IFRS AT A GLANCE

IFRS 10 Consolidated Financial Statements
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**Effective Date**

Periods beginning on or after 1 January 2013

### SCOPEx

A parent is required to present consolidated financial statements, except if:

- It meets the following conditions:
  - It is a subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements
  - Its debt or equity instruments are not traded in a public market
  - It did not, nor is in the process of filing, financial statements for the purpose of issuing instruments to the public
  - Its ultimate or any intermediate parent produces IFRS compliant consolidated financial statements available for public use.
- It is a post or long-term-employment benefit plan to which IAS 19 Employee Benefits applies
- It meets the criteria of an investment entity (see page 2 of 2).

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### THE CONTROL MODEL

**Model**

An investor determines whether it is a parent by assessing whether it controls the investee. An investor is required continuously to reassess whether it controls an investee. An investor controls an investee if it has all of the following:

- **Power over the investee**
- **Exposure, or rights, to variable returns from its involvement with the investee**
- The ability to use its power, to affect the amount of the investor’s returns.

**Considerations (refer to boxes below)**

- The purpose and design of the investee
- What the relevant activities are and how decisions about those activities are made
- Whether the rights of the investor give it the current ability to direct the relevant activities
- Whether the investor is exposed, or has rights, to variable returns from its involvement
- Whether the investor has the ability to use its power to affect the amount of the investor’s returns.

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#### (i) Purpose and design

In assessing the purpose and design of the investee, consider:

- **The relevant activities**
- How decisions about relevant activities are made
- Who has the current ability to direct those activities
- Who receives returns from those activities.

In some cases, voting rights (i.e., if unrelated to relevant activities) may not be the dominant factor of control of the investee.

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#### (ii) Relevant activities

Relevant activities include (but are not limited to):

- Selling and purchasing of goods or services
- Managing financial assets during their life
- Selecting, acquiring or disposing of assets
- Researching/developing new products or processes
- Determining a funding structure or obtaining funding.

Decisions on relevant activities include (but are not limited to):

- Establishing operating and capital decisions & budgets
- Appointing, remunerating, and terminating an investee’s key management personnel (KMP) or service providers.

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#### (iii) Rights to direct relevant activities

Rights that, either individually or in combination, can give an investor power include (but are not limited to):

- Rights in the form of voting rights (or potential voting rights) of an investee
- Rights to appoint, reassign or remove members of an investee’s key management personnel (KMP), or another entity that has the ability to direct the relevant activities
- Rights to direct the investee into (or veto any changes to) transactions for the benefit of the investor
- Other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities.

**Special relationships beyond a passive interest**

- Sometimes there may be indicators present that an investor has more than simply a passive interest
- The presence of indicators alone may not satisfy the power criteria, but may add to other considerations:
  - The investee’s KMP who direct relevant activities are current or previous employees of the investor
  - Investee operations are dependent on the investor (e.g., funding, guarantees, services, materials, etc.)
  - A significant portion of the investee activities involve, or are conducted on behalf of, the investor
  - Investee’s exposure or rights to returns is disproportionately greater that it’s voting (or similar) rights.

**Substantive rights**

- Only designates voting rights (i.e., rights that can be practically exercised) are considered in assessing power
- Factors to consider whether rights are substantive include (but are not limited to):
  - Whether there are barriers that prevent the holder from exercising (e.g., financial penalties, detrimental exercise or conversion price, detrimental terms and conditions, laws and regulations)
  - Whether there is a practical mechanism to facilitate multiple parties exercising rights
  - Whether the party holding the rights would benefit from the exercise of those rights
  - Whether the rights are actually exercisable when decisions about relevant activities need to be made.

**Protective rights**

- Are designed to protect the interests of the holder, but do not give the holder power over the investee, e.g., - operational lending covenants; non-controlling interest rights to approve significant transactions of capital expenditure, debt, and equity; seizure of assets by a borrower upon default
- Franchise arrangements are generally considered protective rights.

**Voting rights**

- Power with a majority of voting rights, occurs where:
  - Relevant activities are directed by vote; or
  - A majority of the governing body is appointed by vote.

- Majority of voting right but no power occurs where:
  - Relevant activities are not directed by vote
  - Such voting rights are not substantive.

**De-facto control**

- Power without a majority of voting rights, occurs where:
  - Contractual arrangements with other vote holders exist
  - Relevant activities directed by arrangements held
  - The investor has practical ability to unilaterally direct relevant activities, considering all facts and circumstances:
    - Relative size and dispersion of other vote holders
    - Potential voting rights held by the investor and other parties
    - Rights arising from contractual arrangements
    - Any additional facts or circumstances (i.e., voting patterns).

**Potential voting rights**

- Potential voting rights are only considered if substantive
- Must consider the purpose and design of the instrument.

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#### (iv) Exposure, or rights, to variable returns (i.e., returns that are not fixed, and vary as a result of performance of an investee)

Based on the substance of the arrangement (not the legal form) assesses whether investee returns are variable, and how variable they are. Variable returns can be: only positive; only negative; or both positive and negative. Including:

- Dividends, other distributions of economic benefits from an investee (e.g., interest from debt securities issued by the investee) and changes in the value of the investor’s investment in that investee
- Fees from servicing assets or liabilities, fees and exposure to loss from providing credit or liquidity support, residual interests in net assets on liquidation, tax benefits, and access to future liquidity
- Returns unavailable to other interest holders - synergies, economies of scale, cost savings, sourcing scarce products, access to proprietary knowledge, limiting operations or assets to enhance the value of the investor’s other assets.
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#### INVESTMENT ENTITIES

Investment entities are required to measure interests in subsidiaries at fair value through profit or loss in accordance with IFRS 9 Financial Instruments (IAS 39) instead of consolidating them.

**Definition of an investment entity**

- Obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services
- Commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both
- Measures and evaluates performance of substantially all of its investments on a fair value basis.

**Other typical characteristics** (not all have to be met, but if not met additional disclosures are required):
- More than one investment
- More than one investor
- Investors not related parties of the entity
- Ownership interests in the form of equity or similar interests.

#### RELATIONSHIP WITH OTHER PARTIES

In assessing control, an investor considers the nature of relationships with other parties and whether they are acting on the investor’s behalf (de facto agents).

**Examples**

- The investor’s related party
- A party whose interest in the investee is through a loan from the investor
- A party who has agreed not to sell, transfer, or encumber its interest in the investee without the approval of the investor
- A party that cannot fund its operations without investor (sub-ordinated) support
- An investee where the majority of the governing body or key management personnel are the same as that of the investor
- A party with a close business relationship with the investor.

#### NON-CONTROLLING INTERESTS

- A parent presents non-controlling interests in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent.
- Changes in a parent’s ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions.

#### CONSOLIDATION PROCEDURES

Consolidation procedures:

- Combine assets, liabilities, income, expenses, cash flows of the parent and subsidiary
- Eliminate parent’s investment in each subsidiary with its portion of the subsidiary’s equity
- Fully eliminate intra group transactions and balances
- Parent and subsidiaries must have uniform accounting policies and reporting dates. If not, alignment adjustments must be quantified and posted to ensure consistency
- Reporting dates cannot vary by more than 3 months.
- Consolidation of an investee begins from the date the investor obtains control of the investee and ceases when the investor loses control of the investee.

### TRANSITION REQUIREMENTS

Refer to Appendix C of IFRS 10.
For further information about how BDO can assist you and your organisation, please get in touch with one of our key contacts listed below.

Alternatively, please visit [www.bdo.global](http://www.bdo.global) where you can find full lists of regional and country contacts.

## EUROPE

<table>
<thead>
<tr>
<th>Name</th>
<th>Country</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Anne Catherine Farlay</td>
<td>France</td>
<td><a href="mailto:annecatherine.farlay@bdo.fr">annecatherine.farlay@bdo.fr</a></td>
</tr>
<tr>
<td>Jens Freiberg</td>
<td>Germany</td>
<td><a href="mailto:jens.freiberg@bdo.de">jens.freiberg@bdo.de</a></td>
</tr>
<tr>
<td>Teresa Morahan</td>
<td>Ireland</td>
<td><a href="mailto:tmorahan@bdo.ie">tmorahan@bdo.ie</a></td>
</tr>
<tr>
<td>Ehud Greenberg</td>
<td>Israel</td>
<td><a href="mailto:ehudg@bdo.co.il">ehudg@bdo.co.il</a></td>
</tr>
<tr>
<td>Stefano Bianchi</td>
<td>Italy</td>
<td><a href="mailto:stefano.bianchi@bdo.it">stefano.bianchi@bdo.it</a></td>
</tr>
<tr>
<td>Roald Beumer</td>
<td>Netherlands</td>
<td><a href="mailto:roald.beumer@bdo.nl">roald.beumer@bdo.nl</a></td>
</tr>
<tr>
<td>Reidar Jensen</td>
<td>Norway</td>
<td><a href="mailto:reidar.jensen@bdo.no">reidar.jensen@bdo.no</a></td>
</tr>
<tr>
<td>Leonid Sidelkovskiy</td>
<td>Russia</td>
<td><a href="mailto:L.Sidelkovskiy@bdo.ru">L.Sidelkovskiy@bdo.ru</a></td>
</tr>
<tr>
<td>David Cabaleiro</td>
<td>Spain</td>
<td><a href="mailto:david.cabaleiro@bdo.es">david.cabaleiro@bdo.es</a></td>
</tr>
<tr>
<td>Beat Rüfenacht</td>
<td>Switzerland</td>
<td><a href="mailto:beat.ruefenacht@bdo.ch">beat.ruefenacht@bdo.ch</a></td>
</tr>
<tr>
<td>Moses Serfaty</td>
<td>United Kingdom</td>
<td><a href="mailto:moses.serfaty@bdo.co.uk">moses.serfaty@bdo.co.uk</a></td>
</tr>
</tbody>
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## ASIA PACIFIC

<table>
<thead>
<tr>
<th>Name</th>
<th>Country</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aletta Boshoff</td>
<td>Australia</td>
<td><a href="mailto:aletta.boshoff@bdo.com.au">aletta.boshoff@bdo.com.au</a></td>
</tr>
<tr>
<td>Hu Jian Fei</td>
<td>China</td>
<td><a href="mailto:hu.jianfei@bdo.com.cn">hu.jianfei@bdo.com.cn</a></td>
</tr>
<tr>
<td>Fanny Hsiang</td>
<td>Hong Kong</td>
<td><a href="mailto:fannyhsiang@bdo.com.hk">fannyhsiang@bdo.com.hk</a></td>
</tr>
<tr>
<td>Pradeep Suresh</td>
<td>India</td>
<td><a href="mailto:pradeepsuresh@bdo.in">pradeepsuresh@bdo.in</a></td>
</tr>
<tr>
<td>Khoon Yeow Tan</td>
<td>Malaysia</td>
<td><a href="mailto:tanky@bdo.my">tanky@bdo.my</a></td>
</tr>
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## LATIN AMERICA

<table>
<thead>
<tr>
<th>Name</th>
<th>Country</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marcello Canetti</td>
<td>Argentina</td>
<td><a href="mailto:mcanetti@bdoargentina.com">mcanetti@bdoargentina.com</a></td>
</tr>
<tr>
<td>Victor Ramirez</td>
<td>Colombia</td>
<td><a href="mailto:vramirez@bdo.com.co">vramirez@bdo.com.co</a></td>
</tr>
<tr>
<td>Ernesto Bartesaghi</td>
<td>Uruguay</td>
<td><a href="mailto:ebartesaghi@bdo.com.uy">ebartesaghi@bdo.com.uy</a></td>
</tr>
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## NORTH AMERICA & CARIBBEAN

<table>
<thead>
<tr>
<th>Name</th>
<th>Country</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Armand Capisciolto</td>
<td>Canada</td>
<td><a href="mailto:acapisciolto@bdo.ca">acapisciolto@bdo.ca</a></td>
</tr>
<tr>
<td>Wendy Hambleton</td>
<td>USA</td>
<td><a href="mailto:whambleton@bdo.com">whambleton@bdo.com</a></td>
</tr>
</tbody>
</table>

## MIDDLE EAST

<table>
<thead>
<tr>
<th>Name</th>
<th>Country</th>
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</thead>
<tbody>
<tr>
<td>Arshad Gadit</td>
<td>Bahrain</td>
<td><a href="mailto:arshad.gadit@bdo.bh">arshad.gadit@bdo.bh</a></td>
</tr>
<tr>
<td>Antoine Gholam</td>
<td>Lebanon</td>
<td><a href="mailto:agholam@bdo-lb.com">agholam@bdo-lb.com</a></td>
</tr>
</tbody>
</table>

## SUB SAHARAN AFRICA

<table>
<thead>
<tr>
<th>Name</th>
<th>Country</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Theunis Schoeman</td>
<td>South Africa</td>
<td><a href="mailto:tschoeman@bdo.co.za">tschoeman@bdo.co.za</a></td>
</tr>
</tbody>
</table>
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