



Solution 22.3

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| Component | Special purpose entities |
| Index | Control and consolidation of SPEs |
| Short title | Investment portfolio and a fiduciary |

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

An entity may control an SPE and should consolidate it when, in substance, its activities are being conducted on behalf of the entity according to its specific business needs, so that the entity obtains benefits from the SPE's operations [SIC-12.10(a)].

Should an entity consolidate an SPE whose activities are managed by another party?

Background

An SPE is used to conduct investment activities exclusively on behalf of entity B.

Entity B invests in the SPE by paying a premium to acquire a total return swap issued by the SPE. The total return swap transfers 90% of the profits and 100% of the losses in a specified portfolio of investments to entity B. Entity B is financing the SPE's investing activities. A specialist investment manager manages the SPE's investments and owns all of its share capital.

An operating agreement between the investment manager and entity B sets out investment guidelines and prohibits the investment manager from obtaining access to the investments for its own benefit. Payment on the swap occurs annually in relation to income, and at the expiry of 5 years in relation to return of capital.

Solution

Entity B should consolidate the SPE.

The SPE operates on autopilot because the investment guidelines were established when the SPE was formed. Entity B controls the SPE because B established the investment guidelines. B also receives 90% of the SPE's profits and is exposed to all of its losses.



The investment manager manages the SPE's investments, but does so within predetermined guidelines. The investment manager incurs no risk and receives the premium and 10% of the profits as a fee for providing management services. The specialist investment manager can only benefit as a consequence of creating profits for the principal (entity B). The investment manager is a fiduciary and does not control the SPE.