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.

Subsidiaries without Public Accountability
Cover Note

Objective

1 The purpose of this session is to seek EFRAG CFSS members' views on the scope of the draft Standard *Subsidiaries without Public Accountability: Disclosures*.

Background

2 On 26 July 2021 the IASB published the ED *Subsidiaries without Public Accountability: Disclosures* with the objective of developing a reduced-disclosure IFRS Standard ('draft Standard') that would apply on a voluntary basis to subsidiaries without public accountability (the project initially was labelled as 'Subsidiaries that are SMEs' but it was subsequently relabelled when the ED was published).

3 The draft Standard would be part of full IFRS Standards and subject to endorsement in the EU under the Regulation No. 1606/2002. It would mainly affect EU Member States that either permit or require the use of IFRS in the annual and consolidated accounts of non-publicly traded companies.

4 In regard to the scope of the project, in paragraph 6 of the ED, the IASB proposes that an entity would be permitted to apply the proposed disclosure requirements in its consolidated, separate or individual financial statements if, at the end of its reporting period, it is a subsidiary that does not have public accountability and has a parent (ultimate or intermediate) that produces consolidated financial statements available for public use that comply with IFRS Standards.

5 When EFRAG discussed the IASB's proposals in the draft Standard with national standard setters and other stakeholders in different outreach events, many questions were raised on who would be able to apply the IASB's proposals in Europe. Many questions were also raised on the interaction between the IASB's proposals and the EU Accounting Legislation.

6 To address those questions, stimulate debate within Europe and clarify the IASB discussions on *Subsidiaries without Public Accountability: Disclosures,* the EFRAG Secretariat is considering publishing a Briefing that is focused on who would apply the proposals in Europe and interaction of the IASB proposals with EU Accounting Law.

7 The draft Briefing will be discussed by EFRAG TEG in November and can be found on the EFRAG TEG meeting page (to be uploaded one week before the meeting).

EFRAG Draft Comment Letter

8 On 30 September 2021, EFRAG published its Draft Comment Letter ('the DCL'), where it welcomes the IASB's efforts in developing reduced disclosure requirements

for subsidiaries without public accountability and cautiously supports the proposed scope of the ED.

9 However, EFRAG recognises that there is also support for the alternative view expressed by Ms Françoise Flores in the Basis for Conclusion of the ED. Therefore, EFRAG has decided to ask constituents for their views on the scope of the ED, including a question to better understand which entities issue insurance contracts and are in the scope of the project.

10 In addition, EFRAG raises some concerns and provides suggestions to the IASB. For example, EFRAG:

(a) suggests that the key principles proposed by the IASB in paragraph BC33 of the Basis for Conclusions should encompass cost-benefit considerations;

(b) highlights the risks of not considering the existing disclosure requirements in IFRS Standards in the light of BC157 when there are no recognition and measurement differences between IFRS for SMEs and IFRS Standards;

(c) suggests that the reasoning for the exceptions should be improved;

(d) suggests considering the interaction between the disclosure requirements of the ED and the disclosure requirements of the ED *Disclosure Requirements in IFRS Standards - A Pilot Approach*;

(e) considers that the application of a full set of disclosure requirements for IFRS 17 *Insurance Contracts* can be burdensome and costly for eligible subsidiaries; and

(f) suggests a number of additional disclosures that it considers relevant for users of financial statements. Nonetheless, EFRAG acknowledges that the assessment of users' needs in terms of disclosures remains difficult and subjective.

11 EFRAG's DCL can be found here and stakeholders' comments are welcome by 26 January 2022.

Proposed scope of the draft Standard

12 As already mentioned above, in paragraph 6 of the ED, the IASB proposes that an entity would be permitted to apply the proposed disclosure requirements in its consolidated, separate or individual financial statements if, at the end of its reporting period, it is a subsidiary that does not have public accountability and has a parent (ultimate or intermediate) that produces consolidated financial statements available for public use that comply with IFRS Standards.

13 In paragraph 11 of the agenda paper 07.02, the IASB provides arguments on **why the draft Standard is not suitable for other entities without public accountability** (i.e., not expanding the scope):

(a) *the draft Standard is unlikely to be suitable for an SME that elects to apply IFRS Standards in preparing its own financial statements.* Such an SME is usually responding to users' needs for full IFRS information. If preparing financial statements applying IFRS Standards is important to an SME's users, then full disclosures are likely to be equally important.

(b) *the draft Standard is unlikely to be suitable for other SMEs that do not need to report to a parent applying IFRS Standards*: Applying the draft Standard rather than the *IFRS for SMEs* Standard could be more costly for these SMEs as the *IFRS for SMEs* Standard considers the costs to SMEs and the resources of SMEs to prepare financial statements and contains several simplifications to the recognition and measurement principles in IFRS Standards. Furthermore,

amendments to the *IFRS for SMEs* Standard are not expected to be more frequent than approximately once every three years to provide SMEs with a stable platform. SMEs may not have the resources to stay up to date with the ongoing changes to IFRS Standards.

(c) *SMEs that are associates or joint ventures of an investor applying IFRS Standards*: These investees are not part of the investor's group, which usually means the investor cannot direct them to report IFRS information under the group's accounting policies and they generally do not have access to the group resources to stay up to date with ongoing changes to IFRS Standards. For these reasons, applying the draft Standard rather than the *IFRS for SMEs* Standard could be more costly for these SMEs as explained in (b).

(d) Paragraphs BC12–BC22 of the Basis for Conclusions of the Exposure Draft further explains the IASB's reasons for restricting the scope to subsidiaries without public accountability.

14 In addition, in paragraph 14 of the agenda paper 07.02 explains the **consequences of widening the scope of the draft Standard to include some publicly accountable entities.** If the scope was widened to include some publicly accountable entities (entities that are outside the scope of the *IFRS for SMEs* Standard), the IASB would need to reconsider its fundamental approach to the project. In particular:

(a) the disclosure requirements in the *IFRS for SMEs* Standard were specifically designed for SMEs and users of SME financial statements, and on this basis, they were substantially reduced from the disclosure requirements in IFRS Standards. Therefore, there would likely to be pressure for additional disclosure requirements to be added to the draft Standard to satisfy the needs of the wider group of financial statement users of publicly accountable entities (e.g., capital market investors).

(b) both during development of the *IFRS for SMEs* Standard and during the second comprehensive review of the *IFRS for SMEs* Standard the IASB performed significant outreach with users of SME financial statements to confirm the principles in paragraph BC157 of the Basis for Conclusions on the *IFRS for SMEs* Standard appropriately identify their needs. Therefore, the IASB would need to go back and perform this outreach with the wider group of users of publicly accountable entities to identify whether the principles in paragraph BC157 are appropriate and if additional principles are necessary.

The EFRAG Secretariat analysis:

15 In Europe, there are EU Member States that either permit or require the use of IFRS in the annual and/or consolidated accounts of non-publicly traded companies (Article 5 of EU Regulation 1606/2002). Consequently:

(a) If the scope is widened to all SMEs, then in jurisdictions where SMEs are permitted to use IFRS, some may decide to move to IFRS Standards and benefit from a reduced set of disclosures. This possibility may reduce inequalities within a jurisdiction, particularly when the competitors of these SMEs are subsidiaries that are in the scope of the project.

(b) If the scope is widened to all SMEs, then some jurisdictions that currently do not permit or require the use of IFRS Standards in accordance with Article 5 of EU Regulation 1606/2002 may reconsider and may decide to start allowing a wider use of IFRS Standards for SMEs.

(c) Currently *IFRS for SMEs* Standard is not used in Europe and there is no endorsement process related to it. Therefore, SMEs either apply local GAAP or full IFRS Standards if permitted (sometimes even both) The draft Standard

could be more costly to apply than local GAAP (due to ongoing changes to IFRS Standards and lengthy disclosures). Nonetheless, if the scope is widened to all SMEs, then SMEs may want to move to IFRS Standards with reduced disclosures for different reasons. For example, the SME is considering expanding its business internationally, trying to reduce the cost of capital, involved in a M&A transaction, aligning its accounting policies with their competitors that use IFRS Standards with reduced disclosures or considers that local GAAP is not appropriate for its investors (e.g., it does not reflect the latest improvements in financial reporting such as IFRS 16 *Leases* or local GAAP is tax oriented.

(d) In jurisdictions where SMEs are permitted to use IFRS, subsidiaries in a group would be able to benefit from reduced disclosures but associates and joint ventures would not. Thus, associates and joint ventures would not be motivated to move to IFRS Standards (as they would have to apply full disclosures) and align their accounting policies with their significant investors. This can be particularly relevant when, for example, there are local restrictions for the acquisition of control of certain SMEs (i.e., the investor cannot control the SME but is fundamental for it).

16 The EFRAG Secretariat agrees that if the scope would be widened to include publicly accountable entities, the IASB would have to reassess the level of disclosures included in the ED and principles for developing them.

17 Nonetheless, if the scope would be widened to include certain publicly accountable entities (i.e., those that hold assets with a fiduciary capacity like most banks and insurance companies that are not listed), maybe the IASB could start by considering whether it would be sufficient to require full disclosures for IFRS 7 *Financial Instruments: Disclosures* and IFRS 17 *Insurance Contracts* and reduced disclosures for all the other IFRS Standards.

Questions for EFRAG CFSS members

18 Do EFRAG CFSS members have any preliminary views or comments on the scope proposed by the IASB in the ED?

Outreach activities

19 EFRAG recently launched two surveys for preparers to evaluate the costs and benefits and some of the content of the IASB proposals. Each survey has 12 questions and completion of the survey should take approximately 30 minutes.

20 They are accessible through the EFRAG's webpage and can be completed until 7 January 2022.

21 EFRAG invites EFRAG CFSS members to distribute the survey to preparers in your jurisdiction.

Agenda Papers

22 In addition to this cover note, agenda paper 07-02 – ASAF Agenda Paper AP05 SwPAD – Scope has been provided for the session.