
IASB[®] meeting

Date	February 2023
Project	Determination of a ‘de facto agent’ (IFRS 10)
Topic	Potential annual improvement
Contacts	Rafal Markowski (rmarkowski@ifrs.org) Jenifer Minke-Girard (jminke-girard@ifrs.org)

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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. The IFRS Interpretations Committee (Committee) discussed this matter at its meeting in November 2022—see [Agenda Paper 3B](#) for that meeting.
3. The objective of this paper is:
 - (a) to provide the International Accounting Standards Board (IASB) with background on the matter and staff analysis, including consideration of the Committee’s discussion; and
 - (b) to ask the IASB whether it agrees with our recommendation to include a proposed amendment to paragraph B74 of IFRS 10 in its next *Annual Improvements to IFRS Accounting Standards Cycle* (annual improvements).

Structure of the paper

4. This paper includes:

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- (a) Background information;
 - (b) Staff analysis, including consideration of the Committee’s discussion and transition requirements;
 - (c) Staff recommendations and questions for the IASB; and
 - (d) Appendix A—recommended proposed amendment to paragraph B74 of IFRS 10.

Summary of staff recommendations

- 5. We recommend that the IASB:
 - (a) propose an amendment to paragraph B74 of IFRS 10 as set out in Appendix A to this agenda paper;
 - (b) develop no specific transition requirements for this proposed amendment; and
 - (c) include this proposed amendment in its next annual improvements cycle.

Background information

- 6. 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).
- 7. Paragraphs B73–B74 of IFRS 10 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.

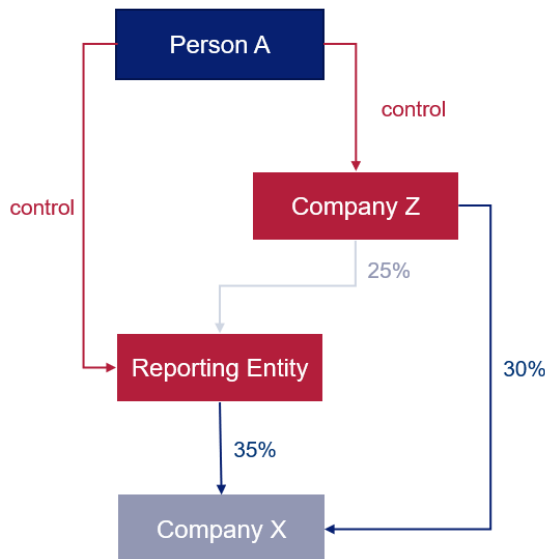
8. Paragraph B75 of IFRS 10 provides examples of such other parties that, by the nature of their relationship, might act as the investor's de facto agents. Those examples include 'the investor's related parties'.
9. Paragraph BC143 of the Basis for Conclusions on IFRS 10 explains the IASB's rationale 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'.
10. 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.
11. 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 and states 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]

Illustrative fact pattern

12. 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



Question raised

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

Staff analysis

14. In the fact pattern illustrated in paragraph 12 of this agenda paper, 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 of IFRS 10:
 - (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 through its de facto

- agent (Company Z) 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 through its de facto agent (Reporting Entity) together with its own when assessing control of Company X.
15. Therefore, applying paragraph B74 of IFRS 10, 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.
16. The second sentence of paragraph B74 of IFRS 10—and specifically the words 'those that direct the activities of the investor'—also has the potential to contradict the requirements in paragraph B73 of IFRS 10. 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, this cannot be assumed and both cannot be considered to simultaneously act on behalf of the other, which is what the second sentence of paragraph B74 would require.
17. In our view, the IASB did not intend for paragraph B74 of IFRS 10 to override or create an inconsistency with paragraph B73 of IFRS 10. Therefore, our preliminary view discussed with the Committee at its November 2022 meeting was to recommend:
- (a) amending paragraph B74 by deleting a portion of its second sentence—that is, the clause 'or those that direct the activities of the investor have'; and
- (b) 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 agenda paper).

The Committee's discussion

18. The Committee discussed this potential annual improvement at its November 2022 meeting. Most Committee members agreed with, or did not disagree with, our analysis and preliminary views.
19. A few Committee members expressed concerns that removing the clause 'or those that direct the activities of the investor have' from paragraph B74 of IFRS 10 might have unintended consequences. They said, were the IASB to delete the clause, some entities might misread the objective of the amendment and change their judgements to conclude that, in fact patterns such as described in paragraph 12 of this agenda paper, neither Reporting Entity nor Company Z controls Company X.

Staff analysis of the Committee input

20. It is not our intention to have an entity conclude that, in fact patterns such as described in paragraph 12 of this agenda paper, neither Reporting Entity nor Company Z controls Company X. Based on the Committee's discussion, we have revised our recommendation. Rather than recommending deletion of a portion of the second sentence in paragraph B74 of IFRS 10, we recommend using less conclusive language, which would replace 'is [a de facto agent]' with 'may act as [a de facto agent]'. In our view, this change would remove the inconsistency with the requirement to use judgement in paragraph B73 of IFRS 10 and would be consistent with the wording of the first sentence in paragraph B75 of IFRS 10, which includes the list of examples of other parties that *might act* as de facto agents for the investor.

Does this matter meet the annual improvements criteria?

21. 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.
22. In our view, our proposed solution to amend paragraph B74 of IFRS 10, as set out in Appendix A to this agenda paper, meets these criteria. Our recommended amendment would eliminate a relatively minor inconsistency between paragraphs B74 and B73 and improve the understandability of the requirements in IFRS 10, without proposing a new (or changing an existing) principle or requirement.

Transition requirements

23. Our proposed amendment to paragraph B74 of IFRS 10 would not propose a new (or change an existing) principle or requirement. We do not expect any change in practice or a material effect on entities' consolidated financial statements. Therefore, in our view, there is no need to develop any specific transition requirements.
24. In the absence of any specific transition requirements, an entity would apply the proposed amendment retrospectively in accordance with paragraph 19(b) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Staff recommendations and questions for the IASB

25. Based on our analysis in paragraphs 14–22 of this agenda paper, we recommend the IASB, as part of its next annual improvements cycle, amend paragraph B74 of IFRS 10 as set out in Appendix A to this agenda paper.
26. Based on our analysis in paragraphs 23–24 of this agenda paper, we recommend the IASB develop no specific transition requirements for the proposed amendment to paragraph B74 of IFRS 10.

Question for the IASB

Does the IASB agree with our recommendations:

- a. to propose an amendment to paragraph B74 of IFRS 10 as set out in Appendix A to this agenda paper;
- b. develop no specific transition requirements for this proposed amendment; and
- c. to include this proposed amendment in its next annual improvements cycle?

Appendix A—recommended proposed amendment to paragraph B74 of IFRS 10

- A1. Our proposed amendment to paragraph B74 would replace ‘is [a de facto agent]’ with ‘may act as [a de facto agent]’ and make a clarifying amendment to the last sentence of this paragraph. New text is underlined and deleted text is struck through.

B74 Such a relationship need not involve a contractual arrangement. A party ~~is~~ may act as 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.