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IFRS 10 *Consolidated Financial Statements*

Presenter:
Anton van Wyk M. Com CA (SA)

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Presenter

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Anton van Wyk M. Com CA (SA)

Anton van Wyk is a **chartered accountant** and independent consultant in International Financial Reporting Standards (IFRS and IFRS for SMEs). As former subject head of Financial Accounting at various higher education providers (including the University of Johannesburg and Monash University South Africa), he has gained valuable insights into and understanding of the important principles underlying the International Financial Reporting Standards (IFRS). Anton is a well-known and popular presenter who has presented numerous IFRS updates for several accounting bodies across South Africa. He is known for his ability to simplify and highlight the most important principles contained in IFRS, whilst keeping the learning process enjoyable for attendees.

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Welcome to the webinar

- IFRS 10 *Consolidated Financial Statements*

- Agenda

1. Introduction to IFRS 10
2. The scope of IFRS 10
3. What is “control”?
4. Accounting requirements
5. Investment entities (in summary)

IFRS 10

Introduction

IFRS 10 *Consolidated Financial Statements*

Pre-IFRS 10

- IAS 27 *Separate and Consolidated Financial Statements*
  - Jointly dealt with parent entities who elected to prepare separate AFS, **and** were required to prepare consolidated financial statements
  - **Control** defined as "the power to **govern** the financial and operating policy decisions of another entity"
  - Not very prescriptive about certain aspects, such as recognition of a gain or loss on disposal of an interest *where control is **not** relinquished*

    (e.g. 80% controlling interest → 60% controlling interest)

IFRS 10

- The objective of IFRS 10 is to establish principles for the **presentation** and preparation of **consolidated** financial statements when an entity **controls** one or more other entities
- To meet this objective, IFRS 10:
  - 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 an exception to consolidating particular subsidiaries of an investment entity
- IFRS 10 does not deal with the accounting for *business combination transactions* and/or their impact on consolidated financial statements, and also not with goodwill arising from a business combination transaction

IFRS 10 versus IAS 27

- IAS 27 was retained, but now only deals with parent entities who specifically elect to prepare **separate** financial statements
  - Renamed to IAS 27 *Separate Financial Statements*
- Three types of financial statements in IFRS:
  - Individual AFS (IAS 1 *Presentation of Financial Statements* and rest of IFRSs)
  - Separate AFS (an election, per IAS 27, only parent entities)
  - Consolidated AFS (IFRS 10, implied)
- IFRS 10 contains a new definition of control, which makes the old definition per IAS 27 redundant
- Disclosure requirements relating to (among others) subsidiaries, included in the new IFRS 12 *Disclosure of Interests in Other Entities*

IFRS 10 and other IFRSs

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- IFRS 10 *Consolidated Financial Statements*

- IAS 27 *Separate Financial Statements*
- IFRS 11 *Joint Arrangements*
- IFRS 12 *Disclosure of Interests in Other Entities*
- IFRS 3 *Business Combinations*
- IAS 28 *Investments in Associates and Joint Ventures*
- IFRS 9 *Financial Instruments*

IFRS 10 is inextricably linked to the other IFRSs and IASs

IFRS 10

IFRS 10 *Consolidated Financial Statements*

The scope of IFRS 10

Relevant terminology

- A **parent** is an entity that <u>controls</u> one or more entities
  - *Control is investigated in more detail in the next section*

Exemption from consolidated AFS

- <u>CRUX:</u> Any entity that is a PARENT, is **required to present consolidated financial statements**
- A parent is **EXEMPT** from preparing consolidated financial statements if it satisfies ALL four the following conditions:
  - it is a wholly-owned subsidiary or is a partially-owned 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 (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets)
  - it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market and
  - its ultimate or any intermediate parent produces financial statements that are available for public use and comply with IFRSs, in which subsidiaries are consolidated <u>or</u> are measured at fair value through profit or loss in accordance with this IFRS (inv. entities)

Two more exemptions

- Post-employment benefit plans and other long-term employee benefit plans within the scope of IAS 19 *Employee Benefits*, are not within the scope of IFRS 10
- A parent that is an *investment entity* shall not present consolidated financial statements if it is required, in accordance with IFRS 10, to measure all of its subsidiaries at fair value through profit or loss *(will be dealt with later)*

IFRS 10

IFRS 10 *Consolidated Financial Statements*

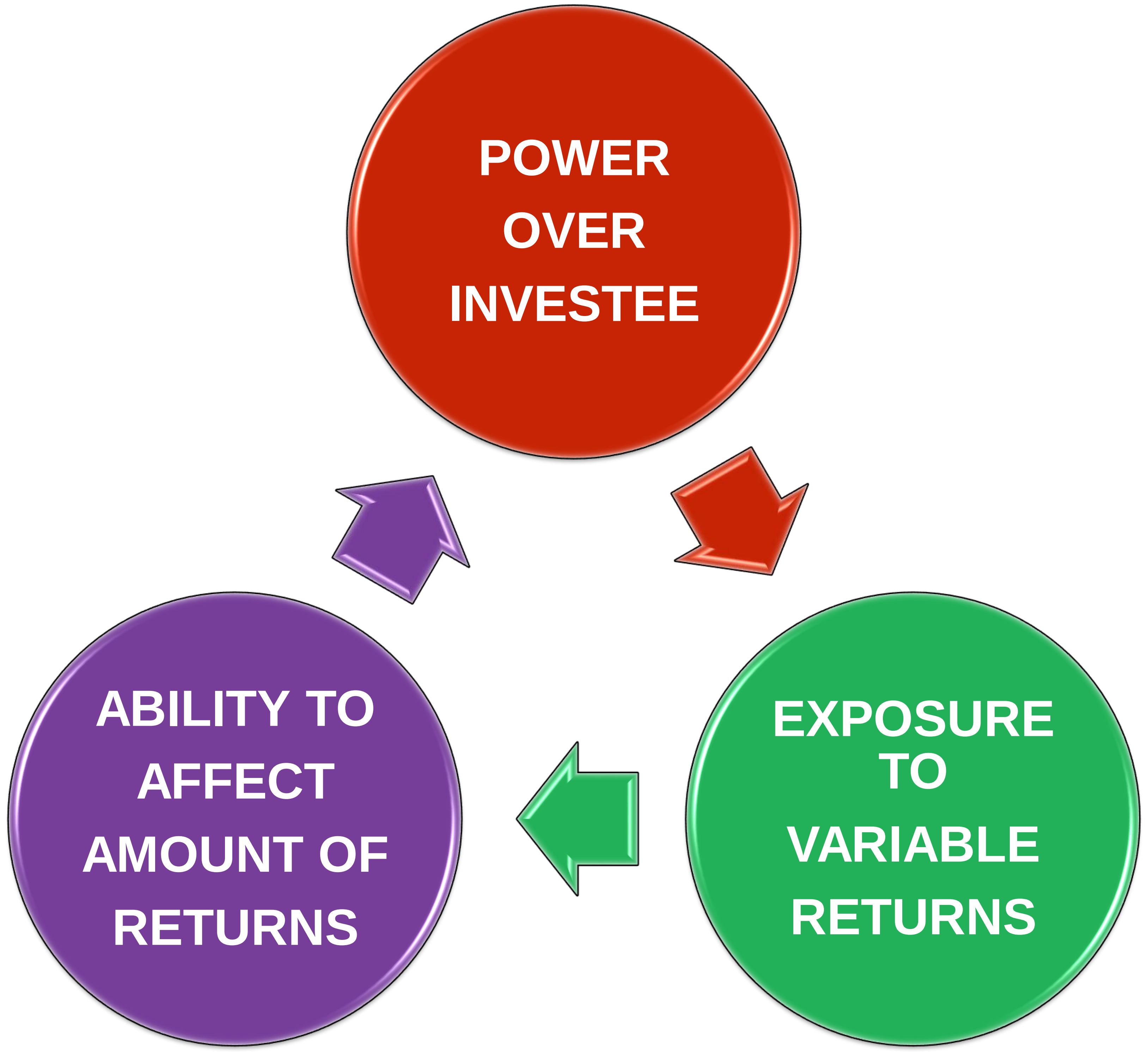
What is control?

Control – what is it now?

An investor **controls** an investee when:

- it is **exposed** to (*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

POWER
EXPOSURE
ABILITY



Control assessment

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- **5 questions need to be considered:**

1. What is the purpose and design of the investee?
2. What are the relevant activities of the investee and how are decisions made about those relevant activities?
3. Do the rights that the investor holds, give the investor the current ability to direct the relevant activities?
4. Is the investor exposed, or does the investor have rights to, variable returns from its involvement with the investee?
5. Does the investor have the ability to use its power over the investee to affect the amount of the investor's returns?

Purpose and design of investee

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What are the RAs? *(will be dealt with later)*

"Activities of the investee that significantly affect the investee's returns"

Aspects we would want to understand are:

- How are decisions made about the RAs? Board of directors' meetings? Shareholders' meetings?
- Who are the key decision-makers?
  - *Decision-maker = an entity with decision-making rights that is either a principal, or an agent for other parties*
- Who has the current ability to direct the RAs?
- Who receives returns from the investee?
- Are there agreements in place that alter decision-making?
- Are voting rights the dominating factor in deciding who controls the entity? E.g. the RAs could be directed by contractual arrangements?
- To which upside and downside risks is the investor exposed due to its involvement with the investee?

So, from here?

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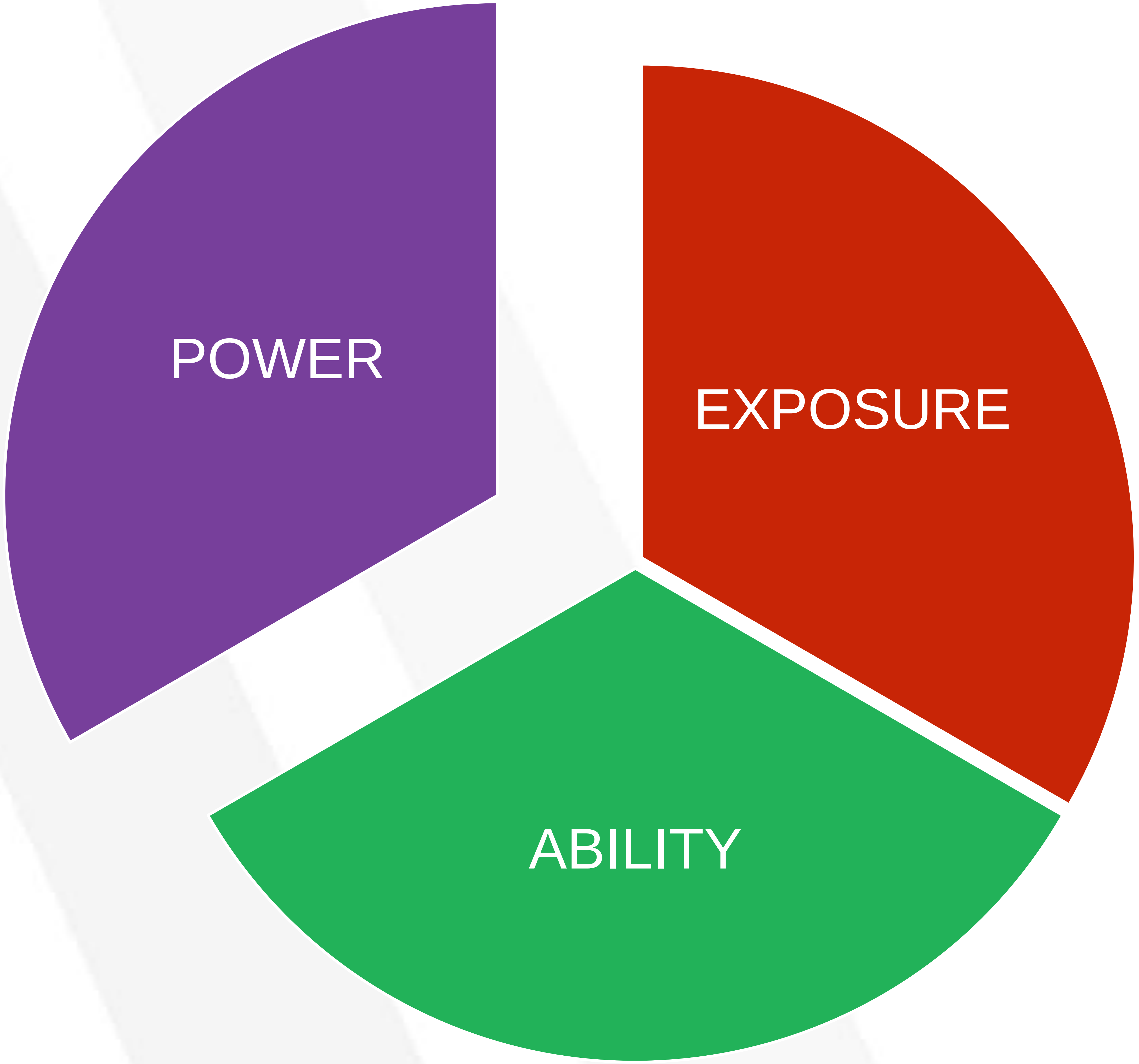

Power (a.k.a. rights)

- An investor has **power** over an investee when the investor has:
  - existing rights (power arises from rights),
  - that give it the current (practical) ability,
  - to direct the relevant activities

Rights

(what are they?)

Ability

(How?)

Direct

Relevant activities (what are relevant activities?)

Power: Relevant Activities

- For the purpose of IFRS 10, **relevant activities (RAs)** are activities of the investee that significantly affect the investee's returns
- Examples of **relevant activities** could be:
  - selling and purchasing of goods or services
  - managing financial assets during their life (including upon default)
  - selecting, acquiring or disposing of assets
  - researching and developing new products or processes
  - determining a funding structure or obtaining funding
- Examples of **decisions about** relevant activities could be:
  - 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
- In some situations, activities both **before and after** a particular set of circumstances arises/event occurs, may be *relevant activities* (i.e. multiple relevant activities)
  - When two or more investors have the current ability to direct relevant activities and those activities occur at different times, the investors shall determine which investor is able to direct the activities that most significantly affect those returns consistently with the treatment of concurrent decision-making rights. The investors shall reconsider this assessment over time if relevant facts or circumstances change

Example: RAs

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Two investors form an entity to develop and market a medical product.

One investor is responsible for developing and obtaining regulatory approval of the medical product – that responsibility includes having the unilateral ability to make all decisions relating to the development of the product and to obtaining regulatory approval.

Once the regulator has approved the product, the other investor will manufacture and market it – this investor has the unilateral ability to make all decisions about the manufacture and marketing of the product.

What are the relevant activities of the entity?

*(… **relevant activities** are activities of the investee that significantly affect the investee's returns)*

Solution

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- It appears that there are **two groups** of relevant activities *(i.e. multiple relevant activities)*
  - Set 1: Development and regulatory approval of medical product
  - Set 2: Manufacture and marketing of medical product
- Both sets of activities appear to be relevant as they both have the potential to each <u>significantly</u> affect the investee's returns to investors
- Each investor will therefore have to decide whether *Set 1* or *Set 2* above is the set of activities that most significantly affects the investee's returns, and whether it is able to direct that set of activities (i.e. power)
- The investors will decide taking cognizance of:
  - The purpose and design of the investee
  - Factors that determine profit margin, revenue and value of investee, as well as the value of the medical product
  - Each investor's decision-making authority w.r.t. the previous point
  - Each investor's exposure to variability in returns from the investee
  - The uncertainty of (and effort required in) obtaining regulatory approval (consider the investor's record of success in similar set of activities)
  - Which investor controls the medical product once the development phase is successfully completed

Power: Rights & Ability

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- Examples of **rights** that could provide the investor with power:
  - 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 who have the ability to direct the relevant activities
  - rights to appoint or remove another entity that directs the relevant activities
  - rights to direct the investee to enter 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

Power: Rights & Ability

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- Generally, when an investee has a range of operating and financing activities that significantly affect the investee's returns and when substantive decision-making with respect to these activities is required continuously, it will be **voting or similar rights** that give an investor power, either individually or in combination with other arrangements
- If an investor has **a real current ability to direct the RAs** of an entity, the investor has power, even if its rights to direct are yet to be exercised (NB)
  - Establishes the principle that rights must be *substantive*, i.e. the assessment must be done very realistically
  - Evidence that the investor has been directing the RAs, can assist to determine if the investor has power, but are not conclusive in itself
- If two or more investors have existing rights that give them the unilateral ability to direct different RAs, the investor that has the current ability to direct the activities that most significantly affect the returns of the investee, has power over the investee
- An investor that holds only *protective* rights, does not have power over the investee
  - 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

Power: Rights & Ability

- In more complex situations, where power is not merely based on voting rights, the investor is required to determine whether it has the **practical ability** to unilaterally direct the relevant activities of the investee
- The following may provide evidence of such practical ability:
  - The investor can, without having the contractual right to do so, appoint or approve the investee's key management personnel who have the ability to direct the relevant activities
  - The investor can, without having the contractual right to do so, direct the investee to enter into, or can veto any changes to, significant transactions for the benefit of the investor
  - The investor can dominate either the nominations process for electing members of the investee's governing body or the obtaining of proxies from other holders of voting rights
  - The investee's key management personnel are related parties of the investor (for example, the chief executive officer of the investee and the chief executive officer of the investor are the same person)
  - The majority of the members of the investee's governing body are related parties of the investor

Power: Rights & Ability

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- Remember: In order to be considered, the rights of the investor have to be **SUBSTANTIVE**, which means that the holder thereof must have the **practical ability to exercise** those rights to direct
  - *The practical ability to exercise must also be currently exercisable*
- Which factors are considered to determine whether rights are substantive (i.e. holder has practical ability to exercise the rights)?
  - Whether there are any **barriers** (economic or otherwise) that prevent the holder/s from exercising the rights?
  - When the exercise of rights requires the agreement of more than one party, or when the rights are held by more than one party, whether a **mechanism** is in place that provides those parties with the practical ability to exercise their rights collectively if they choose to do so. The lack of such a mechanism is an indicator that the rights may not be substantive. The more parties that are required to agree to exercise the rights, the less likely it is that those rights are substantive. However, a board of directors whose members are independent of the decision-maker, may serve as a *mechanism* for numerous investors to act collectively in exercising their rights. Therefore, removal rights (rights to deprive the decision maker of its decision-making authority) exercisable by an independent board of directors, are more likely to be substantive than if the same rights were exercisable individually by a large number of investors
  - Whether the party/s that hold the rights would **benefit from the exercise** of those rights. For example, the holder of potential voting rights in an investee shall consider the exercise/conversion price of the instrument. The terms and conditions of potential voting rights are more likely to be substantive when the instrument is in the money or the investor would benefit for other reasons (e.g. by realising synergies between the investor and the investee) from the exercise or conversion of the instrument

Power: Rights & Ability

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- **How strong must rights be to be substantive?**
- **As an example:** Substantive rights exercisable by *other parties* can prevent an investor from controlling the investee to which those rights relate
- Such substantive rights **do not** require the holders to have the ability to initiate decisions
- As long as the rights are not merely *protective*, substantive rights held by other parties may prevent the investor from controlling the investee even if the rights give the holders only the current ability (being practical too) to approve or block decisions that relate to the relevant activities

PROTECTIVE ⟷ SUBSTANTIVE

Power: Rights & Ability

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- **What are *protective* rights?**
- Examples of protective rights include but are not limited to:
  - a lender's right to restrict a borrower from undertaking activities that could significantly change the credit risk of the borrower to the detriment of the lender
  - the right of a party holding a non-controlling interest in an investee to approve capital expenditure greater than that required in the ordinary course of business, or to approve the issue of equity or debt instruments
  - the right of a lender to seize the assets of a borrower if the borrower fails to meet specified loan repayment conditions

Example 1: Rights & Ability

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Case study info: practical ability to exercise rights (substantive)

The investee has annual shareholder meetings at which decisions to direct the relevant activities are made.

The next scheduled shareholders' meeting is in *eight* months.

However, shareholders that individually or collectively hold at least 5% of the voting rights can call a special meeting to change the existing policies over the relevant activities, but a requirement to give notice to the other shareholders means that such a meeting cannot be held for at least 30 days.

Policies over the relevant activities can be changed only at special or scheduled shareholders' meetings.

This includes the approval of material sales of assets as well as the making or disposing of significant investments.

Solution (1)

- An investor holds a majority of the voting rights in the investee
  - The investor's voting rights are substantive because the investor is able to make decisions about the direction of the relevant activities when they need to be made. The fact that it takes 30 days before the investor can exercise its voting rights does not stop the investor from having the current ability to direct the relevant activities from the moment the investor acquires the shareholding
- An investor is party to a forward contract to acquire the majority of shares in the investee. The forward contract's settlement date is in 25 days
  - The existing shareholders are unable to change the existing policies over the relevant activities because a special meeting cannot be held for at least 30 days, at which point the forward contract will have been settled. Thus, the investor has rights that are essentially equivalent to the majority shareholder in example above (i.e. the investor holding the forward contract can make decisions about the direction of the relevant activities when they need to be made). The investor's forward contract is a substantive right that gives the investor the current ability to direct the relevant activities even before the forward contract is settled

Solution (2)

- An investor holds a substantive option to acquire the majority of shares in the investee that is exercisable in 25 days and is deeply in the money
  - The same conclusion would be reached as in previous example
- An investor is party to a forward contract to acquire the majority of shares in the investee, with no other related rights over the investee. The forward contract's settlement date is in six months.
  - In contrast to the examples above, the investor does <u>not</u> have the current ability to direct the relevant activities. The existing shareholders have the current ability to direct the relevant activities because they can change the existing policies over the relevant activities <u>before</u> the forward contract is settled

Power: Rights & Ability

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- Sometimes there will be indications that the investor has a **special relationship** with the investee, which suggests that the investor has more than a passive interest in the investee. The existence of any individual indicator, or a particular combination of indicators, does not necessarily mean that the power criterion is met. However, having more than a passive interest in the investee may indicate that the investor has **other related rights** sufficient to give it power or provide evidence of existing power over an investee.
- For example, the following suggests that the investor has more than a passive interest in the investee and, in combination with other rights, may indicate power:
  - The investee's key management personnel who have the ability to direct the relevant activities are current or previous employees of the investor
  - The investee's operations are dependent on the investor, for example the investee depends on the investor to fund a significant portion of its operations, the investor guarantees a significant portion of the investee's obligations, the investee depends on the investor for critical services, technology, supplies or raw materials, the investor controls assets such as licences or trademarks that are critical to the investee's operations, the investee depends on the investor for key management personnel, such as when the investor's personnel have specialised knowledge of the investee's operations etc.
  - 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 from its involvement with the investee is disproportionately greater than its voting or other similar rights. For example, there may be a situation in which an investor is entitled, or exposed, to more than half of the returns of the investee but holds less than half of the voting rights of the investee
- The greater an investor's exposure, or rights, to variability of returns from its involvement with an investee, the greater is the incentive for the investor to obtain rights sufficient to give it power. Therefore, having a large exposure to variability of returns is an indicator that the investor may have power.
- However, the extent of the investor's exposure does not, in itself, determine whether an investor has power over the investee.

Power: Rights & Ability

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When assessing whether an investor's voting rights are sufficient to give it power, an investor considers all facts and circumstances, including:

- the **size** of the investor's holding of **voting rights** relative to the size and dispersion of holdings of the other vote holders, noting that:
  - the more voting rights an investor holds, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities
  - the more voting rights an investor holds relative to other vote holders, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities
  - the more parties that would need to act together to outvote the investor, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities
- **potential voting rights** held by the investor, other vote holders or other parties
- rights arising from **other contractual arrangements** and
- any additional **facts and circumstances** that indicate the investor has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings

Example 2: Rights & Ability

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- Investor A holds 45% of the voting rights of an investee.
- Two other investors each hold 26% of the voting rights of the investee.
- The remaining voting rights are held by three other shareholders, each holding 1%.
- There are no other arrangements that affect decision-making.
- In this case, the size of investor A's voting interest and its size relative to the other shareholdings are sufficient to conclude that investor A does not have power. Only two other investors would need to co-operate to be able to prevent investor A from directing the relevant activities of the investee.

Example 3: Rights & Ability

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- An investor holds 35% of the voting rights of an investee.
- Three other shareholders each hold 5% of the voting rights of the investee.
- The remaining voting rights are held by numerous other shareholders, none individually holding more than 1% of the voting rights.
- None of the shareholders has arrangements to consult any of the others or make collective decisions.
- Decisions about the relevant activities of the investee require the approval of a majority of votes cast at relevant shareholders' meetings — 75% of the voting rights of the investee have been cast at recent relevant shareholders' meetings.
- In this case, the active participation of the other shareholders at recent shareholders' meetings indicates that the investor would not have the practical ability to direct the relevant activities unilaterally, regardless of whether the investor has directed the relevant activities because a sufficient number of other shareholders voted in the same way as the investor.

Example 4: Rights & Ability

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- Investor A holds 70% of the voting rights of an investee.
- Investor B has 30% of the voting rights of the investee as well as an option to acquire half of investor A's voting rights.
- The option is exercisable for the next two years at a fixed price that is deeply out of the money (and is expected to remain so for that two-year period).
- Investor A has been exercising its votes and is actively directing the relevant activities of the investee.
- In such a case, investor A is likely to meet the power criterion because it appears to have the current ability to direct the relevant activities. Although investor B has currently exercisable options to purchase additional voting rights (that, if exercised, would give it a majority of the voting rights in the investee), the terms and conditions associated with those options are such that the options are not considered substantive.

Exposure to variable returns

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- Examples of **returns** include:
  - 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
  - remuneration for servicing an investee's assets or liabilities, fees and exposure to loss from providing credit or liquidity support, residual interests in the investee's assets and liabilities on liquidation of that investee, tax benefits, and access to future liquidity that an investor has from its involvement with an investee
  - returns that are not available to other interest holders. For example, an investor might use its assets in combination with the assets of the investee, such as combining operating functions to achieve economies of scale, cost savings, sourcing scarce products, gaining access to proprietary knowledge or limiting some operations or assets, to enhance the value of the investor's other assets
- **When are such returns variable?**

Exposure to variable returns

- Variable returns are returns that are not fixed and have the potential to vary as a result of the performance of an investee
- Variable returns can be only positive, only negative or both positive and negative
- An investor assesses whether returns from an investee are variable and how variable those returns are on the basis of the substance of the arrangement and regardless of the legal form of the returns
- For example, an investor can hold a bond with fixed interest payments. The fixed interest payments are variable returns for the purpose of IFRS 10 because they are subject to default risk and they expose the investor to the credit risk of the issuer of the bond. The amount of variability (i.e. how variable those returns are) depends on the credit risk of the bond
- Similarly, fixed performance fees for managing an investee's assets are variable returns because they expose the investor to the performance risk of the investee. The amount of variability depends on the investee's ability to generate sufficient income to pay the fee

The link between power & returns

- An important part of assessing whether an investor controls an investee, is to establish whether the investor is a **principal or an agent**
- It is also important to establish whether *another* party with decision-making powers is acting as an agent for the investor
  - An 'agent' is a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)) and therefore <u>does not control the investee</u> when it exercises its decision-making authority
  - This means that the principal has **delegated** its decision-making rights to the agent
- <u>But:</u> a decision-maker does not automatically become an agent because others can benefit from its decision-making

The link between power & returns

Investor could be:

An agent

Can have decision-making powers (delegated by principal)

<u>Cannot</u> control the investee

A principal

Considers its own decision-making powers AND those of its agent, to assess if it has control over investee

The link between power & returns

- Factors to consider to determine whether the decision maker is an agent
  - the scope of its decision-making authority over the investee (decisions, discretion, involvement in design of entity etc.)
  - the (substantive) rights held by *other* parties
  - the remuneration to which it is entitled in accordance with the remuneration agreement(s) (i.e. relative to activities? variability?)
  - the decision maker's exposure to variability of returns from other interests that it holds in the investee (returns, variability, subordinations)
- If a single party holds substantive removal rights (i.e. rights to remove the decision maker) and can remove the decision maker without cause, the above need not be assessed

The link between power & returns

- **Take note:** some persons may be directed to act on behalf of the investor, without having contractually entered into a principal/agent relationship
- Such parties are referred to as *de facto* agents, for example:
  - the investor's related parties
  - a party that received its interest in the investee as a contribution or loan from the investor
  - a party that has agreed not to sell, transfer or encumber its interests in the investee without the investor's prior approval (except for situations in which the investor and the other party have the right of prior approval and the rights are based on mutually agreed terms by willing independent parties)
  - a party that cannot finance its operations without subordinated financial support from the investor
  - an investee for which the majority of the members of its governing body or for which its key management personnel are the same as those of the investor
  - a party that has a close business relationship with the investor, such as the relationship between a professional service provider and one of its significant clients
- In these circumstances, the investor shall consider its *de facto* agent's decision-making rights and its indirect exposure, or rights, to variable returns through the de facto agent together with its own, when assessing control of an investee

IFRS 10

IFRS 10 *Consolidated Financial Statements*

Accounting requirements in IFRS 10

Accounting requirements

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- Very small section of IFRS 10…
- A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances
- Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee
- Basic guidance provided (App B) on consolidation procedures
- Certain *pro forma adjustments* may be required in the consolidated financial statements, for example increasing depreciation on depreciable PP&E to reflect the fair value of the PP&E at the acquisition date (i.t.o. IFRS 3 *Business Combinations)*
- Potential voting rights do NOT impact profit allocation at group level – they are merely considered to determine control
- The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall have the same reporting date
  - If not practicable: use sub's reporting date, make adjustments
  - Even so, the difference may not exceed 3 months

Accounting requirements

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- An entity shall attribute the P&L as well as every component of OCI to the owners of the parent and the NCI's
- An entity shall also attribute total comprehensive income to the owners of the parent and the NCI's, even if this results in a debit (deficit) balance
- If a sub has outstanding cumulative preference shares that are classified as equity (i.e. not a FL) and are held by NCI's, the entity will compute its share of profit or loss after adjusting for the preference dividends on the shares, whether declared or not

Accounting requirements

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- Disposal of interest with NO loss of control/acquisition of further interest in an existing subsidiary
  - When the proportion of the equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary
  - The entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent

Accounting requirements

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

- **(a) derecognise:**
  - the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost; and
  - the carrying amount of any non-controlling interests in the former subsidiary at the date when control is lost (including any components of other comprehensive income attributable to them).

- **(b) recognise:**
  - the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control;
  - if the transaction, event or circumstances that resulted in the loss of control involves a distribution of shares of the subsidiary to owners in their capacity as owners, that distribution; and
  - any investment retained in the former subsidiary at its fair value at the date when control is lost.

- (c) **reclassify** to profit or loss, or **transfer directly** to retained earnings if required by other IFRSs, the amounts recognised in other comprehensive income in relation to the subsidiary.

- (d) **recognise** any resulting difference as a gain or loss in profit or loss attributable to the parent.

Accounting requirements

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- **What happens to OCI when the parent loses control?**
- If a parent loses control of a subsidiary, the parent shall account for all amounts previously recognised in **other comprehensive income** in relation to that subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities.
- Therefore, if a gain or loss previously recognised in other comprehensive income would be reclassified to profit or loss on the disposal of the related assets or liabilities, the parent shall reclassify the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses control of the subsidiary. If a revaluation surplus previously recognised in other comprehensive income would be transferred directly to retained earnings on the disposal of the asset, the parent shall transfer the revaluation surplus directly to retained earnings when it loses control of the subsidiary.

IFRS 10

IFRS 10 *Consolidated Financial Statements*

Investment Entities (IE)

What is an IE?

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- An **investment entity** is an entity that:
- (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services
- (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both and
- (c) measures and evaluates the performance of substantially all of its investments on a fair value basis

Characteristics of IEs

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- An entity shall consider whether it has the following typical characteristics of an investment entity:
  - (a) it has more than one investment
  - (b) it has more than one investor
  - (c) it has investors that are not related parties of the entity and
  - (d) it has ownership interests in the form of equity or similar interests
- The absence of any of these typical characteristics does not necessarily disqualify an entity from being classified as an investment entity
- An investment entity that does not have all of these typical characteristics provides additional disclosure required by IFRS 12 *Disclosure of Interests in Other Entities*

Why are IEs relevant?

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- An investment entity itself:
  - Shall not consolidated its investments in subsidiaries (i.e. exempt from consolidation i.t.o. IFRS 10)
  - Shall not apply IFRS 3 *Business Combinations* when it obtains control over an investee
  - Shall measure an investment in a subsidiary at FVTPL in terms of IFRS 9 *Financial Instruments*
- A parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity

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Thank you for your participation

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