STAFF PAPER

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IFRS Interpretations Committee Meeting

Project	**New items for initial consideration**
Paper topic	IAS 28 *Investments in Associates and Joint Ventures* — 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 what factors may indicate that a fund manager has significant influence over a fund that it manages and has a direct holding in. The submitter described a particular situation in which an assessment of control under IFRS 10 *Consolidated Financial Statements* resulted in the conclusion that a fund manager does not control the fund that it manages and has a direct holding in, because it is acting as an agent in accordance with paragraphs B58–B72 of IFRS 10. The submitter raised two questions in respect of this particular situation:

   (a) whether the fund manager should assess whether it has a significant influence over the fund; and

   (b) if yes, how should it make an assessment.

2. The submission is reproduced in Appendix B to this paper.

3. This paper is structured as follows:

   (a) description of the issue submitted (see paragraphs 5 to 10);

   (b) existing IFRS guidance (see paragraphs 11 to 13);

   (c) staff analysis of the issue (see paragraphs 14 to 30);

(d) summary of responses to the outreach (see paragraphs 31 to 35);

(e) assessment of the issue against agenda criteria (see paragraphs 36); and

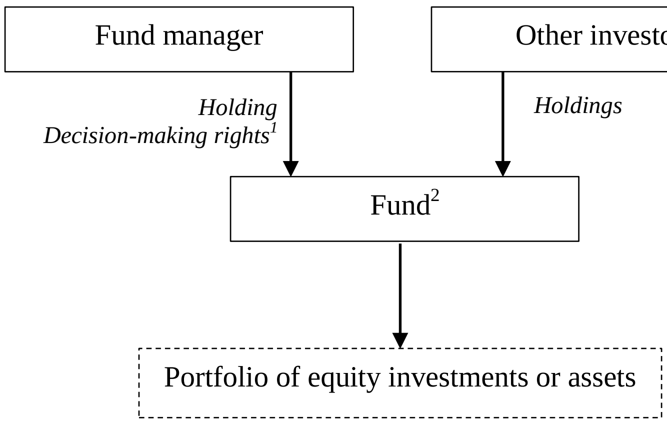
(f) summary of staff recommendations (see paragraphs 37 to 39).

4. Proposed wording for tentative agenda decision is presented in Appendix A to this paper.

Description of the issue

Fact pattern

5. The following diagram illustrates the fact pattern described by the submitter:



6. The submitter described a particular situation in which an assessment of control under IFRS 10 resulted in the conclusion that a fund manager does not control the fund that it manages and has a direct holding in, because it is acting as an agent in accordance with paragraphs B58–B72 of IFRS 10. This is the case when, for example:

(a) the decision-making power of the fund manager is sufficiently constrained by substantial removal rights of other parties; or

(b) the fund manager's exposure to variable returns is sufficiently low.

[1] The fund manager generally has rights to direct 'relevant activities'—activities of the fund that significantly affect the investee's returns, as defined in Appendix A of IFRS 10.

[2] An investment fund or an infrastructure fund.

Questions raised

7. The submitter raised the following questions:

   (a) *Question 1*: Whether the fund manager that is an agent in accordance with paragraphs B58–B72 of IFRS 10 should assess whether it has a significant influence over a fund that it manages and has a direct holding in?

   (b) *Question 2*: If yes, how should the fund manager make this assessment?

Consequence of the issue

8. The submitter pointed out that the main consequence of the issue is classification of the changes in the carrying amount of the investment in the financial statements of the fund manager. More specifically:

   (a) if an investment is accounted for as an associate, the fund manager would recognise its share in the profit or loss of the fund in its own *profit or loss*; but

   (b) if an investment is accounted for as a financial instrument (an 'available-for-sale' financial asset under IAS 39 or an equity investment under IFRS 9), changes in its carrying amount would be recognised in *other comprehensive income* of the fund manager.

9. This consequence could have a significant effect on financial institutions due to the capital requirements imposed on them. In some jurisdictions regulatory capital includes retained earnings, but excludes other comprehensive income.

10. The submitter noted that the issue would also affect disclosures that the fund manager would be required to make. In particular, IFRS 12 *Disclosure of Interests in Other Entities* requires disclosing summarised financial information for associates. IFRS 7 *Financial Instruments: Disclosures* does not require such disclosures.

Existing IFRS guidance

Guidance in IFRS 10

11. Paragraph B60 of IFRS 10 describes factors that should be considered by an investor to determine whether it is acting as an agent (as part of the control assessment):

> (a) the scope of its decision-making authority over the investee (paragraphs B62 and B63).
>
> (b) the rights held by other parties (paragraphs B64–B67).
>
> (c) the remuneration to which it is entitled in accordance with the remuneration agreement(s) (paragraphs B68–B70).
>
> (d) the decision maker's exposure to variability of returns from other interests that it holds in the investee (paragraphs B71 and B72).
>
> Different weightings shall be applied to each of the factors on the basis of particular facts and circumstances.

Guidance in IAS 28

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. Paragraphs 5–6 of IAS 28 describe how significant influence over an investee is assessed:

> 5 If an entity holds, directly or indirectly (eg through subsidiaries), 20 per cent or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the entity holds, directly or indirectly (eg through subsidiaries), less than 20 per cent of the voting power of the investee, it is presumed that the entity does not have significant influence, unless such

influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.

6 The existence of significant influence by an entity is usually evidenced in one or more of the following ways:

(a) representation on the board of directors or equivalent governing body of the investee;

(b) participation in policy-making processes, including participation in decisions about dividends or other distributions;

(c) material transactions between the entity and its investee;

(d) interchange of managerial personnel; or

(e) provision of essential technical information.

Staff analysis

Question 1: Whether a fund manager that is an agent in accordance with paragraphs B58–B72 of IFRS 10 should assess whether it has a significant influence over a fund that it manages and has a direct holding in?

14. We think that:

(a) In accordance with paragraph 2 of IAS 28 the Standard should be applied by investors with significant influence over an investee. In order to determine if an investment falls in the scope of IAS 28, the investor is required to assess whether it has significant influence over the investment in accordance with paragraphs 5–9 of IAS 28.

(b) The fact, that decision-making rights of the fund manager are constrained such that it is acting as an agent in accordance with IFRS 10, does not necessarily preclude significant influence in accordance with IAS 28.

(c) The significant influence assessment is different from the control assessment. For example, the concept of control as a whole and guidance on agency relationships in particular focus on all three elements of control[3]. In contrast, the concept of significant influence focus only on investor's power to participate in policy decisions of the investee. It does not refer to the following elements:

(i) exposure, or rights, to variable returns of the investee; and

(ii) the ability to use investor's power to affect the amount of its returns.

Consequently, the guidance in IFRS 10 should not necessarily be considered as part of the significant influence assessment.

(d) The IASB decided not to revisit the definition and assessment of significant influence under IAS 28 as a part of its consolidation project. Consequently, we think that the introduction of IFRS 10 itself should not change the assessment of significant influence.

15. Consequently, we think that a fund manager that is an agent in accordance with paragraphs B58–B72 of IFRS 10 should assess whether it has a significant influence over the fund. We also think that existing guidance in this respect is sufficient and that neither an interpretation nor an amendment to IFRS is necessary. Consequently, we do not recommend adding this issue on the Interpretations Committee's agenda.

Question 2: If yes, how should the fund manager make this assessment?

16. The fund manager would need to apply the IAS 28 requirements to assess whether it has significant influence over the fund that it manages and has a holding in. More specifically, it would need to consider:

[3] For example, paragraph B60(c) –(d) describes the following factors that should be considered under IFRS 10:

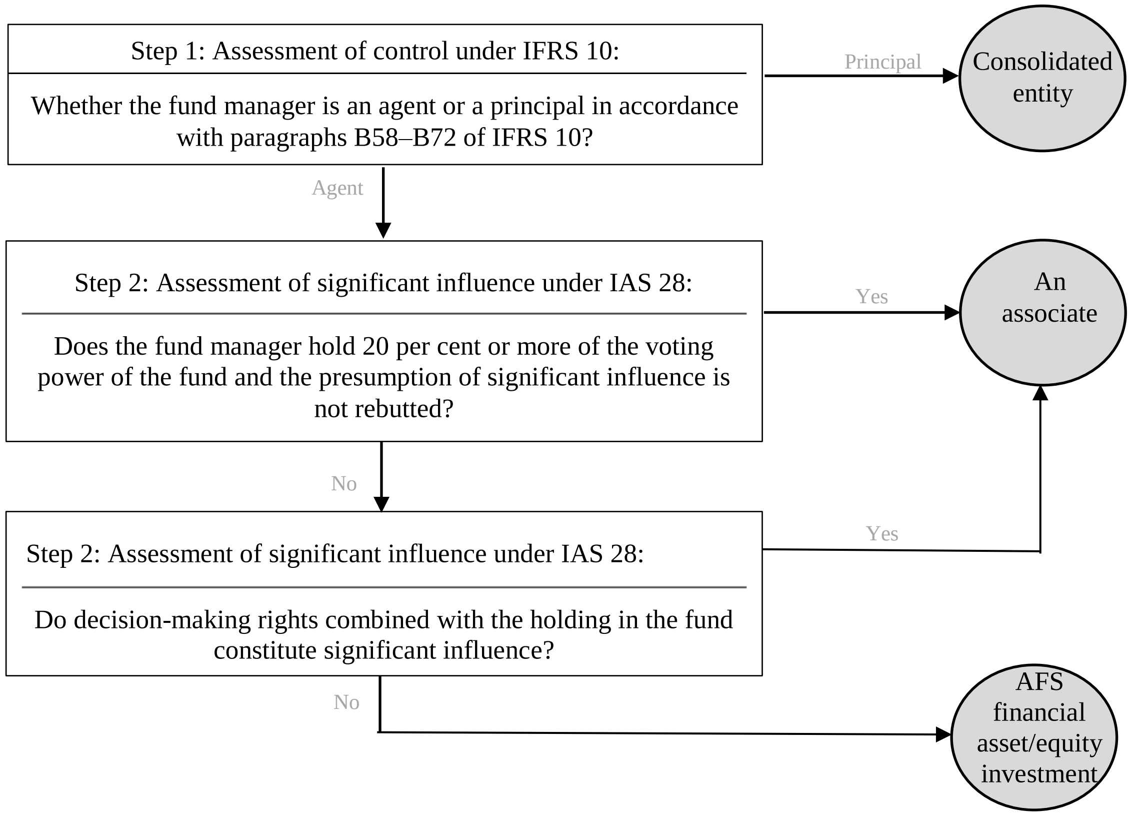
- the remuneration to which a decision maker is entitled in accordance with the remuneration agreement(s);
- the decision maker's exposure to variability of returns from other interests that it holds in the investee.

We do not think that those factors should necessarily be considered as a part of significant influence assessment under the existing IAS 28.

(a) firstly, its direct or indirect holding in the fund; and

(b) secondly (if the fund manager holds less than 20 per cent of the voting power over the fund), whether its decision-making rights combined with its holding constitute significant influence.

17. The following flowchart illustrates the steps we think the fund manager would need to follow:



18. In accordance with paragraph 5 of IAS 28, a fund manager has significant influence over a fund if it holds 20 per cent of the voting power over that fund, unless it can be clearly demonstrated that this is not the case.

19. Paragraph 5 of IAS 28 also states that a fund manager holding less than 20 per cent of the voting power has significant influence if its power to participate in the financial and operating decisions can be clearly demonstrated. We think that the fund manager should base its assessments on the combination of both its decision-making rights and its holding in the fund.

20. Paragraph 6 of IAS 28 provides examples of rights that constitute significant influence. In particular, paragraphs 6(b) and 6(e) state that significant influence is usually evidenced in one or more of the following ways:

    (a) participation in policy-making processes; or

    (b) providing essential technical information.

21. We think that those requirements (paragraphs 5 and 6 of IAS 28) provide guidance on how the fund manager should assess whether it has significant influence over the fund it manages and has a holding in.

22. However, an additional question that can arise is whether the fund manager should include in the significant influence assessment its participation in financial and operating policy decisions that it undertakes on behalf and for the benefit of others. We analyse this question in the paragraphs below.

Question 2.1: Whether the fund manager should include in the significant influence assessment its participation in financial and operating policy decisions that it undertakes on behalf and for the benefit of others?

23. We think that there are the following two approaches to this question.

    View A: The fund manager should exclude from the significant influence assessment its participation in financial and operating policy decisions that it undertakes on behalf and for the benefit of others.

24. Under this view the ability to participate in policy decisions because of its role as a fund manager for other investors is not included in the significant influence assessment.

25. The rationale for this view is that:

    (a) Participation in policy decisions principally for the benefits of others is not considered as entity’s own rights. It can rather be seen as an obligation under the management agreement. As such, participation in policy decisions principally for the benefits of others is not considered as the fund manager’s power. Consequently, it is not included in the assessments of significant influence.

(b) Decision-making rights undertaken on behalf and for the benefit of others constitute delegated power, but not investor's own power. This consideration is seen to be relevant both in the context of the control assessment (agent vs principal), and in the context of the significant influence assessment for the same reasons.

View B: The fund manager includes in the significant influence assessment all factors, including its participation in financial and operating policy decisions that it undertakes on behalf and for the benefit of others.

26. Under this view all rights to participate in policy decisions that the fund manager holds are considered to be sufficient under IAS 28.

27. The rationale for this view is that the existing IAS 28 is focused on the rights to participate in the financial and operating policy decisions of the investee. The Standard does not require an investor to assess whether it has the ability to exercise these rights for its own benefits.

Staff view

28. We are concerned to conclude that participation in policy decisions exercised principally to perform management services constitutes significant influence. However, we cannot say that the existing IAS 28 prohibits to include such rights in the significant influence assessment.

29. We think that the existing IAS 28 does not explicitly address this issue. The IASB decided not to address this issue as part of its consolidation project in 2011.[4] The IASB thought that it should instead be included as part of a separate

[4] Paragraph BC16 of IAS 28 states:

> The Board observed that the definition of significant influence in IAS 28 (ie 'the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies') was related to the definition of control as it was defined in IAS 27. The Board had not considered the definition of significant influence when it amended IAS 28 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.

project that addresses all aspects of IAS 28 that are considered to be in need of review.

30. Consequently, we think that this issue is too broad an issue for the Interpretations Committee to address and it would be better considered within the context of a research project on IAS 28.

Summary of responses to the outreach

31. We have performed an outreach with the IFASS members, securities regulators, one industry group and global accounting firms. Specifically, we asked:

(a) What is the prevalent approach to accounting by a fund manager for an investment in the fund in the specific situation in which the fund manager manages and has a direct holding in the fund, but does not control it (a financial asset or an investment in an associate)?

(b) What is the rationale for that accounting treatment?

(c) To what extent do the respondents observe diversity in the accounting treatment by the fund manager in such circumstances?

32. We received 18 responses from 11 IFASS members, 2 security regulators, 4 global accounting firms and 1 industry group.

33. By region, responses were received from 4 global accounting firms and also from 15 jurisdictions (7 jurisdictions from Europe, 6 – from Asia and Oceania, 1 – from Africa and 1 – from Americas). The views received represent informal opinions and do not reflect the formal views of those organisations.

34. In summary, the responses are:

(a) The majority respondents (7) indicated that the prevalent approach is to account for the investment in the fund as a financial asset. The rationale for this accounting treatment is that the decision-making authority of the fund manager is often limited by the terms of the fund (akin to an 'autopilot').

See also to *IASB Update* and Agenda Paper 13 for IASB meeting in January 2011.

(b) Some respondents (3), including the member of industry group responded, noted that the prevalent approach is to account for the investment in the fund as an associate. The rationale for this accounting treatment is that the fund manager participates in the policy-making decisions under the management contract, irrespective of whether it is acting as a principal or as an agent for other investors.

(c) Other respondents did not identify the prevalent approach under IFRS. Many of them noted that IAS 28 is the relevant standard to apply. They also indicated that the investment in the fund is accounted based on the particular facts and circumstances.

35. Respondents also indicated that accounting under the equity method is the prevalent approach under US GAAP. The basis for this accounting treatment is that:

(a) Significant influence is evidenced by "participation in policy-making processes" (Topic ASC 323-10-15-6 *Investments—Equity Method and Joint Ventures* in the FASB *Accounting Standards Codification*®).

(b) The equity method of accounting is specifically required if a general partner does not control a limited partnership (ASC 810-20-25-10 *Consolidation* in the FASB *Accounting Standards Codification*®). We understand that partnership relationships are common for the analysed fact patterns.

Assessment of the issue against agenda criteria

36. Our assessment against the Interpretations Committee agenda criteria is as follows:[5]

[5] As presented in paragraphs 5.16–5.17 and 5.21 of the *IFRS Foundation Due Process Handbook*.

Agenda criteria	
We should address issues:	
that have widespread effect and have, or are expected to have, a material effect on those affected.	Yes, this issue could have a significant effect on financial institutions. The main consequence of the issue is classification of the changes in the carrying amount of the investment (investment in an associate: profit or loss; financial assets: other comprehensive income).
when financial reporting would be improved through the elimination, or reduction, of diverse reporting methods.	IAS 28 provides some guidance. However, it does not address the issue of whether the fund manager should assess its ability to participate in policy decisions for its own benefits under IAS 28 (Question 2.1).
that can be resolved efficiently within the confines of existing IFRS and the *Conceptual Framework for Financial Reporting*.	
In addition:	
Is the issue sufficiently narrow in scope so that the Interpretations Committee can address it in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process that would be required when making changes to IFRS?	No.
Will the solution that was developed by the Interpretations Committee be effective for a reasonable time period?	N/a.

Staff recommendations

37. We think that:

    (a) The fact, that decision-making rights of a fund manager are constrained such that it is acting as an agent in accordance with IFRS 10, does not necessarily preclude significant influence in accordance with IAS 28. In such a situation, a fund manager would need to make a separate assessment of significant influence over the fund that it manages and has a holding in.

    (b) When making this assessment, a fund manager would need to apply the guidance in IAS 28. In particular it should consider:

(i) its holding in the fund; and

(ii) whether its rights to participate in financial and operating policy decisions combined with its holding constitute significant influence.

38. We think that the existing guidance in this respect is sufficient and, therefore, recommend that the Interpretations Committee should not take these issues onto its agenda.

39. We also recommend that the Interpretations Committee should not take onto its agenda the issue of whether the fund manager should include in the significant influence assessment its participation in financial and operating policy decisions that it undertakes on behalf and for the benefit of others (Question 2.1). This is because we think the issue would be better considered as a part of the IASB research project on the equity method of accounting.

Questions for the Interpretations Committee

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff's analysis and conclusions in paragraph 37? 2. Does the Interpretations Committee agree with the staff's recommendation that the issue should not be added to its agenda? 3. Does the Interpretations Committee have any comments on the proposed wording for the tentative agenda decision in Appendix A?

Appendix A
Proposed wording for tentative agenda decision

A1 The proposed wording for the tentative agenda decision is presented below.

IAS 28 *Investments in Associates and Joint Ventures*—

Fund manager's significant influence over a fund

The Interpretations Committee received a request to clarify what factors may indicate that a fund manager has significant influence over a fund that it manages and has a direct holding in. The submitter described a particular situation in which an assessment of control under IFRS 10 *Consolidated Financial Statements* resulted in the conclusion that the fund manager does not control the fund that it manages and has a direct holding in, because it is acting as an agent in accordance with paragraphs B58–B72 of IFRS 10. The submitter raised two questions in respect of this particular situation:

(a) whether the fund manager should assess whether it has a significant influence over the fund; and

(b) if yes, how should it make an assessment.

The Interpretations Committee noted that the fact that decision-making rights of a fund manager are constrained such that it is acting as an agent in accordance with IFRS 10, does not necessarily preclude significant influence in accordance with IAS 28.

The Interpretations Committee further noted that a fund manager would need to make a separate assessment of significant influence over the fund that it manages and has a holding in under IAS 28. In particular it should consider:

(a) its holding in the fund; and

(b) whether its rights to participate in financial and operating policy decisions combined with its holding in the fund constitute significant influence.

The Interpretations Committee noted that IAS 28 does not address the issue of whether the fund manager should include in the significant influence assessment its participation in financial and operating policy decisions that it undertakes on behalf and for the benefit of others. The Interpretations Committee thought that this issue would be better considered as a part of the comprehensive project on the equity method of accounting.

Consequently, the Interpretations Committee [decided] not to take the issue onto its agenda but instead to recommend to the IASB that it could analyse and assess this issue in its research project on the equity method of accounting.

Appendix B—Submission received

B1. We received the following submission. All information has been copied without modification, except for details that would identify the submitter of the request and details that are subject to confidentiality.

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 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.