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## IFRS<sup>®</sup> Interpretations Committee meeting

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| Date     | <b>November 2022</b>  |
| Project  | <b>Potential annual improvements—'de facto agent' assessment (IFRS 10)</b>              |
| Topic    | <b>Initial consideration</b>  |
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## Introduction

1. We have been informed about potential confusion arising from an inconsistency between paragraphs B73 and B74 of IFRS 10 *Consolidated Financial Statements* related to an investor determining whether another party is acting on its behalf.
2. This paper:
  - (a) provides the IFRS Interpretations Committee (Committee) with a summary of the matter;
  - (b) presents our research and analysis; and
  - (c) asks the Committee whether it agrees with our preliminary views to include a proposed amendment to paragraph B74 of IFRS 10 in the next *Annual Improvements to IFRS Accounting Standards Cycle* (annual improvements).

## Structure of this paper

3. This paper includes:
  - (a) background information (paragraphs 4–11);
  - (b) staff analysis and preliminary views (paragraphs 12–20);
  - (c) question for the Committee; and
  - (d) Appendix A— recommended proposed amendment to IFRS 10.

## Background information

4. Paragraph B4 of IFRS 10 states:

When assessing control of an investee, an investor shall consider the nature of its relationship with other parties (see paragraph B73–B75).

5. Paragraphs B73–B74 state:

B73 When assessing control, an investor shall consider the nature of its relationship with other parties and whether those other parties are acting on the investor's behalf (ie they are 'de facto agents'). The determination of whether other parties are acting as de facto agents requires judgement, considering not only the nature of the relationship but also how those parties interact with each other and the investor.

B74 Such a relationship need not involve a contractual arrangement. A party is a de facto agent when the investor has, or those that direct the activities of the investor have, the ability to direct that party to act on the investor's behalf. In these circumstances, the investor shall consider its de facto agent's decision-making rights and its indirect exposure, or rights, to variable returns through the de facto agent together with its own when assessing control of an investee.

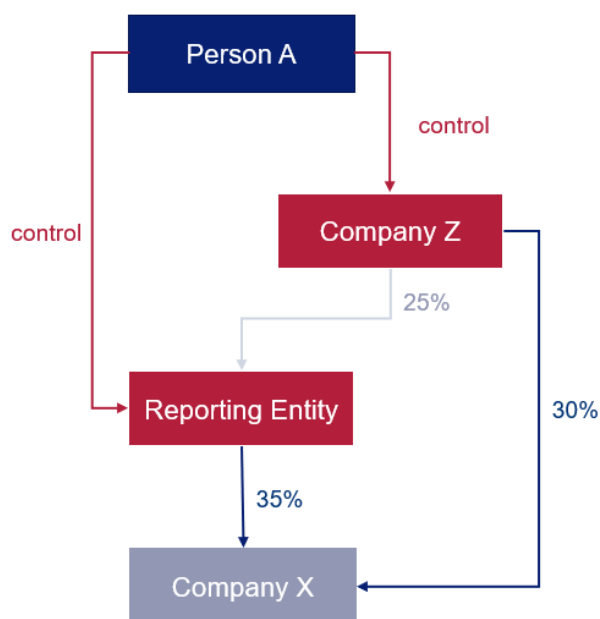
6. Paragraph B75 provides examples of such other parties that, by the nature of their relationship, might act as the investor's de facto agents. Those examples include 'the investor's related parties'.
7. Paragraph BC143 explains the IASB's rationale for the requirements in paragraphs B73–B74. That paragraph explains the IASB 'decided that an investor should, when assessing control, consider the nature of its relationships with other parties. An investor may conclude that the nature of its relationship with other parties is such that those other parties are acting on the investor's behalf (they are 'de facto agents'). Such a relationship need not involve a contractual arrangement, thereby creating a non-contractual agency relationship'.
8. Paragraph BC144 states that in providing the examples of parties that might act as de facto agents of the investor, 'the [IASB's] intention was that an investor would look closely at its relationships with such parties and assess whether the party is acting on behalf of the investor'. Paragraph BC146 notes the IASB's view that 'it would be inappropriate to assume that all other parties listed in paragraph B75 would *always* or *never* act for the investor. [...] the assessment of whether the nature of the relationship between the investor and the other party is such that the other party is a de facto agent requires judgement [...]', as specified in paragraph B73.

### Illustrative fact pattern

9. The following fact pattern illustrates the potential inconsistency between paragraphs B73 and B74 of IFRS 10:
- (a) Person A (the ultimate parent) controls Reporting Entity and Company Z. Company Z holds a 25% interest (and voting rights) in Reporting Entity and also holds a 30% interest (and voting rights) in Company X. Reporting Entity holds a 35% interest (and voting rights) in Company X.

- (b) The other 35% ownership interest (and voting rights) in Company X is held by a number of shareholders, each holding a small percentage ownership interest.
- (c) If the voting rights held by Reporting Entity and Company Z (together, 65%) were held directly by one party, that party would—applying IFRS 10—conclude that it controls Company X.

**Diagram 1—The group structure**



10. We have been informed that, in some situations (such as the one illustrated), the requirements in paragraph B74 potentially contradict the requirements in paragraph B73. Confusion may arise because paragraph B73 states the principle—that a de facto agent is a party that acts on the investor's behalf—and that the determination of whether other parties are acting as de facto agents requires judgement. However, the second sentence of paragraph B74 includes more conclusive language.

### Question raised

11. The question raised is whether to amend paragraph B74 of IFRS 10 to remove the potential inconsistency with the requirements in paragraph B73.

### Staff analysis and preliminary views

12. Paragraph B74 states in its second sentence that 'a party is a de facto agent when the investor has, or *those that direct the activities of the investor have*, the ability to direct that party to act on the investor's behalf'. [emphasis added]
13. In the fact pattern illustrated above in paragraph 9, Person A controls both Company Z and Reporting Entity. Person A therefore has the ability (a) to direct Company Z to act on behalf of Reporting Entity,

and (b) to direct Reporting Entity to act on behalf of Company Z. If we assume that both Reporting Entity and Company Z were required to prepare financial statements that comply with IFRS Accounting Standards, applying paragraph B74:

- (a) Reporting Entity would conclude that it controls Company X. This is because it would consider both Company Z's decision-making rights and its indirect exposure, or rights, to variable returns from Company X together with its own when assessing control of Company X; and
  - (b) Company Z would conclude that it controls Company X for the same reason. It would consider both Reporting Entity's decision-making rights and its indirect exposure, or rights, to variable returns from Company X together with its own when assessing control of Company X.
14. Therefore, applying paragraph B74 both Reporting Entity and Company Z would conclude that they control Company X, which contradicts the IASB's view when it developed IFRS 10. As stated in paragraph BC69 of the Basis for Conclusions on IFRS 10, the IASB confirmed that only one party, if any, can control an investee.
15. The second sentence of paragraph B74—and specifically the words 'those that direct the activities of the investor'—also has the potential to contradict the requirements in paragraph B73. Paragraph B73 specifies that a de facto agent is a party that acts on the investor's behalf. In the example illustrated above, depending on the specific facts and circumstances, Reporting Entity may act on behalf of Company Z—or vice versa—but, in our view, both cannot be considered to simultaneously act on behalf of the other, which is what the second sentence of paragraph B74 would require.
16. In our view, the IASB did not intend for paragraph B74 to override or create an inconsistency with paragraph B73. Therefore, we recommend amending paragraph B74 by deleting a portion of its second sentence to remove the inconsistency between the requirements in paragraphs B73 and B74. We also recommend a clarifying amendment to remove 'in these circumstances' at the beginning of the third sentence of paragraph B74. 'In these circumstances' could be read to mean only the circumstances set out in the second sentence of paragraph B74 whereas paragraph BC146 of the Basis for Conclusions on IFRS 10 explains that the IASB intended the third sentence to apply in all circumstances in which an investor has one or more de facto agents (see Appendix A to this paper).
17. Our recommendation would result in the second sentence of paragraph B74 stating that 'a party is a de facto agent when the investor has the ability to direct that party to act on the investor's behalf'. In considering this matter, we considered whether to recommend deleting all of the second sentence of paragraph B74. We decided against such a recommendation because we think it is best to restrict the annual improvement to amending only the wording that has created the inconsistency.

### Does this matter meet the annual improvements criteria?

18. Paragraphs 6.10–6.13 of the *Due Process Handbook* include the criteria for annual improvements. To meet these criteria, the proposed solution would need to be limited to:
- (a) clarifying the wording in an Accounting Standard, which involves either replacing unclear wording in existing Accounting Standards or providing requirements where an absence of requirements is causing concern; or
  - (b) correcting relatively minor unintended consequences, oversights or conflicts between existing requirements.
19. In our view, the proposed solution regarding paragraph B74 (see Appendix A) meets the second of these criteria. It would eliminate a relatively minor inconsistency between existing requirements and improve the understandability of the requirements in IFRS 10, without proposing a new (or changing an existing) principle or requirement.

### Summary of staff preliminary views

20. Based on our analysis in paragraphs 12–19, our preliminary views are to:
- (a) propose that the IASB amend paragraph B74 as set out in Appendix A to this paper; and
  - (b) include this proposed amendment in the next annual improvements cycle.

### Question for the Committee

#### Question for the Committee

Do Committee members agree with our preliminary views as summarised in paragraph 20 of this paper? If 'no', do you have any other suggestions?

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## Appendix A—recommended proposed amendment to IFRS 10

A1. Our proposed amendment would delete a portion of the second sentence of paragraph B74 of IFRS 10 and remove the opening words of the third sentence. New text is underlined and deleted text is struck through.

B74 Such a relationship need not involve a contractual arrangement. A party is a de facto agent when the investor has, ~~or those that direct the activities of the investor have,~~ the ability to direct that party to act on the investor's behalf. ~~In these circumstances, t~~ The investor shall consider its de facto agent's decision-making rights and its indirect exposure, or rights, to variable returns through the de facto agent together with its own when assessing control of an investee.