This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG-CFSS. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG-CFSS. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

IASB Research Project on SMEs that are subsidiaries
Issues Paper

Objective

1 The objective of the session is to ask EFRAG CFSS and TEG members if it would be feasible in their jurisdictions to permit subsidiaries of a parent entity that applies IFRS Standards to use the recognition and measurement requirements in IFRS Standards and the disclosure requirements in the *IFRS for SMEs* Standard, if the IASB were to develop such a Standard.

Background

2 In response to feedback from the 2015 Agenda Consultation, the IASB added a research project to assess whether it would be feasible to permit subsidiaries that meet the definition of a small and medium-sized entity (SMEs) to use the recognition and measurement requirements in IFRS Standards and the disclosure requirements in the *IFRS for SMEs* Standard.

3 In the consultation, some respondents suggested that introducing such an approach would have the potential to reduce costs in financial reporting for subsidiaries of listed groups, without removing information needed by the users of their separate financial statements. This is because these entities need to report to their parent, for consolidation purposes, numbers that comply with the recognition and measurement requirements of the full IFRS Standards. For their own financial statements, they would prefer to use those same recognition and measurement requirements, but with less onerous disclosure requirements.

4 To assess the feasibility of such an approach, the research undertaken by the IASB staff considers two steps:

(a) Reach out to National Standard Setters to obtain their views on the feasibility of such an approach; and

(b) Assess the extent to which disclosure requirements from the *IFRS for SMEs* Standard would need to be ‘tailored’ and adapted (considering the differences between the two sets of GAAPs). The objective of the IASB staff is to keep tailoring to the absolute minimum so as to avoid the risk of creating a 'third tier' of IFRS.

EFRAG Secretariat initial views

5 At this stage, the staff of the IASB has not yet provided further details or the exact content of the guidance nor an initial drafting, and is only enquiring about potential

feasibility matters in local jurisdictions. At the EFRAG CFSS and TEG meeting, members will be, in particular, invited to discuss how the following questions apply in their jurisdictions:

(a) The National Standard Setter has developed (or is considering developing) guidance permitting subsidiaries or private entities to provide reduced disclosures when applying the recognition and measurement requirements of IFRS Standards?

(b) If the IASB were to issue an IFRS Standard as suggested, would it be permitted in their jurisdiction and how would it link to the options in the IAS Regulation? If not, why not?

6 The following paragraphs contain the EFRAG Secretariat's initial considerations on the practical issues and matters that should be considered if such a Standard was to be issued; both in general and in the specific context of the European Union.

Compatibility with the EU Accounting Directive

7 The IFRS for SMEs Standard has not been endorsed in the EU as some of the requirements were assessed to be incompatible with the EU Accounting Directive[1]. Although some of the inconsistencies may have been addressed when both the Accounting Directive and the IFRS for SMEs Standard were subsequently revised (in 2013 and 2015, respectively) IFRS for SMEs Standard have never been reconsidered for endorsement in the EU.

8 As a consequence, decisions on which entities are required or permitted to use the IFRS for SMEs Standard rest with the legislative and regulatory authorities in each individual jurisdictions in Europe and Member States may transpose the IFRS for SMEs Standard requirements (into their legislation, only to the extent that the requirements (including disclosures) are compatible with the EU-Accounting Directive.

9 Interestingly, some European countries have already developed tiered reporting frameworks with reduced disclosure requirements using the IFRS for SMEs Standard principles as a starting point. For example, UK and Ireland have adopted a 3-tier approach with:

(a) EU-adopted IFRS for group listed companies and other publicly accountable entities,

(b) an 'adaptation' of IFRS for SMEs Standard for non-publicly accountable entities to suit the needs in the UK and Republic of Ireland (FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* which was issued in 2013), and

(c) a simplified version for micro-entities incorporating the requirements of the Accounting Directive.

10 Tiers (b) and (c) are not consistent with the approach being considered by the IASB staff.

Application to 'subsidiaries that are SMEs'

11 The approach under consideration by the IASB staff is targeting specifically 'subsidiaries that are SMEs' that is entities that cumulatively meet the following conditions :

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[1] In November 2009, the European Commission asked EFRAG to provide it with advice on which points the IFRS for SMEs Standard is incompatible with the EU Accounting Directives.

(a) Their parent company applies full IFRS Standards; and

(b) They are SMEs as defined by the IASB in the *IFRS for SMEs* Standard that is:

   (i) They do not have public accountability; and

   (ii) they publish general purpose financial statements.

12 The IASB's definition of SMEs does not include quantified size criteria for defining an SME. Conversely, the EU and many European jurisdictions have developed definitions of SMEs for a broad range of purposes, including prescribing financial reporting obligations. Those national or regional definitions often include quantitative criteria based on revenue, assets, employees or other factors.

13 If the IASB were to issue guidance for all non-listed entities (regardless of quantitative criteria) that are controlled by an entity applying IFRS Standards, this may create inconsistencies in the use of the term SME which would require careful analysis by relevant entities.

14 More broadly, the EFFRAG Secretariat is not persuaded that developing guidance and standard-setting for only a subset of non-listed entities (i.e. those controlled by IFRS applicants), would be beneficial. This is because the creation of a standard would impose costs on all affected by the development of standards. However it is unclear, if such a standard were permitted or required, whether there would be sufficient entities in the different European jurisdictions, that would apply the standard to make the benefits outweigh the costs. EFRAG CFSS members input on this question would be important.

Periodic review and update of IFRS for SMEs Standard

15 The IASB maintains the IFRS for SMEs Standard through only periodic reviews triggered by a list of principles developed by the IASB for dealing with new and revised IFRSs. The IASB carried out its first such review in 2012 and made some targeted improvements in 2015. The IASB is to conduct its next comprehensive review of the Standard only in the second half of 2019. And, as a consequence, he principles of major recently issued IFRS Standards (such IFRS 15, IFRS 16) have not yet been considered for update to the IFRS for SMEs Standard.

16 If the IASB were to permit subsidiaries that are SMEs to use the recognition and measurement requirements in IFRS Standards and the disclosure requirements in the IFRS for SMEs Standard, the latter would need to be updated more regularly to reflect changes to existing and new IFRS standards to avoid increasing the gap in recognition and measurement requirements; and adapt the disclosure requirements accordingly.

Tailoring of the disclosure requirements from the IFRS for SMEs Standard

17 In practice, it is likely that the reduced disclosure requirements could rely on the IFRS for SMEs Standard only to the extent that recognition and measurement requirements in IFRS Standards are the same as (or aligned with) those under the IFRS for SMEs Standard.

18 However when recognition and measurement requirements differ significantly, it is unlikely that the existing disclosure requirements in IFRS for SMEs Standard would be appropriate. For example, differences that may warrant tailoring of disclosure include (but are not limited to) the following:

(a) Business combinations (IFRS for SMEs Standard provide for amortisation of goodwill, capitalisation of transaction cost, variable consideration…)

(b) Intangibles (no capitalisation of internally generated intangibles such as development costs, no distinction between assets with finite or indefinite useful lives),

(c) Investment properties and Non-current Assets Held for Sale (no cost option for investment Properties, no guidance on assets held for sale equivalent to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* …)

(d) Employee benefits (actuarial gains)

(e) Deferred taxation (recognition of deferred tax assets, uncertain tax positions, initial recognition exception,…).

19 Although the IASB staff objective is to keep differences between the *IFRS for SMEs* Standard and full IFRS Standards to the absolute minimum, the EFRAG Secretariat is concerned that, unless the principles in IFRS Standards and IFRS for SMEs Standard are very closely aligned, there could be a need for significant adaptation of the disclosure requirements in the *IFRS for SMEs* Standard under the proposed approach. In any case, a thorough review of the disclosure requirements in the IFRS for SMEs Standard would be needed to assess when tailoring is needed.

20 As an evidence of the above, the EFRAG Secretariat observes that the Australian Accounting Standards Board currently uses the 'user need' and 'cost-benefit' principles applied by the IASB in developing its IFRS for SMEs Standard when recognition and measurement requirements in IFRS Standards are not the same as those in the *IFRS for SMEs* Standard.

Questions for EFRAG TEG - CFSS

21 Have you (or the national standard-setter in your jurisdictions) developed standard(s) permitting subsidiaries or private entities to provide reduced disclosures when applying the recognition and measurement requirements of IFRS Standards?

22 If the IASB issued a Standard permitting SMEs that are subsidiaries to apply the recognition and measurement requirements of IFRS Standards with the disclosure requirements of the IFRS for SMEs Standard, would that be permitted in your jurisdiction? If not, why not?

23 If such a Standard were required or permitted in your jurisdiction, would there be sufficient eligible SMEs that would apply such as Standard so that the benefits would outweigh the costs of development and application?

24 Do you have any preliminary views on whether the reduction in disclosures would significantly disadvantage users of financial statement information?

Agenda Papers

25 In addition to this cover note, agenda paper 12-02 - *ASAF Paper 09 – SMEs that are Subsidiaries* has been provided for the session.