Snapshot – IFRS 10 – Consolidated Financial Statements

OBJECTIVE

To establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities

MEETING THIS OBJECTIVE

The standard
- Requires an entity (the parent) that controls one or more other entities (subsidiaries) to present consolidated financial statements
- Defines the principle of "control", and establishes control as the basis for consolidation
- Sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee
- Sets out the accounting requirements for the preparation of consolidated financial statements, and
- Defines an investment entity and sets out the exception to consolidating particular subsidiaries of an investment entity

SCOPE

IFRS 10 applies to all entities, except as follows
- If all of the following conditions are met, a parent need not present consolidated financial statements
  - 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 file, nor is in the process of filing, financial statements for the purpose of issuing instruments in a public market, and
  - Its ultimate or any intermediate parent produces consolidated financial statements that comply with the IFRSs and are available for public use
- Post or long-term employee benefit plans to which IAS 19 *Employee Benefits* applies
- An investment entity need not present consolidated financial statements but rather measure all of its subsidiaries at fair value through profit or loss

EFFECTIVE DATE

- Effective for annual periods beginning on or after 1 January 2013
- Amendments made to IFRS 10 with regards to Investment Entities, are effective for annual periods beginning on or after 1 January 2014
- Early application is permitted

THE CONTROL MODEL

CONTINUOUS ASSESSMENT – An investor must continuously assess whether it controls an investee

CONTROL (i.e. the investor controls the investee IF AND ONLY IF ALL of the following three element are met)

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POWER OVER THE INVESTEE

'Power' is defined as 'existing rights that give the current ability to direct the relevant activities'

Therefore, when assessing whether an investor has power, there are two critical concepts, existing rights and relevant activities

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EXPOSURE OR RIGHTS TO VARIABLE RETURNS

An investor is exposed or has rights to variable returns from its involvement with the investee. This refers to returns that are not fixed but rather vary depending on the performance of the investee

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LINK BETWEEN POWER AND RETURNS

The investor must have the ability to use its power to affect the amount of the investor's returns from its involvement with the investee

STEPS TO CONSIDER WHEN DETERMINING WHETHER THERE IS CONTROL

- Identifying the investee, consideration of its purpose and design
- Identifying the relevant activities of the investee
- Identifying how decisions about the relevant activities are made
- Assessing whether the investor controls the investee

IDENTIFYING THE INVESTEE, CONSIDERATION OF ITS PURPOSE AND DESIGN

The term "investee" is not defined in IFRS 10, therefore the purpose and design of an investee shall be considered by the investor when assessing whether it has control of an investee

Investee controlled by means of equity instruments
- An investor controls an investee when the investor holds majority of the voting rights and is able to exercise these rights to determine the investee's operating and financing policies and no additional arrangements that alter this decision-making are present

Where voting rights are not the dominant factor in determining control, the investor would need to consider

The design of the investee in terms of
- The risks the investee will be exposed to
- The risk it will pass on to the parties involved with it, and
- Whether the investor is exposed to some or all of that risk

By implication, if the investee's risk exposure is high, it passes part of it on to the investor and the investor is exposed to some of that risk, it is likely that the investee has been set up under the power of the investor

Refer to IFRS 10 Summary for detail on control of specified assets (Silo's)

IDENTIFYING THE RELEVANT ACTIVITIES OF THE INVESTEE

'Relevant activities' is a new concept which is integral to the control model as it assists in determining whether an investor has power over an investee

Definition of 'relevant activities' - these are activities of the investee that SIGNIFICANTLY affect the investee's returns

Examples of relevant activities include, but are not limited to:
- Selling and purchasing of goods or services
- Managing financial assets during their life
- Selecting, acquiring and disposing of assets
- Researching and developing new products or processes
- Determining a funding structure or obtaining funding

HOW DECISIONS ABOUT THE RELEVANT ACTIVITIES ARE MADE

The definition of "power" requires consideration of whether the investor has the current ability to direct the relevant activities, therefore it's important to consider how decisions about the relevant activities are made

Decisions about relevant activities are (but are not only limited to these two examples)
- Establishing operating and capital decisions of the investee, including budgets
- Appointing and remunerating an investee's key management personnel or service providers and terminating their services or employment

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STEPS TO CONSIDER WHEN DETERMINING WHETHER THERE IS CONTROL

Power arises from rights

- In the form of voting rights or potential voting rights
- To appoint, reassign, or remove members of an investee's key management personnel or any other entity that has the ability to direct the relevant activities
- To direct the investee to enter into or veto any changes to transactions for the benefit of the investor
- That give the holder the current ability to direct the relevant activities even if its rights to direct have yet to be exercised

When assessing power, only substantive rights that are NOT protective shall be considered

SUBSTANTIVE RIGHTS

A right is substantive when the holder of that right has the practical ability to exercise that right

Factors to consider when making this decision include (but are not limited to) whether

- There are barriers that prevent the holder from exercising its rights, for example laws and regulations
- There is a practical mechanism to facilitate multiple parties to collectively exercise their rights
- The party(s) holding the rights would benefit from the exercise of those rights
- The rights are exercisable when decisions about relevant activities need to be made

PROTECTIVE RIGHTS

Is defined as 'Rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate'

VOTING RIGHTS

Power with a majority of the voting rights

- Relevant activities are directed by a vote
- Majority of the governing body members are appointed by a vote

Majority of voting rights but no power

- Voting rights are not substantive
- Relevant activities are not directed by vote

Power without a majority of voting rights ("De facto power")

Power without a majority of voting rights can be exercised by ANY of the following

- Contractual arrangements with other vote holders
- Rights from other contractual arrangements
- The investor's voting rights
- The investor has the practical ability to direct the relevant activities unilaterally after considering all facts and circumstances

Potential voting rights

- Only considered if they are substantive
- Could arise from convertible instruments, options or forward contracts
- The investor must consider the purpose and the design of the instrument

MORE THAN A PASSIVE INTEREST

Sometimes there will be indications that an investor has more than simply a passive interest. This may indicate that the investor has other related rights sufficient to give it power or provide evidence of existing power over an investee.

Examples that suggest that the investor has a more than passive interest

- The investee's key management personnel who direct relevant activities are current or previous employees of the investor
- The investee's operations are dependent on the investor
- A significant portion of the investee's activities either involve or are conducted on behalf of the investor
- The investor's exposure or rights to returns is disproportionally greater than its voting or other similar rights

LINK BETWEEN POWER AND RETURNS

An investor with decision making rights has to determine whether it is a principal or an agent

An agent is defined as 'a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)) and therefore does not control the investee when it exercises its decision making authority'

Thus, sometimes a principal's power may be held and exercisable by an agent, but on behalf of the principal. An investor that is an agent does not control an investee when it exercises decision making rights delegated to it.

Principal versus Agent

To determine whether a decision maker is an agent, it shall consider the overall relationship between itself, the investee being managed and other parties involved with the investee

ALL the following factors also need to be considered

- Scope of decision making authority
- Remuneration
- Rights held by other parties
- Decision maker's returns from other interests in the investee

The evaluation of these factors is NOT required when a single party holds substantive rights to remove the decision maker without cause

Refer to IFRS 10 Summary for detail on these factors

INVESTMENT ENTITIES

An investment entity is defined as 'an entity that

- 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 the performance of substantially all of its investments on a fair value basis'

An investment entity shall NOT consolidate its subsidiaries but rather measure an investment in a subsidiary at fair value through profit or loss in accordance with IFRS 9

Refer IFRS 10 Summary for investment entity exceptions to this

RELATIONSHIP WITH OTHER PARTIES ("DE FACTO AGENTS")

When assessing control, an investor needs to consider the nature of its relationship with other parties. In doing so the investor must consider whether those other parties are acting on the investor's behalf (i.e. they are 'de facto agents'). Such a relationship need not have a contractual arrangement.

Refer to IFRS 10 Summary for examples of "de facto agents"

ACCOUNTING REQUIREMENTS

- **Consolidation** – Combine assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiary. Offset (eliminate) the parent's investment in each subsidiary with its portion of equity of the subsidiary. Eliminate in full all intra-group transactions and balances.
- Parent and its subsidiaries must have and apply **uniform accounting policies**, if not, alignment adjustments must be quantified and posted
- Consolidation **begins** from the date the investor gains control of an investee and ceases when the investor loses control of an investee
- **Reporting dates** cannot vary by more than 3 months

DISCLOSURE AND ACCOUNTING TREATMENT OF NON-CONTROLLING INTERESTS

A parent must present 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.

ACCOUNTING TREATMENT – LOSS OF CONTROL

If the parent loses control of a subsidiary, the parent will

- Derecognise the assets and liabilities of the former subsidiary
- Recognise 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
- Recognise the gain or loss associated with the loss of control in profit or loss