



**IFRS AT A GLANCE**  
**IFRS 10 *Consolidated Financial Statements***



# IFRS 10 Consolidated Financial Statements

## SCOPE

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

- It meets all 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).



### (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.

### (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.

## 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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## THE CONTROL MODEL (continued)

### (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 than its voting (or similar) rights.

**Substantive rights**

- ▶ Only substantive 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.

### (iv) Exposure, or rights, to variable returns (i.e. returns 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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## (v) Link between power and returns - delegated power

- ▶ When an investor with decision-making rights (a decision maker (DM)) assesses whether it controls an investee, it determines whether it is a principal or an agent. An agent is primarily engaged to act on behalf of the principal and therefore does not control the investee when it exercises its decision-making authority
- ▶ An investor may delegate its decision-making authority to an agent on specific issues or on all relevant activities. When assessing whether it controls an investee, the investor treats the decision-making rights delegated to its agent as held by itself directly
- ▶ A DM considers the relationship between itself, the investee and other parties involved, in particular the following factors below, in determining whether it is an agent.

Scope of decision making authority	Rights held by other parties	Remuneration	Returns from other interests
Activities permitted in agreements and specified by law: <ul style="list-style-type: none"> <li>▶ Discretion available on making decisions</li> <li>▶ Purpose and design of the investee:               <ul style="list-style-type: none"> <li>– Risks the investee was designed to be exposed to</li> <li>– Risks to be passed to other involved parties</li> <li>– Level of involvement of DM in design of the investee.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▶ May affect the DM's ability to direct relevant activities</li> <li>▶ Removal rights, or other rights, may indicate that the DM is an agent</li> <li>▶ Rights to restrict activities of the DM are treated the same as removal rights.</li> </ul>	The greater the magnitude of, and variability associated with the DM's remuneration relative to returns, the more likely the DM is a principal. <p>DM's consider if the following exists:</p> <ul style="list-style-type: none"> <li>▶ Remuneration is commensurate with the services provided</li> <li>▶ The remuneration includes only terms customarily present in arrangements for similar services and level of skills negotiated on an arm's length basis.</li> </ul>	An investor may hold other interests in an investee (e.g. investments, guarantees). In evaluating its exposure to variability of returns from other interests in the investee the following are considered: <ul style="list-style-type: none"> <li>▶ The greater the magnitude of, and variability associated with, its economic interests, considering its remuneration and other interests in aggregate, the more likely the DM is a principal</li> <li>▶ Whether the variability of returns is different from that of other investors and, if so, whether this might influence actions.</li> </ul>

## 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.



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## 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).

Such a relationship need not have a contractual arrangement, examples may be:

- ▶ The investor's related parties
- ▶ 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 interests in the investee without the approval of the investor
- ▶ A party that cannot fund its operations without investor (subordinated) 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.

## CONTROL OF SPECIFIED ASSETS (SILOS)

An investor considers whether it treats a portion of an investee as a deemed separate entity and whether it controls it. Control exists if and only if, the following conditions are satisfied:

- (i) Specified assets of the investee (and related credit enhancements, if any) are the only source of payment for specified liabilities of, or specified other interests in, the investee
- (ii) Parties other than those with the specified liability do not have rights or obligations related to the specified assets or to residual cash flows from those assets
- (iii) In substance, returns from the specified assets cannot be used by the remaining investee and none of the liabilities of the deemed separate entity are payable from the assets of the remaining investee.

Thus, in substance, all the assets, liabilities and equity of that deemed a separate entity are ring-fenced from the overall investee. Such a deemed separate entity is often called a 'silo'.

## LOSS OF CONTROL

- ▶ Derecognition of the assets and liabilities of the former subsidiary from the consolidated statement of financial position
- ▶ Recognition of any investment retained in the former subsidiary at its fair value when control is lost and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant IFRSs.

### Subsidiary constitutes a business

- ▶ Recognition of the gain or loss associated with the loss of control in profit or loss.

### Subsidiary does not constitute a business

- ▶ Recognition of the gain or loss in profit or loss to the extent of the unrelated investors' interest in the associate or joint venture. The remaining part is eliminated against the carrying amount of the investment
- ▶ Retained interest is an associate or joint venture using the equity method: Recognition of the gain or loss in profit or loss to the extent of the unrelated investors
- ▶ Retained interest accounted for at fair value in accordance with IFRS 9: Recognition of the gain or loss in full in profit or loss.

## 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.

## DISCLOSURE

Refer to IFRS 12  
*Disclosure of Interests in Other Entities.*

## TRANSITION REQUIREMENTS

Refer to Appendix C of IFRS 10.

# Contact

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

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