if we adopt Alternative 1 we will have reporting entities consolidating other entities that they, clearly, do not control. Similarly, if we adopt Alternative 3 we will have reporting entities that, in our opinion, control other entities being able to avoid consolidation. We think that the only approach that will lead to appropriate reporting under a control model is to provide principles and guidance that distinguish between:
- a reporting entities that are genuinely directing activities of entities as agents of other parties; and

- b reporting entities that do not have more than half the voting rights in another entity but have been given power by other parties sufficient to direct the activities of that other entity.
- 13 A reporting entity would apply the general requirements for identifying agents. We think that a reporting entity should not be required to treat voting rights from other parties as if they were its own voting rights if the reporting entity can demonstrate according to those requirements that it acts as an agent of another party. The requirements in the staff draft would, for example, conclude that the reporting entity acts as an agent of another party if that party can remove the reporting entity from its functions without cause. If the reporting entity can be removed by another party without cause, we do not think that it has power or control.
- 14 We address the situation described in 12(b) in the section of the ED titled ‘power to direct the activities without a majority of the voting rights’. The staff draft of the exposure draft states that a reporting entity has the ‘power to direct the activities of another entity if the reporting entity has voting interests in that entity along with other arrangements that allow the reporting entity to direct the activities of that other entity’. We believe that this guidance would lead to a conclusion that a reporting entity controls another entity in situations in which the reporting entity, together with its own voting rights, has the ability to use voting power given to it by other parties to direct the activities for its own benefit. For example, a venture capital company might own 35% of the voting interests in another entity. Other investors, who are not in a position to control the investment, might decide to give their voting interests to the venture capital company because they see this as the best way of maximising their returns.
- 15 We will ensure that the exposure draft includes examples to help demonstrate the concept.
- 16 ***Does the Board agree that the exposure draft should provide principles and guidance that distinguish between:***
- 1 ***reporting entities that are genuinely directing activities of entities as agents of other parties; and***

- 2 *reporting entities that do not have more than half the voting rights of an entity but have been given power by other parties sufficient to direct the activities of that other entity?*