



Solution 121.26

Component	Investment entities
Index	The Group
Short Title	Forced redemption

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 consolidate an investment in an underlying fund where the directors of the underlying fund have the ability to effect the compulsory redemption of the shares of any investor?

Background

Fund A, a Cayman Islands company, has one class of shares in issue, voting ordinary shares.

The voting ordinary shares can vote on:

- a) material changes in the investment objectives, policies or restrictions of the fund;
- b) assignments by the fund of any material portion of the fund's assets to any hedge fund or managed account;
- c) the merger, consolidation or combination of any part of the fund with, or into any associated entity;
- d) the appointment and removal of directors of the Fund.

The directors of fund A may, at their absolute discretion, effect the compulsory redemption of all of the ordinary shares registered in the name of any shareholder.

21 days notice is required to convene a general meeting.

Fund X, a BVI fund of funds investment company, invests in a number of underlying funds. Fund X holds 75% of the voting ordinary shares of fund A. None of the directors of fund A have been appointed by fund X.

Should fund X consolidate fund A?



Solution

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

The ability of the directors to effect the compulsory redemption of any investor's shares in the fund at short notice means that it is the directors of the fund and not the investors, who have control. This situation is analogous to an entity that has contingently issuable shares in circulation as in both situations the controlling party is the entity that has the ability to remove control from the party that has the majority of the voting rights in the entity.