IFRS 10 CONSOLIDATED FINANCIAL STATEMENTS

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IFRS 10- Consolidated Financial Statements

SCOPE

This standard applies to all entities except:

If all the following conditions are met, consolidation not required :

- ❖ 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;
- ❖ If neither Debt or Equity instruments are traded in public
- ❖ 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 benefits plans as per IAS 19.

NOTE- An investment entity need not present consolidated financial statements but rather measure all of its subsidiaries at fair value through profit or loss.

DEFINITIONS

Consolidated Financial Statements-
The financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.

Investment Entity-
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, and measures and evaluates the performance of substantially all of its investments on a fair value basis.

Parent-
An entity that controls one or more entities

Control of the Investee-
An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

Protective Rights-
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.

Relevant Activities-
Activities of the investee that significantly affect the investee's returns

Power-
Existing rights that gives the current ability to direct the relevant activities

INVESTMENT ENTITIES

Entities that obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services and commits them that, its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both also.

Measures and evaluates performance of substantially all of its investments on a fair value basis. Its characteristics are-

- ❖ 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.

CONTROL MODEL

The control model under IFRS 10 is based on the existence of three elements of control. When all of the following three elements of control are present then an investor is considered to control an investee and consolidation is required.

1. Power of Investor over Investee
2. exposure, or rights, to variable returns
3. the ability to use its power to affect the amount of the investor's returns

The investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above

STEPS INVOLVED WHILE DETERMINING CONTROL

Purpose and Design of Investee

Identifying relevant activities of investee

Identify how decisions are made i.e power on investee

Identify whether control still exists on investee

STEP 1- PURPOSE & DESIGN OF INVESTEE

When assessing control of an investee, an investor shall consider

1. How decisions about relevant activities are made?
2. Who has the current ability to direct those activities?
3. Who receives the return from those activities?

The Investee is said to

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

I. The risks the investee was designed to be exposed to;
II. The risk it is designed to pass on to the parties involved with it; and
III. Whether the investor is exposed to some or all of that risk

Consideration of the risks includes not only the downside risk, but also the potential risks.

STEP 2- RELEVANT ACTIVITIES AND DIRECTION OF RELEVANT ACTTIVITIES

Examples of activities that, depending on the circumstances, can be relevant activities include, but are not limited to:

(a) Selling and purchasing of goods or services;
(b) Managing financial assets during their life (including upon default);
(c) Selecting, acquiring or disposing of assets;
(d) Researching and developing new products or processes; and
(e) Determining a funding structure or obtaining funding.
It integral step to the control model as it assists in determining whether an investor has power over an investee

STEP 3- RIGHTS THAT GIVE AN INVESTOR POWER OVER AN INVESTEE

Rights of investor includes but not limited to

1. Right to Vote
2. Right to appoint , resign or remove investee's KMPs
3. Right to direct the investee for the activities that are beneficial to him.
4. Other decision making rights.

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

Substantive rights:

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

- Existence of barriers that prevent the holder from exercising its rights, for example Legal barriers
- Existence of multiple parties to collectively exercise their rights
- The party(s) holding the rights would achieve some benefit from the exercise of those rights
- The rights are exercised when decisions about relevant activities need to be made.

Protective rights

Rights which are designed to protect the interests of the holder, but do not give the holder power over the investee, therefore an investor that only holds protective rights does not have power over an investee.

Franchise arrangements are generally considered protective rights.

Voting rights :

Power to Vote

- 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

De-facto control

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

Step 4 . Exposure, or rights, to variable returns

Variable returns are those returns which are not fixed but are dependent on the performance of the investee. In order to determine this, the investor should focus on substance of arrangement not the legal form. e.g.

- Dividend, interest, management fees
- Fees from servicing assets or liabilities
- Synergies etc.

POWER AND RETURNS ARE INTERLINKED LINKED **i.e. delegated power**
While exercising decision making rights investor needs to check whether it has control over investee, in order to check this he should first determine whether it is a principal or agent

Does the investor have the ability to use its power and affect the amount of its returns?

YES

Investor is principal if he:

- Is a decision maker
- has rights to remove any management personal
- has rights over remuneration decisions
- has exposure to variability of returns from other interests it holds in the investee

NO

If the Investor has delegated his rights to other parties' i. e De-facto agents but indirectly has exposure to variability of returns as its own

If above conditions not satisfied then investor is an agent, it does not control the investee.

NON controlling interest

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.

Loss of control - Accounting treatment:

If the parent loses control of a subsidiary, the parent shall:

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.

That fair value shall be regarded as the fair value on initial recognition of a financial asset in accordance with IFRS 9 or, when appropriate, the cost on initial recognition of an investment in associate or joint venture.

Recognise the gain or loss associated with the loss of control in profit or loss.

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