Subsidiaries without Public Accountability

Cover Note

Objective

1 To seek the views of EFRAG FRB members whether EFRAG should comment on Question 1 of on the clarifications to the definition of 'public accountability' published in the IASB Exposure Draft: Third edition of the IFRS for SMEs Accounting Standard and on the key messages to be included in the EFRAG draft comment letter.

Background of the IASB project *Subsidiaries without Public Accountability*

IASB and EFARG developments after the ED consultation

2 In its meeting in June 2022 the IASB decided to proceed with its proposal for a new IFRS Accounting Standard as set out in the ED *Subsidiaries without Public Accountability: Disclosures* and agreed on a project plan for developing the new Accounting Standard.

3 In July 2022, the IASB discussed this project at the Accounting Standards Advisory Forum (ASAF) meeting. In preparation for that meeting, the EFRAG FR TEG-CFSS members discussed this project on 28 June 2022 (summary of feedback received can be found here) and EFRAG FRB discussed in its meeting on 6 July 2022.

4 At the ASAF meeting, some members expressed concerns on how the terms used to define the scope of the draft Standard would interact with local regulations. These members noted that:

(a) the term 'public accountability' may result in several challenges, including on endorsement (e.g., it is a term similar but different from the legal term 'public interest entity' (PIE)); and

(b) the terms "available for public use" and "fiduciary capacity" should be clarified.

5 There were also questions on whether the benefits of applying the Standard would outweigh the costs as subsidiaries would still have to provide information for its parent's consolidated financial statements or would not be able to apply the Standard due to local legislation.

6 As respondents to the ED *Subsidiaries without Public Accountability*, expressed some concerns about applying the definition of public accountability contained in paragraphs 7 and 8 of the ED, which is carried forward from paragraphs 1.3 and 1.4 of the IFRS for SMEs Standard, the IASB proposes now to amend those paragraphs in the IFRS for SMEs Standard. The ED *Third edition of the IFRS for SMEs Accounting Standard* was published in September. As part of the proposals in the ED the IASB is proposing to amend paragraph 1.3(b) to list banks, credit unions,

insurance companies, securities brokers/dealers, mutual funds and investment banks as examples of entities that often meet the second criterion of public accountability in paragraph 1.3(b). To assist an understanding of the basis for the definition of public accountability, the IASB is also proposing to clarify that an entity with these characteristics would usually have public accountability.

7 The IASB refers in Question 1 - Definition of public accountability of the ED IFRS for SMEs, to the concerns about applying the definition of public accountability expressed by respondents in the feedback to the IASB ED on SWPA. The IASB expects that the proposed amendments to paragraphs 1.3 and 1.3A of Section 1 of the ED IFRS for SMEs will add clarity, without changing the intended scope of the Standard IFRS for SME.

8 On the 4 October 2022, the EFRAG Secretariat discussed this issue with EFRAG IAWG. Members reiterated that <u>insurance companies should not be scoped-out from the IASB's project Subsidiaries without Public Accountability (SWPA).</u> They confirmed that IFRS for SMEs is not designed for Insurance Companies. Therefore, instead, the IASB should reconsider the scope of its project SWPA (i.e., decoupling it from the scope of IFRS for SMEs) by for example, removing the notion of fiduciary capacity.

Discussions in the ED stage and EFRAG comment letter

9 On 26 July 2021 the IASB published the ED *Subsidiaries without Public Accountability* with the objective of developing a reduced-disclosure IFRS Standard that would apply on a voluntary basis to subsidiaries without public accountability. The description of public accountability, contained in paragraphs 7 and 8 of the ED, is from paragraphs 1.3 and 1.4 of the IFRS for SMEs Standard.

10 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.

11 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.

12 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.

13 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.

14 Alongside the concerns expressed about the term ‘fiduciary capacity’, EFRAG expressed concerns that the IASB uses the concept ‘public accountability’ when defining the scope of this project. This is because, its meaning is not often entirely clear for stakeholders (these concepts are not currently being used in IFRS Standards available for use in the EU) and it could be in conflict with existing legal terms used in different EU Member States. For example, National Standard Setters have expressed concerns that the notion of public accountability is different from the notion of Public Interest Entities, a similar term used in the European Union accounting law. Therefore, the IASB’s proposals in this project are likely to also put pressure on the definition of ‘public accountability’. Considering this, EFRAG would welcome further application guidance in this area.

15 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.

16 Also in April 2022, the IASB started to discuss the feedback received from comment letters and outreach events. In general, most respondents agreed with the objective of the draft Standard. However, respondents had mixed views on the proposed scope of the draft Standard. Although, some respondents agreed with the proposed scope of the draft Standard, many respondents suggested a wider scope. Nonetheless, respondents had different views on what that wider scope should be. Some respondents also suggested that the IASB considers widening the scope at a later stage, for example, after the draft Standard has been effective for a period of time. After considering the feedback received, the IASB tentatively decided to confirm the scope as proposed in the draft Standard and review the scope after the draft Standard has been finalised, possibly during the post-implementation review.

Background of the IASB project *IFRS for SMEs*

17 The IASB is carrying out a second comprehensive review of the *IFRS for SMEs* Accounting Standard, which the IASB issued in 2009 and amended in 2015 (as a result of the first comprehensive review).

18 As part of the first phase of the second comprehensive review, the IASB published a *Request for Information* requesting views on whether and, if so, how the *IFRS for SMEs* Accounting Standard should be updated to take account of IFRS Accounting Standards and amendments not currently incorporated into the *IFRS for SMEs* Accounting Standard.

19 During the second phase of the second comprehensive review, in response to feedback on the *Request for Information* and advice of the SME Implementation Group, the IASB published on 8 September 2022 proposals to update the *IFRS for SMEs* Accounting Standard to reflect improvements made to full IFRS Accounting Standards, while keeping the Standard suitable for small and medium-sized entities: Exposure Draft: Third edition of the IFRS for SMEs Accounting Standard. The deadline for comments is 7 March 2023.

20 As Section 1 of the ED includes clarifications to the definition of public accountability. The IASB refers as a reason for the proposed change to the feedback received on the ED *Subsidiaries without Public Accountability* in the Introduction, Basis for Conclusions and in question 1 of the ED*: Third edition of the IFRS for SMEs Accounting Standard*.

Key discussion points for the session

21 The standard IFRS for SMEs is not endorsed for use in Europe and as such is not in the EFRAG workplan. However, EFRAG could consider writing a comment letter to the IASB as part of the IFRS for SME consultation, as there is a direct link between the scope of the IFRS for SME standard and the scope of the future standard Subsidiaries without public accountability.

22 The first question of the ED currently in consultation covers the scope of the *IFRS for SMEs* Accounting and more precisely the proposed clarifications to the definition of 'public accountability'. The IASB states that the proposed clarifications will not change the intended scope of the Standard.

23 In its CL EFRAG supported that the IASB should proceed with its project with the scope proposed in the ED as mixed views were provided and different suggestions made to widen the scope (see paragraph 12 above). EFRAG acknowledged that there are potential benefits of a broader scope, nonetheless EFRAG also recognised that there is no consensus on whether and to what extent the scope should be widened. EFRAG concluded, any decision on the extension of the scope is likely to be challenging and controversial, which in turn reflects the differences on the current options for application of IFRS outside the consolidated financial statements. During the debate leading to the comment letter, it was also considered that deciding the scope of a reduced disclosure regime is something that should continue to stay in the remit of the jurisdictions rather than of the IFRS.

24 A specific ARC meeting was also held on 19 January 2022 and confirmed that the possible endorsement of the reduced disclosure standard raises a number of legal issues and will require a careful assessment of the cost/benefit profile by EFRAG.

25 As illustrated in Agenda Paper 07-02, the EFRAG FR TEG and IAWG most recent meetings confirmed that the main content of a possible letter commenting on the scope at this stage would be the opportunity to (or not to) relax the scope to make it clearly applicable to subsidiaries that are insurance companies. However, EFRAG did not form a view in its comment letter on Subsidiaries Without Public Accountability on whether or not a reduced disclosures approach would be appropriate for subsidiaries that are insurers, in consideration of (1) the mixed views and (2) the possible conflict that this could create with the existing EU legislations that already have a specific accounting transparency regime for them (being PIE).

26 Considering this, the EFRAG Secretariat considers the following possible alternatives:

(a) Calling for the IASB to decouple the two scopes, however this would be contrary to the overall standard setting approach taken so far by the IASB;

(b) not commenting on the IASB's consultation on IFRS for SMEs;

(c) calling for further clarifications to the definitions of public accountability and fiduciary capacity in the IFRS for SMEs.

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Questions for EFRAG FRB

28 Does EFRAG FRB agree that EFRAG should comment on the first question of the IASB ED *Third edition of the IFRS for SMEs Accounting Standard*?

29 If yes, which of the options included in the issues paper 07-02 would you suggest exploring in a draft comment letter?

Next steps

30 The EFRAG Secretariat to follow the EFRAG FRB recommendations.

Agenda Papers

31 In addition to this cover note, agenda paper 07-02 – *IFRS for SMEs – definition of public accountability* – has been provided for the session.