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Subsidiaries without Public Accountability
Cover Note

Objective

1 The purpose of this agenda paper is to:

(a) provide an update on the IASB's discussions on this project;

(b) discuss with, and ask, EFRAG FR Board members on the interaction between local regulations and the proposed IFRS Accounting Standard (draft Standard) set out in the IASB's Exposure Draft *Subsidiaries without Public Accountability: Disclosures* ('ED or Draft Standard').

IASB's latest discussion on the project

Feedback received by the IASB

2 In April 2022 the IASB started to discuss the feedback received from comment letters received (68 comment letters) and outreach events.

3 The key messages from the IASB's respondents were:

(a) most respondents agreed with the objective and benefits of the draft Standard;

(b) there were mixed views on the proposed scope:

(i) many respondents suggested widening the scope to allow more entities to apply the proposals. However, respondents expressed a variety of different views on how the scope should be widened;

(ii) some respondents agreed with the proposed scope but suggested the IASB considers widening the scope at a later stage (e.g., after the draft Standard has been implemented);

(iii) a few suggested a narrower scope; and

(iv) a few observed that the regulator should determine who could apply the draft Standard.

(c) some respondents sought further guidance on the description of 'public accountability, including fiduciary capacity;

(d) many respondents agreed with the IASB's approach to developing the disclosure requirements of the draft Standard. However, some respondents disagreed with starting with the *IFRS for SMEs* Standard. Instead, these respondents suggested that the starting point should be IFRS Standards;

(e) many provided comments on the proposed disclosure requirements in the draft Standard. Comments were wide-ranging and across different IFRS Standards. A few respondents were of the view that the draft Standard should be developed as a separate stand-alone framework.

(f) many agreed with the proposal to have a separate IFRS Standard and organise disclosure requirements by Standard.

(g) many disagreed with including footnotes in the main body of the draft Standard to identify the disclosure requirements in other IFRS Accounting Standards that continue to apply. Instead, the IASB should include a list of all required disclosures within the body of the draft Standard or reproduce the disclosures requirements in the footnotes in the main body of the draft Standard.

IASB's redeliberations

4 In May 2022, the IASB started its redeliberations by discussing the proposed scope of the draft Standard. In that meeting, the IASB tentatively decided to:

(a) confirm the scope as proposed in the draft Standard; and

(b) review that scope after the draft Standard has been finalised, possibly during the post-implementation review.

5 The IASB also tentatively decided to provide guidance to improve understandability of the definition of 'public accountability' defined in *IFRS for SMEs* (see ASAF Agenda Paper 8), including clarifying amendments on the notion of holding assets in a fiduciary capacity (e.g. avoid specifying how often the entities listed in paragraph 7(b) of the draft Standard hold assets in a fiduciary capacity for a broad group of outsiders as one of their primary businesses);

6 In June, the IASB agreed on the direction of the project (i.e. to proceed with the IASB proposal for a new IFRS Accounting Standard as set out in the ED) and on a project plan. The IASB also decided to consider amendments to the disclosure requirements in IFRS Accounting Standards issued after 28 February 2021 after the new Standard is issued.

7 One of the topics identified for discussion is the interaction of the proposals in the draft Standard with local regulations. The EFRAG TEG-CFSS members discussed this topic on 29 July 2022 and provided the following feedback;

(a) EFRAG TEG-CFSS members expressed concerns that the IASB was using the concept of 'public accountability' when defining the scope of this project. Particularly, when considering that this concept is different from the notion of Public Interest Entities (PIE), a similar but different term used in the European Union accounting law. This could create confusion at the European Union level;

(b) EFRAG TEG-CFSS members noted that having the draft IFRS Standard and the *IFRS for SMEs* Standard exactly the same scope was likely to put pressure for unnecessary changes to the *IFRS for SMEs* Standard;

(c) Some members questioned whether having the IASB clarifying the concept 'public accountability' would be sufficient to address the complexities of the interaction between the IASB's proposed scope and the European legislation. This would raise the risk of having the IASB addressing EFRAG's requests for clarification but, on the endorsement stage, having the European Union rejecting that concept due to legal reasons (and use instead the concept PIE at European level);

(d) Considered that the IASB should better clarify the objective of this draft IFRS Standard and how it would fit together with the objectives of the *IFRS for SMES* Standard and IFRS Standards with full disclosures; and

(e) Raised questions on to what extent EU Member States would change their options on the Regulation (EC) No 1606/2002 to adapt themselves to a new IFRS Standard focused on reduced disclosures.

8 This topic will be discussed at the ASAF meeting in July 2022

The applicability of the IASB's ED in the European Union

9 The EFRAG Secretariat published two briefings focused on the applicability of the IASB's ED in the EU.

10 The key messages from the briefings were:

Interaction with Regulation (EC) No 1606/2002 and endorsement process

(a) For every new IFRS Standard issued by the IASB, the EU needs to endorse it before it comes into force. Regulation (EC) No 1606/2002 establishes a specific endorsement process under the responsibility of the European Commission. If the IASB decides to publish a final IFRS Standard on reduced disclosures for subsidiaries without public accountability, the European Commission will have to decide whether it will start the endorsement process and request an endorsement advice from EFRAG.

(b) If endorsed, it would mainly directly affect the EU Member States that either permit or require the use of IFRS in the annual and/or consolidated financial statements of companies that are non-publicly traded in regulated markets (Article 5 of Regulation (EC) No 1606/2002). Its application would be optional and entities could apply or revoke it at any time.

(c) EU Member States that permit or require the use of IFRS in the annual financial statements and/or consolidated financial statements of companies that are non-publicly traded in regulated markets, can always determine who can apply IFRS Standards under the Article 5 of the Regulation (EC) No 1606/2002, and consequently who can apply the Draft IFRS Standard proposed by the IASB in its jurisdiction. For example, when applying Article 5 of the Regulation (EC) No 1606/2002, an EU Member State may restrict the use of IFRS Standards to specific sectors such as real state, to entities that are either audited or meet other criteria.

(d) EU Member States that currently do not permit or allow the use of IFRS Standards for companies that are non-publicly traded in regulated markets would not be significantly affected by the IASB's proposals, even if endorsed. Nonetheless, companies located in those EU member states may still be affected if they have subsidiaries located outside of the EU in countries where IFRS Standards are applied.

(e) If considered useful, these EU Member States might reconsider the use of the options given by the Regulation (EC) No 1606/2002 and start allowing or permitting the use of IFRS Standards in the annual accounts and/or consolidated financial statements of companies that are non-publicly traded in regulated markets, including for tax and other legal purposes.

(f) EU Members States may always use the IASB's proposals as a point of reference for their local accounting requirements (similar to what happened with the *IFRS for SMEs* Standard). However, EU Member States will always have to assess the extent the IASB's proposals are compatible with the EU Accounting Directive (there are several recognition and measurement differences between these two – please see the EFRAG Secretariat compatibility study).

(g) If more entities elect to use IFRS Standards and consequently move from local GAAP to IFRS Standards (in accordance with the options provided by the Regulation (EC) 1606/2002 as described above), then the IASB's draft Standard could be seen as competing with the Accounting Directive 2013/34/EU, even if only in a limited way (when considering the narrow scope proposed by the IASB).

An EU perspective on the scope

(h) Companies publicly traded in a non-regulated market (e.g. growth-share markets and over-the-counter markets) would meet the definition of having public accountability. Thus, although these entities would be under the scope of Article 5 of Regulation (EC) No 1606/2002, they would be out of the scope of the IASB proposals and would not be able to present reduced disclosure requirements under IFRS (i.e. they would be able to apply IFRS Standards but would have to provide full disclosures).

(i) The IASB's notion of public accountability is different from the notion of public interest entity ('PIE') included the Accounting Directive. For example, there are entities that are PIEs due to the nature of their business, their size or the number of employees. As the IASB's definition of public accountability does not have quantity thresholds, some PIEs may be under the scope of the IASB's proposals. Consequently, if an EU Member State permits or requires the use of IFRS Standards by PIEs under Article 5 of Regulation (EC) 1606/2002 (e.g. Greece, Croatia, Romania and Slovakia), then it is possible that some PIEs that currently apply full IFRS Standards may opt to benefit from significantly fewer disclosure requirements.

(j) Most banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks would not be able to apply the IASB's proposals, because they typically hold assets in a fiduciary capacity for a broad group of outsiders as one of their primary businesses (in accordance with ED).

(k) An intermediate parent that has subsidiaries that have public accountability would normally not be able to apply the IASB's proposals in its (sub)consolidated financial statements but it may be able to do so in its separate financial statements.

(l) Current scope of the project may lead to 'inequalities' for non-publicly traded companies that currently already apply IFRS Standards.

Costs and benefits

(m) If a company already applies IFRS Standards to its financial statements and is under the scope of the proposals, the company would benefit from significantly fewer disclosure requirements.

(n) If a company currently applies local GAAP to its financial statements but is under the scope of the IASB's proposals, the company may decide to prepare financial statements in accordance with IFRS Standards (assuming that it is allowed by the Member State). Such a company would incur first-time implementation costs and the company may have to provide additional disclosures when compared to local GAAP. In addition, the company will have to consider all future new and amended IFRS Standards when preparing its financial statements.

11 In addition, in its final comment letter, EFRAG stated that should a final IFRS Standard on *Rate-regulated Activities* ('RRA') be issued before the reduced-disclosure IFRS Standard, the provisions of a new RRA IFRS Standard, and not IFRS 14 *Regulatory Deferral Accounts*, should be analysed and included in the reduced disclosure IFRS Standard. Particularly when considering that IFRS 14 has not been endorsed in the EU since it was deemed as a temporary standard offering an accounting option to companies that adopt IFRS for the first time and very few European companies would fall within its scope. Thus, if IFRS 14 is included, EFRAG would have to consider a possible carve-out.

Questions for EFRAG FR Board

12 If the IASB decides to proceed and issue an IFRS Standard on reduced disclosures for subsidiaries without public accountability (with the scope proposed in the ED but with clarifications to the definition of public accountability), do you see any challenges that might arise from adopting/endorsing such an IFRS Standard in Europe? Please specify.

13 Is there anything else that the IASB can address in finalising its proposals?