



# INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF KENYA

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Credibility

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# IFRS 10

## Consolidated Financial Statements

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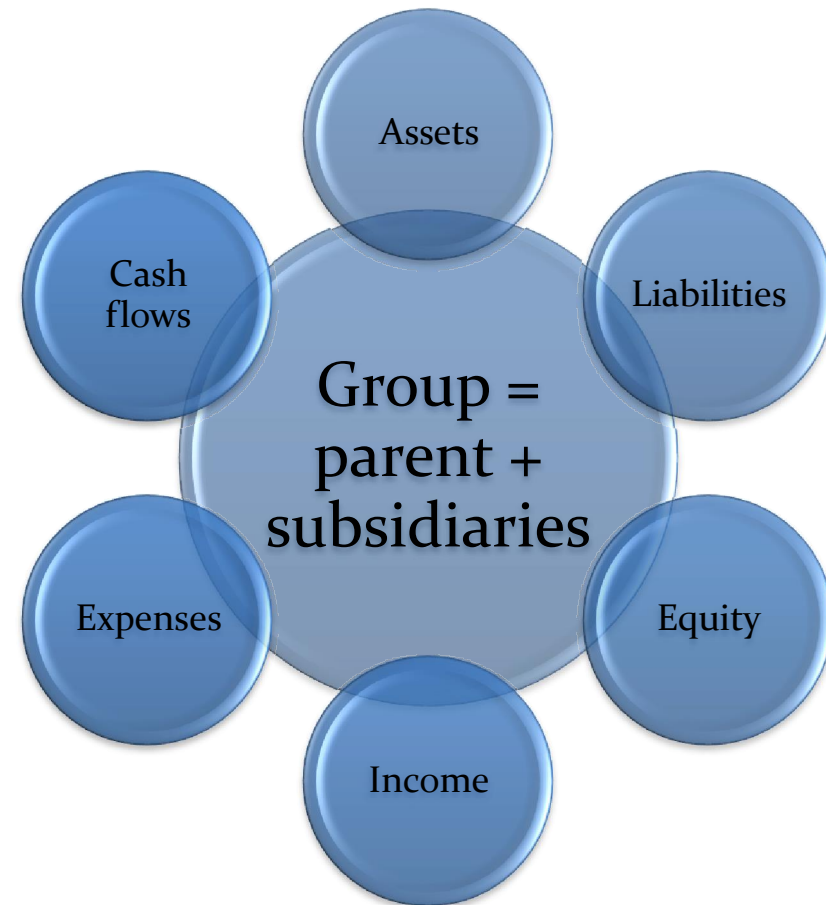
# IFRS 10: Consolidated Financial Statements

## 1. Objective

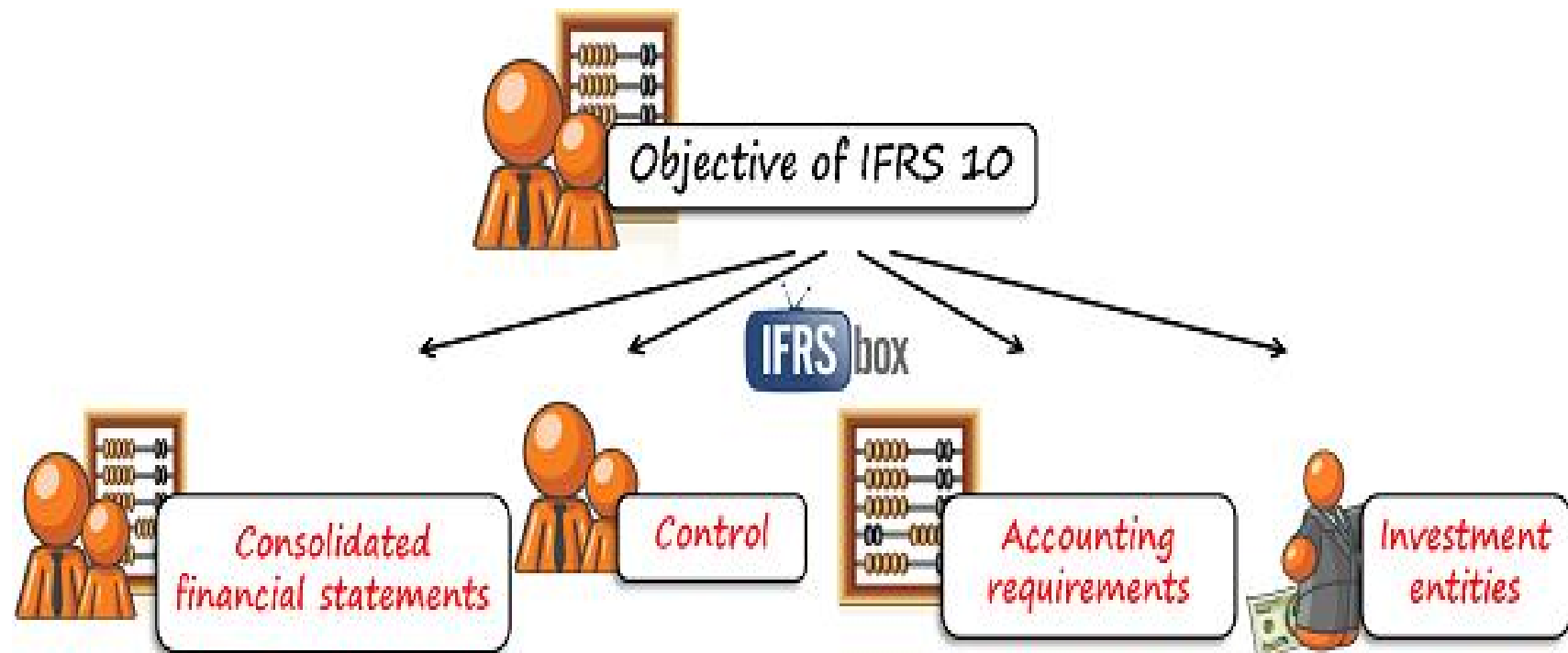
# Objective of IFRS 10



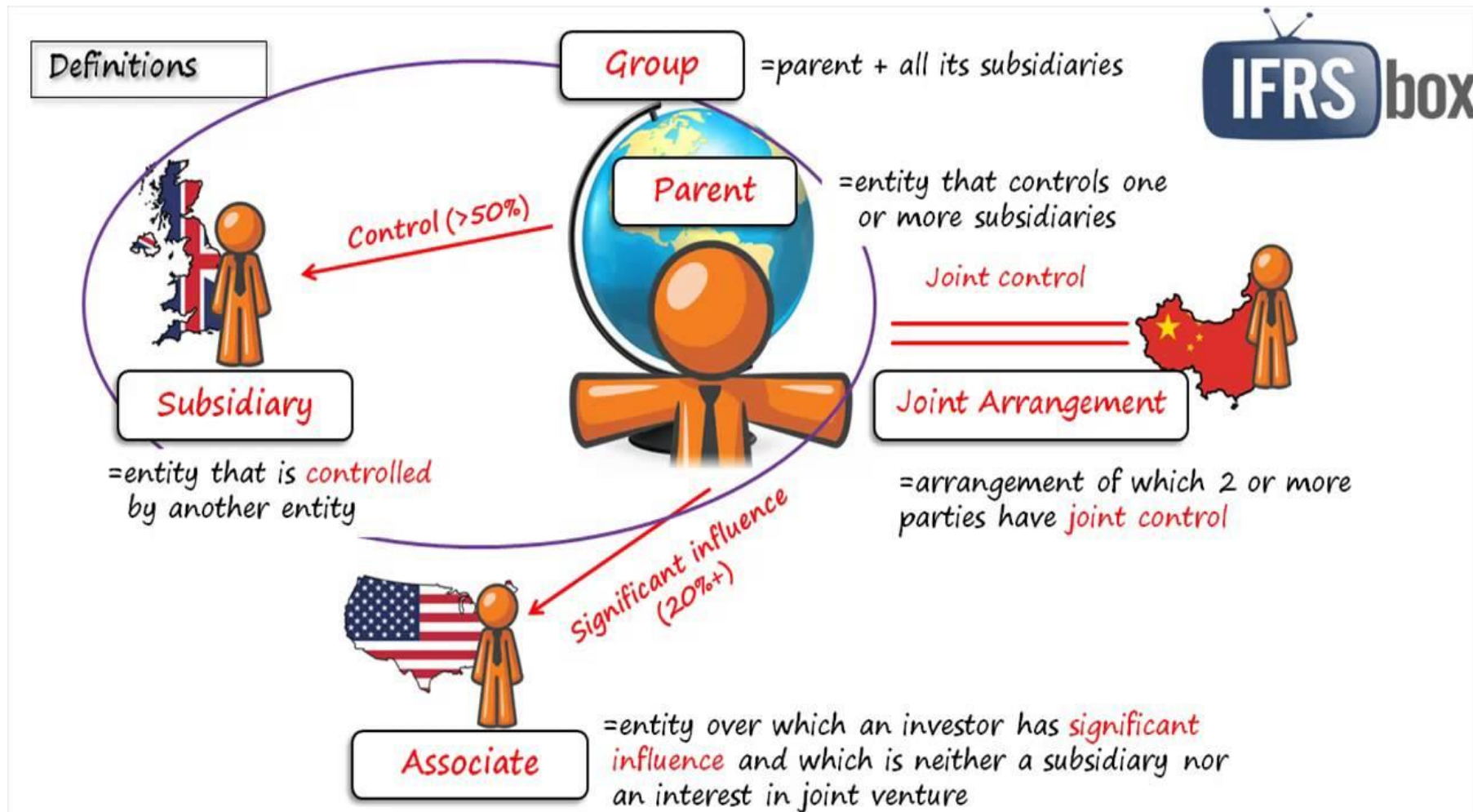
“ Applicable in preparing consolidated financial statements (CFSs) when an entity controls one or more other entities (IFRS 10.1).



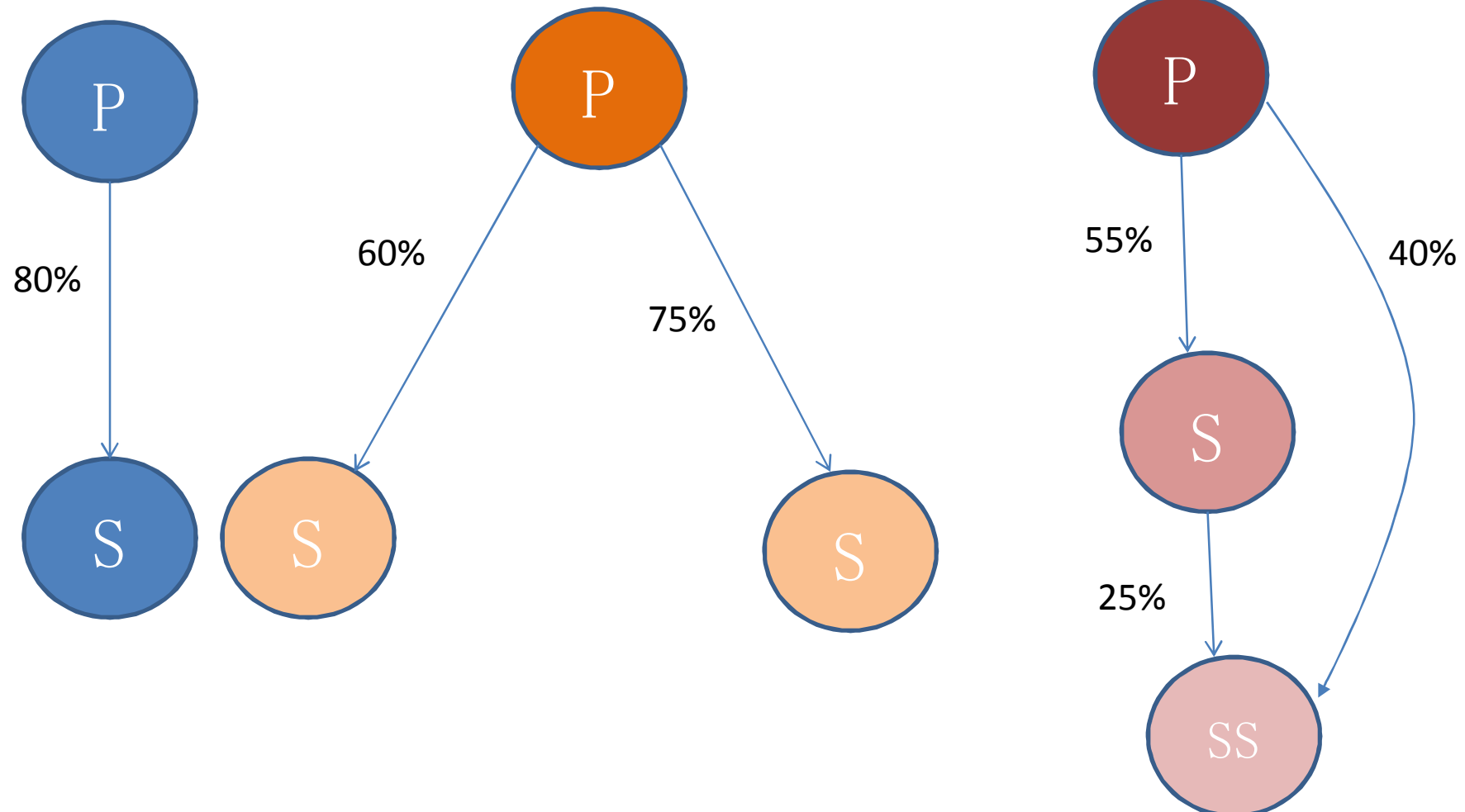
# Objective of IFRS 10



# Some Definitions



# Recall: Group Structures





# Meeting the Objective



- “ An entity (parent) should control one or more other entities (subsidiaries)
- . Control should be clearly defined
  - . Application of Control principle and whether an investor controls an investee and therefore must consolidate the investee
  - . Sets out accounting requirements for preparation of CFSs
  - . Defines investment entity and sets out exceptions



# IFRS 10: Consolidated Financial Statements

## 2. Determination

# Determination: S, A, JA or Other Investment?



Criteria	Control	Significant influence	Joint control	Other
Share	>50%	20%+	Equal	Other
Accounting	Acquisition method (full consolidation)	Equity method	Depends on type (IFRS 11)	Depends on type (IFRS 9, IAS 39)

# Departure from IFRS 3: BCs



- ” IFRS 10 does not deal with:
- . Accounting requirements for business combinations
  - . Effect on consolidation (including goodwill arising on business combination)

# Scope of IFRS 10



“ Parent shall present CFSs. (IFRS 10.4)

“ HOWEVER: No need to prepare CFSs if:

- . Wholly-owned subsidiary or partially-owned subsidiary of another entity and all its other owners – as long as there are no objections
- . Debt or equity not traded in a public market (domestic or foreign stock exchange or OTC – locally/regionally)
- . Does not file FSs with SEC/any regulatory organization
- . Ultimate/any intermediate parent produces FSs available for public use and comply with IFRSs – where subsidiaries are consolidated or measured at



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## 3. Control, Power & Returns

# Control



“ Investor shall determine whether it is a parent by assessing whether it controls investee (IFRS 10.5).

- . An investor controls an investee when it 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.

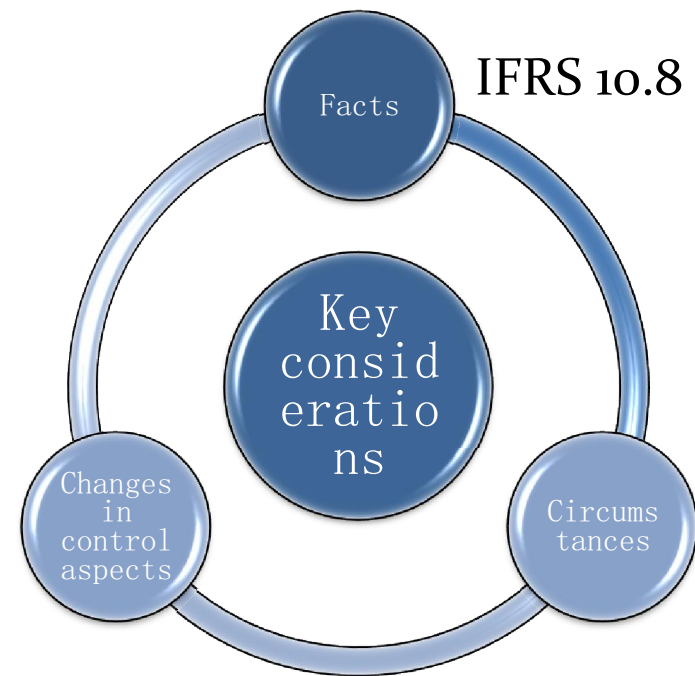


# Control



” Thus, an investor controls an investee if and only if the investor has all the following (IFRS 10.7):

- . power over the investee;
- . exposure, or rights, to variable returns from its involvement with the investee; and
- . the ability to use its power over the investee to affect the amount of the investor's returns





# Control



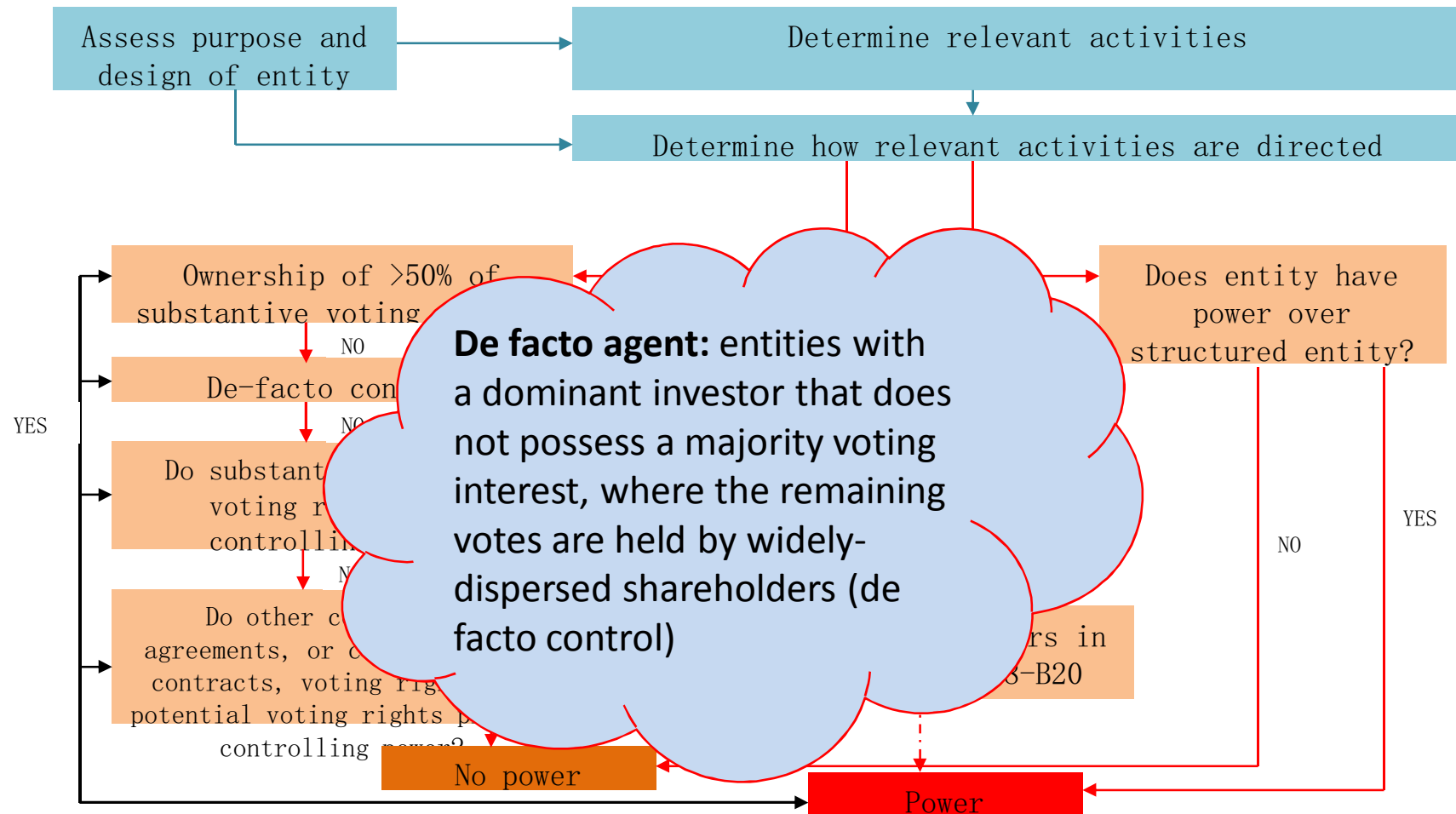
- “ Two or more investors collectively control an investee when they must act together to direct the relevant activities (IFRS 10.9).
  - . No investor individually controls the investee.
- “ Each investor would account for its interest in the investee in accordance with the relevant IFRSs, such as:
  - . IFRS 11: *Joint Arrangements*,
  - . IAS 28 *Investments in Associates and Joint Ventures* or
  - . IFRS 9 *Financial Instruments*.

# Power



- “ Arises when investor has existing rights that give it the current ability to direct the *relevant activities*, i.e. the activities that significantly affect the investee's returns (IFRS 10.10).
- “ Power arises from rights (IFRS 10.11). E.g. voting rights granted by equity instruments.
  - . Assessment can be complex when power results from one or more contractual arrangements.
- “ If two or more investors each have existing rights:
  - . The one with current ability to direct the activities that most significantly affect the returns of the investee has power over the investee.

# CF for IFRS 10



# Returns



- “ An investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance.
- “ The investor's returns can be only positive, only negative or both positive and negative.
- “ Although only one investor can control an investee, more than one party can share in the returns of an investee.
  - . For example, holders of non-controlling interests can share in the profits or distributions of an investee.

# Link between Power & Returns



- ” An investor controls an investee if the investor not only has power over the investee and exposure or rights to variable returns from its involvement with the investee, but also has the ability to use its power to affect the investor's returns from its involvement with the investee.
- ” Thus, an investor with decision-making rights shall determine whether it is a principal or an agent.
  - . An investor that is an agent does not control an investee when it exercises decision-making rights delegated to it.

# Accounting Requirements



- “ A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances (IFRS 10.19).
- “ 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 (IFRS 10.20).

. Control date == `similar to acquisition

# Non-Controlling Interests (NCIs)



- “ A parent shall present non-controlling interests in the consolidated S0FP within equity, separately from the equity of the owners of the parent (IFRS 10.22).
- “ 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
  - . (i.e. transactions with owners in their capacity as owners) (IFRS 10.23).

# Loss of Control



- ” If a parent loses control of a subsidiary, the parent (IFRS 10.25) :
- . derecognises the assets and liabilities of the former subsidiary from the consolidated statement of financial position.
  - . recognises any investment retained in the former subsidiary and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant IFRSs. That retained interest is remeasured. The remeasured value at the date that control is lost shall be regarded as the fair value on initial recognition of a financial asset in accordance with IFRS 9 or the cost on initial recognition of an investment in an associate or joint venture, if applicable.
  - . recognises the gain or loss associated with the loss of control attributable to the former controlling interest.





# IFRS 10: Consolidated Financial Statements

## 4. Investment Entity

# Determining Whether an Entity is an Investment Entity



- “ A parent shall determine whether it is an investment entity. An investment entity is an entity that (IFRS 10.27) :
- . 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.

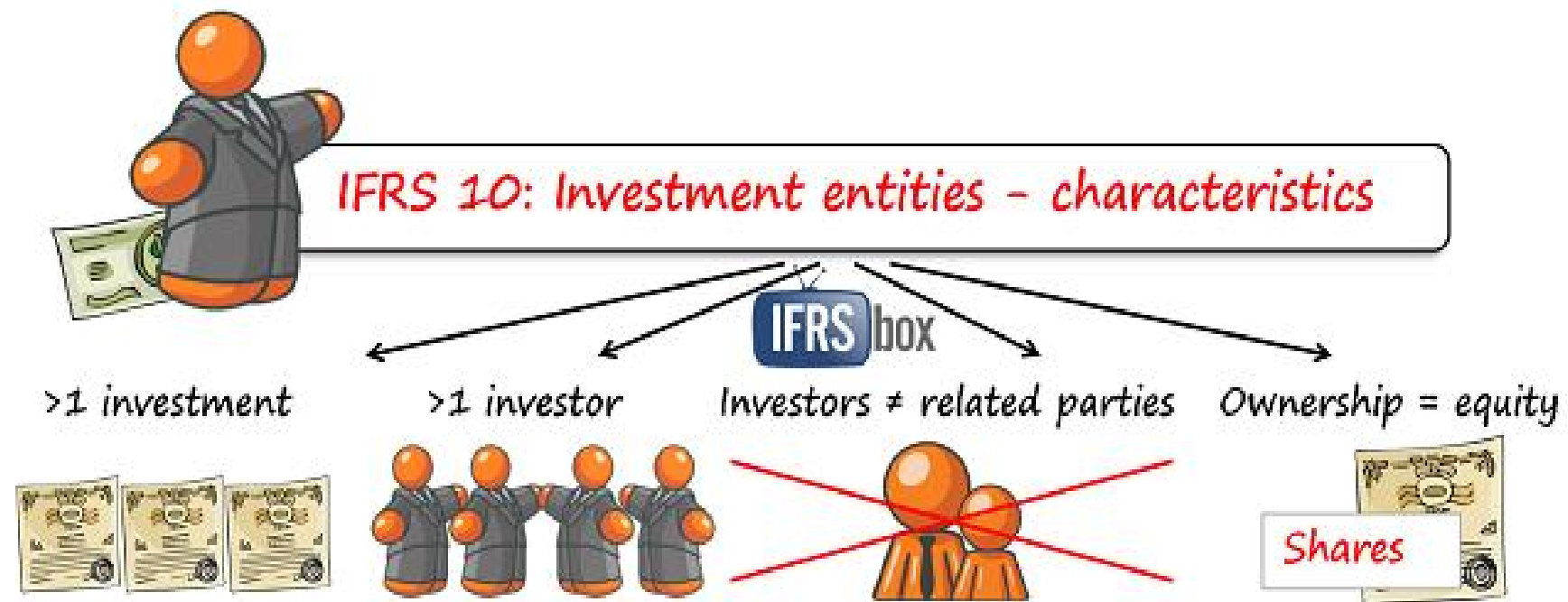
# Investment Entity?



“ In assessing whether it meets the definition of an IE, an entity shall consider whether it has the following typical characteristics of an investment entity (IFRS 10.28) :

- . it has more than one investment (see paragraphs B850–B85P) ;
- . it has more than one investor (see paragraphs B85Q–B85S) ;
- . it has investors that are not related parties of the entity (see paragraphs B85T–B85U) ; and
- . it has ownership interests in the form of equity or similar interests

# Characteristics of Investment Entities



# Investment Entities: Exception to Consolidation (IFRS 10.31–33)



- ” Except as described in paragraph 32, an investment entity shall not consolidate its subsidiaries or apply IFRS 3 when it obtains control of another entity.
- ” Instead, an investment entity shall measure an investment in a subsidiary at fair value through profit or loss in accordance with IFRS 9.1 (IFRS 10.31).
- ” If an investment entity has a subsidiary that is not itself an investment entity and whose main purpose and activities are providing services that relate to the investment entity's investment activities (see paragraphs B85C–B85E), it shall consolidate that subsidiary in accordance with paragraphs 19–26 of this IFRS and apply the requirements of IFRS 3 to the acquisition of any such subsidiary.

# Investment Entities: Exception to Consolidation (IFRS 10.31–33)



“ 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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## 5. Illustrations

# Illustrative Example 1



- ” An entity, Limited Partnership, is formed in 20X1 as a limited partnership with a 10-year life. The offering memorandum states that Limited Partnership's purpose is to invest in entities with rapid growth potential, with the objective of realising capital appreciation over their life.
- ” Entity GP (the general partner of Limited Partnership) provides 1 per cent of the capital to Limited Partnership and has the responsibility of identifying suitable investments for the partnership.
- ” Approximately 75 limited partners, who are unrelated to Entity GP, provide 99% of the capital to the partnership.



# Illustrative Example 1



” Limited Partnership begins its investment activities in 20X1. However, no suitable investments are identified by the end of 20X1. In 20X2 Limited Partnership acquires a controlling interest in one entity, ABC Corporation. Limited Partnership is unable to close another investment transaction until 20X3, at which time it acquires equity interests in five additional operating companies. Other than acquiring these equity interests, Limited Partnership conducts no other activities. Limited Partnership measures and evaluates its investments on a fair value basis and this information is provided to Entity GP and the external investors.

# Illustrative Example 1



- “ Limited Partnership has plans to dispose of its interests in each of its investees during the 10-year stated life of the partnership.
- “ Such disposals include the outright sale for cash, the distribution of marketable equity securities to investors following the successful public offering of the investees’ securities and the disposal of investments to the public or other unrelated entities.

*. Does Limited Partnership meet the definition of an investment entity?*

# Illustrative Example

## 2



- “ High Technology Fund was formed by Technology Corporation to invest in technology start-up companies for capital appreciation.
- “ Technology Corporation holds a 70 per cent interest in High Technology Fund and controls High Technology Fund; the other 30 per cent ownership interest in High Technology Fund is owned by 10 unrelated investors.

# Illustrative Example 2



- ” Technology Corporation holds options to acquire investments held by High Technology Fund, at their fair value, which would be exercised if the technology developed by the investees would benefit the operations of Technology Corporation.
- ” No plans for exiting the investments have been identified by High Technology Fund.
- ” High Technology Fund is managed by an investment adviser that acts as agent for the investors in High Technology Fund.

*. Is High Technology Fund is an investment entity?*

# Illustration 3



- ” Real Estate Entity was formed to develop, own and operate retail, office and other commercial properties.
- ” Real Estate Entity typically holds its property in separate wholly-owned subsidiaries, which have no other substantial assets or liabilities other than borrowings used to finance the related investment property.
- ” Real Estate Entity and each of its subsidiaries report their investment properties at fair value in accordance with IAS 40 Investment Property.
- ” Real Estate Entity does not have a set time frame for disposing of its property investments, but uses fair value to help identify the optimal time for disposal.

# Illustration 3



- “ Although fair value is one performance indicator, Real Estate Entity and its investors use other measures, including information about expected cash flows, rental revenues and expenses, to assess performance and to make investment decisions.
- “ The key management personnel of Real Estate Entity do not consider fair value information to be the primary measurement attribute to evaluate the performance of its investments but rather a part of a group of equally relevant key performance indicators.

# Illustration 3



- ” Real Estate Entity undertakes extensive property and asset management activities, including property maintenance, capital expenditure, redevelopment, marketing and tenant selection, some of which it outsources to third parties.
- ” This includes the selection of properties for refurbishment, development and the negotiation with suppliers for the design and construction work to be done to develop such properties.
- ” This development activity forms a separate substantial part of Real Estate Entity's business activities.

*. Is Real Estate Entity an investment entity?*



End