



Solution 121.25

Component	Investment entities
Index	The Group
Short Title	Control in a fund of fund structures

Attention: This guidance is based on the revised standards and interpretations that are mandatory for accounting periods commencing 1 January 2005. A company may early adopt an individual revised standard, but only in its entirety. Guidance based on the previous version of the standards is included in the "Applying IFRS 2004" guidance.

Issue

A parent shall present consolidated financial statements in which it consolidates its investments in subsidiaries. A subsidiary is defined as an entity that is controlled by another entity. Control is defined as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Should an entity that is a Fund of Funds structure consolidate an investment in an underlying fund where the entity does not have the power to govern the financial and operating policies of the underlying fund?

Background

Fund A, a Cayman Islands fund, has two classes of shares in issue, voting ordinary shares and non-voting ordinary shares. The voting and non-voting ordinary shares are sold to investors. Fund A is not an SPE.

The voting ordinary shares can vote on:

- material changes in the investment objectives, policies or restrictions of the fund including the removal of the investment manager;
- determination of the distribution policy of the fund;
- assignments by the fund of any material portion of the fund's assets to any hedge fund or managed account; and
- the merger, consolidation or combination of any part of the fund with, or into, any associated entity.

Fund X, a BVI fund of funds investment company, invests in a number of underlying funds. Fund X holds 100% of the non-voting ordinary shares of fund A. The non-voting ordinary shares amount to 60% of the ordinary shares in issue in fund A, the voting ordinary shares amount to 40%.

Should fund X consolidate fund A?

Solution



Fund X should not consolidate fund A, as it does not control it.

Control is defined as the power to direct the financial and operating policies of an entity so as to obtain benefits from its activities. The holders of the voting ordinary shares and not the holders of the non-voting ordinary shares of fund A have the ability to direct the financial and operating policies of fund A.