Subsidiaries without Public Accountability
Issues Paper

Objective

1 The objective of the session is to:

(a) provide an update and discuss EFRAG Secretariat's outreach and research activities on applicability of the IASB Exposure Draft *Subsidiaries without Public Accountability: Disclosures* in the European Union;

(b) discuss the scope of the project; and

(c) agree on the process of approval of final comment letter.

Background

IASB Exposure Draft Subsidiaries without Public Accountability: Disclosures

2 On 26 July 2021 the IASB published the Exposure Draft *Subsidiaries without Public Accountability: Disclosures* (ED or draft Standard) with the objective of developing a reduced-disclosure IFRS Standard that would apply on a voluntary basis to subsidiaries without public accountability. A short overview of the exposure draft is also available in the snapshot published by the IASB.

3 The ED would permit eligible subsidiaries to apply reduced disclosure requirements, while continuing to use the recognition, measurement and presentation requirements in full IFRS Standards. An entity in the scope of the project would be permitted to apply the ED in its consolidated, separate or individual financial statements.

4 The IASB Board Member, Ms Françoise Flores voted against the proposals in the ED as she opposed to restricting the IASB's proposals to subsidiaries without public accountability. Ms Flores believed that all entities without public accountability should be eligible to apply the ED, because it is by design relevant to all of them.

EFRAG Draft Comment Letter

5 On 30 September 2021, EFRAG published its Draft Comment Letter, where it welcomes the IASB's efforts in developing reduced disclosure requirements for subsidiaries without public accountability and cautiously supported the proposed scope of the ED.

6 However, EFRAG recognised that there is also support for the alternative view expressed by Ms Françoise Flores in the Basis for Conclusions of the ED. Therefore, EFRAG 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.

7 In addition, EFRAG raised some concerns and provided suggestions to the IASB. For example, EFRAG:

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

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

(c) suggested that the reasoning for the exceptions is improved;

(d) suggested 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) considered 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) suggested 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 is difficult and subjective.

EFRAG Outreach Activities

8 EFRAG has conducted several outreach activities to gather input from European constituents, which are described below.

Webinars and outreach events

9 On 5 October 2021, EFRAG organised a joint webinar with the Confederation of Danish Industry, FSR – Danish Auditors with the participation of the IASB, where participants exchanged views on the costs and benefits of the IASB's project *Subsidiaries without Public Accountability: Disclosures*, as well as its scope and the approach used in developing the disclosure requirements.

10 In general, panel members welcomed the project and its objective. They highlighted that this project was long-awaited by the preparers, it was likely to reduce the costs for many subsidiaries, promote the use of IFRS Standards and promote the use of consistent accounting policies within a group (i.e., the use of IFRS Standards within a group).

11 However, panel members considered that the proposed disclosure requirements appeared to be extensive for subsidiaries without public accountability and that the proposed scope was too narrow. In particular, considered that the IASB should discuss the possibility of widening the scope to include at least associates and joint ventures. Nonetheless, it was noted that the IASB's proposals could also be beneficial for all entities without public accountability

12 One panel member questioned whether the *IFRS for SMEs* Standard was the right starting point as it had been developed for small and individual entities. It was suggested that the IASB should rather use full IFRS Standards as a starting point and then reduce those disclosure requirements for subsidiaries without public accountability. This approach would ensure the usefulness of the disclosed information to users of financial statements.

13 On 12 January 2022, EFRAG and the Accounting Standards Committee of Germany organised a joint webinar. The participants welcomed the IASB's objective of developing an IFRS with reduced disclosure requirements for subsidiaries. The

IASB's proposals seemed to be particularly relevant for globally operating entities with a large number of foreign subsidiaries.

14 When discussing the scope, participants regretted that the IASB proposals would not be applicable to subsidiaries in the insurance industry. They also acknowledged that there were pros and cons in extending the scope to all entities without public accountability.

15 From a cost-benefit point of view, participants considered the IASB's proposals would significantly reduce the number of the disclosure, the costs of collecting relevant information and the auditing costs.

Surveys with National Standard Setters

16 EFRAG has also reached out to European National Standard Setters to better understand the costs and benefits of the IASB proposals and whether there are any incompatibilities with the European Accounting Legislation. The latter was discussed twice with the EFRAG CFSS members in September and November 2021.

17 National Standard Setters noted that the usefulness of and the benefits from the IASB's project would differ between EU Member States and would depend, amongst others, on the use of the option included in the Regulation (EC) No 1606/2002.

18 In addition, no significant incompatibilities between the IASB's proposals and the Regulation (EC) No 1606/2002 or Directive 2013/34/EU were identified by the national standard setters that participated in the survey.

19 However, one EU Member State that requires the use of IFRS Standards in its jurisdiction noted that eligible subsidiaries will be filing their financial statements with reduced disclosures under IFRS Standards whereas companies that are not subsidiaries will be required to follow the full scope IFRS Standards. In addition, it was also noted that it was not clear whether a subsidiary would be allowed to use the proposed standard in case that the ultimate or intermediate parent uses the exemptions from consolidation under Article 23 of the Accounting Directive 2013/34/EU.

Surveys for preparers

20 On 8 November 2021, EFRAG launched two surveys for preparers of financial statements (parents and subsidiaries) on the costs and benefits and some of the content of the IASB proposals.

21 The online survey for parents or subsidiaries is open until 20 January 2022.

22 From a preliminary analysis, it seems that:

(a) the ongoing cost-savings have been identified at both subsidiary and parent level, particularly in terms of reduction of costs with employees, reduction in auditing costs and elimination of the need to maintain additional accounting records;

(b) only one parent and one subsidiary considered that no cost-savings were expected (e.g. still having to produce the detailed IFRS disclosures for the group reporting package);

(c) some (subsidiaries and parents) highlighted the benefit of preparing financial statements under IFRS, as users of financial statements prefer the use of IFRS Standards; and

(d) mixed views on the scope (from the parents), reflecting the different experiences on the use of the options in Regulation (EC) No 1606/2002.

EFRAG Research Activities

EFRAG Secretariat Briefing on the scope of the IASB's project from an EU perspective

23 When EFRAG discussed this project 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. There were also many questions on the interaction between the IASB's proposals and the EU Accounting Legislation.

24 To address those questions, on 9 December 2021 the EFRAG Secretariat issued a briefing focused on the scope of the IASB's project from an EU perspective. In particular, this Briefing highlighted that:

(a) The draft Standard would be part of full IFRS Standards and in principle subject to endorsement in the EU under the EU Regulation 1606/2002;

(b) If endorsed in the EU, the direct effects on reporting entities of an IFRS Standard based on this ED would depend on how the Article 5 of the EU Regulation 1606/2002 has been implemented by the EU Member State to which the entity belongs and whether the subsidiary exemption in Article 37 of the 2013 Accounting Directive has been used; and

(c) If not endorsed, companies located in EU Member States may still be affected by the Draft Standard if they have subsidiaries located outside of the EU in countries where IFRS Standards are applied.

EFRAG Secretariat study on compatibility of the Accounting Directive 2013/34/EU with the IASB's ED

25 As already mentioned above, in July 2021 the IASB issued an ED. If, following this consultation:

(a) the IASB decides to issue a reduced-disclosure IFRS Standard (draft Standard) for eligible subsidiaries;

(b) the European Union ("EU") decides to endorse such an IFRS Standard; and

(c) EU Member States permit or require the use of IFRS Standards in accordance with the Article 5 of the EU Regulation 1606/2002,

then several subsidiaries may decide to move away from full disclosures in IFRS Standards or move from national GAAP to IFRS Standards in jurisdictions where EU Member States allow or require IFRS Standard for non-listed entities [1].

26 Therefore, the IASB's draft Standard could be seen, to a certain extent, as "competing" with national GAAPS and the Accounting Directive 2013/34/EU, even if in a limited way (when considering the narrow scope proposed by the IASB and the number of EU Member States that allow or require the use of EU-endorsed IFRS Standards for non-listed entities).

27 In the context of the IASB consultation on the ED, the EFRAG Secretariat undertook a high-level analysis of:

(a) whether there are different disclosure requirements in the Accounting Directive 2013/34/EU and the ED as a result of different measurement and recognition requirements (e.g. disclosures on amortisation of goodwill); and

[1] In accordance with the Article 5 of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards.

(b) whether there are any disclosures in the Accounting Directive 2013/34/EU that are missing or insufficient in the IASB's ED. In particular, whether the reduced disclosure requirements of the ED, when compared to full IFRS, implies losing disclosures that are required by the AD.

28 Such an assessment is expected to help European stakeholders and the European Commission to assess, among other things, whether the Draft Standard ensures an equivalent level of protection of shareholders (including non-controlling shareholders), creditors, members and other third parties as the Accounting Directive 2013/34/EU.

29 The key conclusions from this preliminary compatibility study were:

(a) *Step 1: Different disclosures requirements as a result of different recognition and measurement requirements*

(i) no disclosures in the ED on the period over which intangibles with indefinite useful lives are written off, including goodwill. The same applies for full IFRS Standards; and

(ii) for many accounting areas (for example on leases, deferred tax and pension obligations) the Accounting Directive is silent. In those cases, there is no incompatibility between the ED and the Accounting Directive but there may be still different disclosure requirements between the ED and the national GAAPs as EU member States have discretion in setting their disclosures.

(b) *Step 2: Disclosures in the Accounting Directive that are not required in the ED or that are different in the ED*

(i) some disclosures in the Accounting Directive are missing in the IASB's ED. However, in most of the cases, those disclosures are not required neither by the ED nor full IFRS Standards. Still, there a number of disclosures that are required by the IFRS Standards and the Accounting Directive 2013/34/EU but not required in the ED (e.g. disclosures on the composition of the group, which the ED requires limited disclosures); and

(ii) when IFRS standards or the ED do not include specific disclosures that are required by the Accounting Directive, such disclosures should be required by the national accounting laws.

(c) *Step 3: Updated overview of the use of options provided in the IAS Regulation (1606/2002) in the EU*

(i) EFRAG received responses from 14 National Standard Setters. In almost cases, there is no change.

30 EFRAG TEG discussed this study on 18 January 2022 and provided a number of suggestions to EFRAG Secretariat to improve the study. EFRAG TEG also suggested that this study could be an EFRAG Secretariat Briefing which should be issued when EFRAG reaches an agreement on its final position.

Scope of the project

Scope of the project as defined by the IASB

31 In accordance with paragraphs 6-8 of the ED, a subsidiary would be in the scope of the ED if, at the end of the reporting period, it:

(a) does not have public accountability (its debt or equity instruments are not traded in a public market, or it is not in the process of issuing such instruments for trading in a public market; and it does not hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses); and

(b) has an ultimate or intermediate parent that produces financial statements available for public use that comply with IFRS Standards.

32 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.

33 In addition, an intermediate parent that has subsidiaries that are listed in the previous paragraph would not be able to apply the IASB's proposals in its consolidated financial statements.

34 Finally, subsidiaries of an investment entity, when the investment entity (the parent) does not present consolidated financial statements, would not be able to apply the IASB's proposals.

Scope of the project when considering EU Accounting Legislation

35 When considering the EU accounting legislation, we have seen that if the IASB's proposals were endorsed in the EU, the direct effects on reporting entities of an IFRS Standard based on this ED would depend on how the Article 5 of the EU Regulation 1606/2002 has been implemented by the EU Member State to which the entity belongs. Therefore, the scope of this project, from a European perspective, is even narrower when compared to the IASB's proposals as not all subsidiaries without public accountability in Europe would be able to apply the IASB proposals.

36 Still, if the IASB decides to issue an IFRS Standard focused on reduced disclosures for eligible subsidiaries and if the IFRS Standard is endorsed in the EU, then several subsidiaries may decide to move from local GAAP to IFRS Standards (in accordance with the Article 5 of the EU Regulation 1606/2002). Therefore, the IASB's draft Standard could be seen as competing with the Accounting Directive 2013/34/EU.

37 Considering this, the European Commission may need to assess, among other things, whether the Draft Standard ensures protection of shareholders (including non-controlling shareholders), creditors, members and other third parties. Such an assessment will significantly depend on the scope of the project, in particular whether the scope of the IASB's project is extended.

Preliminary feedback received until now

38 The EFRAG Secretariat notes that stakeholders have provided different views, which to some extent, reflect the fact that the usefulness of and the benefits from the IASB's project would differ between EU Member States. For example, the following different views have been expressed:

(a) support for the scope of the project as it addressed a direct request from stakeholders and would give the IASB the possibility to test its new approach with a limited number of entities;

(b) having a wider scope would give more options to the European regulators and national standard setters to decide which companies could apply the reduced disclosures;

(c) the IASB should not indicate a scope but simply make available a reduced disclosure standard and leave to the local regulation to indicate the scope;

(d) the IASB should discuss the possibility of widening the scope to include at least associates and joint ventures. This is because groups structure their investments differently (under the form of subsidiaries, joint ventures, joint operations or associates). The application of the IASB's proposals should not depend on management's decision on how to structure a group;

(e) the IASB's proposals could be beneficial for all entities without public accountability; and

(f) having reduced disclosures available for more entities could also be beneficial for subsidiaries of insurance companies that also issue insurance contracts (also pointed out in EFRAG DCL).

Possible ways of moving forward on the scope of the project

39 If the IASB decides to issue a reduced-disclosure IFRS Standard (draft Standard) for eligible subsidiaries, the scope of the project will be a key factor in the endorsement process. Currently the scope of the project, when considering EU Accounting Legislation, is narrow.

40 The EFRAG Secretariat notes that as the scope of the IASB's proposals is enlarged, more likely EFRAG will have, in the future, to analyse the safeguard of the interests of minority shareholders and creditors. That is, EFRAG will have to analyse whether the loss of information from applying the ED instead of full IFRS, sufficiently warrants stakeholders' possibility to protect their interests in the subsidiary, particularly if the scope is large and affects a wide range of entities.

41 Thus, extending the scope of the ED to all subsidiaries without public accountability could create a valid challenge for the endorsement of a future standard on reduced disclosures.

42 In the draft comment letter EFRAG expressed cautious support for the scope of the project. However, if there is support for changing EFRAG's initial position to enlarge the scope, the EFRAG Secretariat considers that then special attention should be given to non-controlling shareholders and creditors. For example, request for additional disclosures to ensure the safeguard of the interests of non-controlling shareholders and creditors or obtain consent from non-controlling shareholders to apply the reduced disclosure IFRS Standard. A final decision will only be possible following the end of the consultation on the draft comment letter.

Agree on the process of approval of final comment letter

43 When EFRAG issued its draft comment letter, it decided to include 26 January 2022, with the objective of providing EFRAG stakeholders sufficient time to participate in outreach activities, including providing a comment letter to EFRAG.

44 Therefore, the EFRAG Secretariat planned to ask EFRAG TEG and EFRAG Board approval of the final comment letter immediately after. Nonetheless, the earliest EFRAG Board meeting is on 2 March 2022.

45 Considering the EFRAG is making efforts to submit its final comment letter to the IASB earlier and that the EFRAG Board will be updated on this project on 26 January 2022, the EFRAG Secretariat asks whether it is possible to proceed with a written approval procedure.

Questions for EFRAG Board

46 Does EFRAG Board has any comments on the EFRAG Secretariat analysis above on the scope?

47 Does EFRAG Board agrees to proceed with written procedure?