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Subsidiaries without Public Accountability
Cover Note

Objective

1 The purpose of this session is to discuss with, and ask, EFRAG FR TEG-CFSS 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').

2 In addition to this cover note, agenda paper 13-02 – *IASB Agenda Paper AP7* – has been provided for the session.

Background

3 On 26 July 2021 the IASB published the ED with the objective of developing a reduced-disclosure IFRS Standard that would apply on a voluntary basis to subsidiaries without public accountability.

4 EFRAG published its Draft Comment Letter ('DCL') on 30 September 2021 which was open for comments until 26 January 2022. In its DCL, EFRAG welcomed the ED and the IASB's efforts to reduce disclosure requirements for subsidiaries without public accountability. EFRAG also cautiously agreed with the IASB's proposed scope but recognised that there was also support for the alternative view expressed by the IASB board member Françoise Flores in the Basis for Conclusions of the ED.

5 EFRAG then embarked into an extensive programme of outreach events and stakeholder meetings, in partnership with other organisations. EFRAG also conducted research activities that led to the publication of two briefings focused on the applicability of the IASB's ED in the European Union.

(a) *Subsidiaries without Public Accountability: Disclosures. Who would be able to apply it in the EU?* focused on the scope of the IASB's project from an EU perspective and

(b) *EFRAG Secretariat study on compatibility of the EU Accounting Directive with the IASB's Exposure Draft* included a two-step comparison of disclosure requirements in the ED and the EU Accounting Directive.

6 In general, participants in outreach events and respondents to EFRAG DCL welcomed the IASB's ED and acknowledged that the IASB's efforts would ease financial reporting for eligible subsidiaries while meeting the reasonable needs of the users of financial statements. When referring to the scope, European constituents expressed mixed views, in particular on whether and to what extent the scope should be widened. European constituents also raised questions and some concerns on the interaction of the IASB's proposals with EU accounting law.

7 After consulting its constituents, EFRAG published its final comment letter on 25 February 2022 where it reiterated its initial support for the IASB's project and highlighted the requests from many constituents to widen the scope. However, as there was no clear consensus whether and to what extent the scope should be widened, EFRAG suggested that the IASB continues with the current scope of the project but in parallel assesses the possibility of a scope extension. In addition, EFRAG proposed that the IASB considers clarifying the concept of holding assets in a fiduciary capacity before issuing a finalised standard.

8 On 14 April 2022, EFRAG issued a feedback statement, which summarised the main comments received by EFRAG on its DCL to the IASB ED and explained how those comments were considered in EFRAG's FCL.

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

9 As mentioned above, 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.

IASB's latest discussion on the project

12 In May 2022, the IASB discussed whether the proposed scope of the draft Standard is appropriate for the purposes of finalising 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.

13 The IASB also tentatively decided to provide guidance to improve understandability of the description 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);

14 In June, the IASB discussed the direction of the project and a plan for redeliberating the proposals in the ED, including topics for redeliberation. The IASB staff proposed to proceed with the development of a final IFRS Accounting Standard, to address the matters raised in a feedback and not to publish a 'catch-up' exposure draft (an exposure draft considering amendments to IFRS Accounting Standards issued after 28 February 2021 to ensure the final Standard includes reduced disclosure requirements for all IFRS Accounting Standards in issue at the date the final Standard is issued)

15 The outcome of this discussion is not known at the time of writing of this paper and will be provided verbally during the meeting.

16 One of the topics identified for discussion on IASB's future redeliberation is the interaction of the proposals in the draft Standard with local regulations. It will be discussed during the ASAF meeting in July.

Questions for EFRAG FR TEG/CFSS

17 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 in your jurisdiction from adopting/endorsing such an IFRS Standard? Please specify.

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

19 In addition to this paper, issues paper 13-02 SWPA - IASB Agenda Paper 7 on Interaction between local regulations and the proposed IFRS Accounting Standard is provided for this session.