AUSTRIAN FINANCIAL REPORTING AND AUDITING COMMITTEE

AUSTRIAN FINANCIAL REPORTING AND AUDITING COMMITTEE
C/O KAMMER DER STEUERBERATER UND WIRTSCHAFTSPRÜFER
AM BELVEDERE 10 I TOP 4
A-1100 VIENNA
AUSTRIA

TEL +43 (1) 81173 228
FAX +43 (1) 81173 100
E-MAIL office@afrac.at
WEB http://www.afrac.at

January 28, 2022

IFRS Foundation
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom
commentletters@ifrs.org

Comments on Exposure Draft "Disclosure Initiative – Subsidiaries without Public Accountability: Disclosures"

Dear Mr Barckow,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, we appreciate the opportunity to comment on the Exposure Draft ED/2021/7 *Subsidiaries without Public Accountability: Disclosures*, issued by the IASB on 26 July 2021. Principal authors of this comment letter were Max Eibensteiner, Klemens Eiter, Werner Fleischer, Christian Höllerschmid, Helmut Kerschbaumer, Gerhard Margetich, Gerhard Prachner, and Alfred Wagenhofer. In order to ensure a balanced Austrian view on the consultation, the professional background of these authors is diverse.

Bet regards,
Romuald Bertl
Chairman

Comments on Exposure Draft "Disclosure Initiative – Subsidiaries without Public Accountability: Disclosures"

General comments

Austria requires IFRS for consolidated financial statements of publicly traded companies and permits the use of IFRS (as an alternative to local GAAP) for consolidated financial statements of non-publicly traded companies. It does not permit IFRS for annual accounts of publicly traded and non-publicly traded companies. Consequently, the immediate applicability of this IFRS Standard with reduced disclosure requirements is relatively narrow, i.e., the Standard would apply only to consolidated financial statements of non-listed companies that are subsidiaries, do not have public accountability and have an ultimate or intermediate parent that produces full IFRS financial statements. However, the issuance of the IFRS Standard with reduced disclosure requirements has triggered a discussion within AFRAC to consider whether it should recommend to the legislator to permit IFRS Standards also for annual accounts.

Therefore, AFRAC welcomes the initiative to introduce reduced disclosure requirements for the financial statements of entities that fall within the scope of the project. As further explained in our response to question 2, we suggest extending the scope of this draft Standard to all SMEs and beyond. Based on our internal discussion we concluded that the scope appears to be the most critical aspect of this project and, therefore, requires special attention.

Specific comments

Question 1—Objective

Paragraph 1 of the draft Standard proposes that the objective of the draft Standard Subsidiaries without Public Accountability: Disclosures is to permit eligible subsidiaries to apply the disclosure requirements in the draft Standard and the recognition, measurement and presentation requirements in IFRS Standards. Do you agree with the objective of the draft Standard? Why or why not? If not, what objective would you suggest and why?

Annual financial statements address different stakeholders and pursue different purposes and objectives, depending on the specific characteristics of the reporting entity, such as its business model, its financing, the number of shareholders, etc. While full disclosures are meaningful and necessary for listed entities in order to provide useful and relevant information, we agree that there are reporting entities where reduced disclosures may be allowed in order to fulfil the purpose of financial reporting. In line with the cost-benefit considerations in para. 2.39 – 2.43 of the IFRS framework, we, therefore, support permitting eligible entities to apply reduced disclosure requirements.

We note that there will be cases in which this draft Standard leads to a slight loss of information concerning a subsidiary because of different materiality thresholds being applicable to the subsidiary and the group. Yet, we believe that the benefits of the draft Standard exceed this potential information loss.

Question 2—Scope

Paragraphs 6–8 of the draft Standard set out the proposed scope. Paragraphs BC12–BC22 of the Basis for Conclusions explain the Board's reasons for that proposal. Do you agree with the proposed scope? Why or why not? If not, what approach would you suggest and why?

We observed the discussion about extending the scope to all SMEs as outlined in BC15, BC16 and BC AV1. Taking into consideration these arguments we favour an extension of the scope to all SMEs. This is mainly due to the following considerations:

- As outlined in BC15 (b) and (c), permitting other types of SMEs to apply the draft Standard could encourage more SMEs, including entities which plan to issue debt or equity instruments in the near future, to voluntarily apply IFRS Standards instead of local GAAP (BC15 (b) and (c)), where permitted. This view is supported by our observation that SMEs abstain from preparing their (in Austria only consolidated) financial statements in accordance with IFRS, because they consider the current (full) disclosure requirements as too burdensome. While applying IFRS recognition and measurement requirements may also impose a burden on SMEs, this may be compensated by the fact that SMEs usually do not have complex business models. In addition, some SMEs may wish to prepare their financial statements in accordance with IFRS to take advantage of specific IFRS requirements, e.g., to capitalize eligible development costs for comparability reasons, which is currently not allowed under Austrian GAAP.

- In our view, the Board's conclusion in BC6 that the draft Standard would ease the burden for subsidiaries and save costs for the group, they are a member of (BC15 (a)), is not an argument for the narrow scope of the draft Standard to this group of entities. Saving of time and of other resources would equally hold as an argument to permit all SMEs to apply the draft Standard.

- As IFRS for SMEs are not endorsed within the EU, the draft Standard – if endorsed – would provide an adequate financial reporting alternative for European companies that are not listed on public markets. IFRS recognition and measurement requirements as well as reduced disclosures as included in the draft Standard are comparable to the requirements of the Directive 2013/34/EU and are, therefore, in our opinion, sufficient for the users' needs concerning such companies.

- Finally, we think that, if the Board decides to introduce a new alternative for IFRS reporting, it should optimally use this decision by allowing the application of this draft Standard by the largest possible number of entities with similar users' needs. We believe that exercising caution (refer to BC16 (g)) is not a valid reason to narrow the scope to subsidiaries only.

- We understand the concern that the Board might receive requests for the effective date of changes to the recognition and measurement requirements in IFRS Standards to be later for SMEs (BC16 (h)). However, it is already good practice by the Board to consider the complexity of the changes made in new IFRS Standards when determining the effective date. This should provide for sufficient time for a suitable preparation even to smaller companies, which want to apply IFRS recognition and measurement requirements. In addition, most smaller companies have less complex business models which should facilitate transitions to new recognition and measurement requirements.

- The statement in BC21 that companies that apply the draft Standard, where parents prepare consolidated accounts based on other GAAP, would need to monitor recognition and measurement differences between the two reporting frameworks, is not a valid argument as the application of this draft Standard is optional.

In addition to the discussion above, we propose that the IASB considers widening the scope even further, namely a) to parent entities and b) to small/medium-sized banks and insurance entities.

a) We suggest to include in the scope of the draft Standard the separate financial statements of parent entities that are not subsidiaries, if their consolidated financial statements are prepared under IFRS Standards (refer to AP 31B, January 2021, para. 17 (c)). We believe that widening the scope to separate financial statements of parent entities is adequate, because the main objective of these financial statements in Austria is not to communicate financial information to shareholders (this is the objective of their consolidated financial statements), but to provide the basis for dividend distribution and taxation. At present, these financial statements are prepared in accordance with local GAAP. Except for a few specific local reporting requirements (see answer to question 8 (c)), separate financial statements prepared in accordance with the draft Standard would provide even more information than that required according to local GAAP. Thus, there will be no reduction of information for users of those financial statements.

b) In the EU, all banks and insurance entities are Public Interest Entities (PIEs). However, only those that issue debt or equity instruments traded in a public market are required to issue IFRS consolidated financial statements. There are several banking regulations within the EU that include exemptions from specific (reporting) requirements for small or medium-sized banks. For example, consider a small or medium-sized bank that applies IFRS and is a subsidiary. It would not be within the scope of the draft Standard and could not benefit from reduced disclosures because holding assets in a fiduciary capacity for a broad group of outsiders is its primary business. To exclude such banks from the scope of the draft Standard contrasts with the implicit interest of European regulators to promote the application of IFRS by regulated entities.

To summarize, we recommend that the Board considers widening the scope of the draft Standard by deleting (b) of paragraph 7 of the draft. Although this would establish a difference in scope between this draft and the IFRS for SMEs, we think that such difference is justified, because

a) entities that will apply this draft Standard will apply all recognition and measurement requirements of IFRS Standards, which means a higher level of financial reporting compared to IFRS for SMEs, and
b) entities that hold assets in a fiduciary capacity for a broad group of outsiders as one of their primary businesses are subject to regulatory requirements (e.g., the banking and insurance industry), which would compensate for the loss of information from applying the reduced disclosure Standard.

Question 3— Approach to developing the proposed disclosure requirements

Paragraphs BC23–BC39 of the Basis for Conclusions explain the Board's reasons for its approach to developing the proposed disclosure requirements.
Do you agree with that approach? Why or why not? If not, what approach would you suggest and why?

We generally agree with the Board's approach to the development of disclosures. The proposed approach pursues a consistent progression from IFRS for SMEs to the new draft Standard and thus a) avoids unnecessary discontinuity for entities already applying IFRS for SMEs and b) builds on the experience due to the application of the SME Standard. We further support the Board's clarification of the terms "presentation" as related to primary financial statements and "disclosure" as referring to information contained in the notes to financial statements (as explained in BC39). This clarification helps to avoid misunderstandings and enables an easier orientation within financial statements.

In the medium or long term, we believe that there may be good arguments for issuing stand-alone disclosure requirements, i.e., to consolidate in a comprehensive document the paragraphs 22 – 213 (including the footnotes), appendix A to the draft Standard and the paragraphs from full IFRS remaining in force. This would result in a full set of IFRS for non-publicly accountable entities, which would result in a more practical application of the draft Standard.

Question 4— Exceptions to the approach

Paragraphs BC40–BC52 of the Basis for Conclusions explain the Board's reasons for the exceptions to its approach to developing the proposed disclosure requirements. Exceptions (other than paragraph 130 of the draft Standard) relate to:

- *disclosure objectives (paragraph BC41);*
- *investment entities (paragraphs BC42–BC45);*
- *changes in liabilities from financing activities (paragraph BC46);*
- *exploration for and evaluation of mineral resources (paragraphs BC47–BC49);*
- *defined benefit obligations (paragraph BC50);*
- *improvements to disclosure requirements in IFRS Standards (paragraph BC51); and*
- *additional disclosure requirements in the IFRS for SMEs Standard (paragraph BC52).*

(a) Do you agree with the exceptions? Why or why not? If not, which exceptions do you disagree with and why? Do you have suggestions for any other exceptions? If so, what suggestions do you have and why should those exceptions be made?

(b) Paragraph 130 of the draft Standard proposes that entities disclose a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities. The proposed requirement is a simplified version of the requirements in paragraphs 44A–44E of IAS 7 Statement of Cash Flows.

> *(i) Would the information an eligible subsidiary reports in its financial statements applying paragraph 130 of the draft Standard differ from information it reports to its parent (as required by paragraphs 44A–44E of IFRS 7) so that its parent can prepare consolidated financial statements? If so, in what respect?*
>
> *(ii) In your experience, to satisfy paragraphs 44A–44E of IAS 7, do consolidated financial statements regularly include a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities?*

The following responses are based on the scope as determined in paragraphs 6–8 of the draft Standard, whereas we argued for a broader scope – see our response to question 2.

Response to 4 (a):
We agree with the proposed exceptions except for those mentioned below. With respect to the disclosure objectives (BC41) we support the Board's arguments for excluding disclosure objectives in the draft Standard.

Investment entities (BC42 - BC45): If we interpret the scope correctly, investment entities will be outside the scope of the draft Standard in most cases as they fall under para. 7 (b) of the ED (holding assets in a fiduciary capacity). Accordingly, it is debatable whether specific requirements for investment entities are needed.

Defined benefit obligations (BC50): In the case of IAS 19 disclosures, we do not see the reason for an exception to the general approach. Especially smaller entities may have only a few, if any, beneficiaries of a defined benefit pension plan, and in this case the requirements outlined in the IFRS for SMEs appear to be sufficient. The argument that subsidiaries should provide more details because – subject to an assessment of materiality – such information will also be required for group reporting purposes would also be applicable to other disclosure requirements.

Response to 4 (b) (i):
Financing activities of a subsidiary may be completely different from those of the parent or the rest of the group. In many cases, the subsidiary may not have a financing function, since all financing activities are managed and provided by the group. Therefore, the financing cash flow of the subsidiary will differ significantly from the group's financing cash flow.

Since the relevant information about the financing activities is frequently available in the group, many subsidiaries do not need to report such information to the parent and, therefore, may need to collect this information only for the purpose of their own financial statements. In addition, under these circumstances, the reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities may only have a limited benefit for users. Considering the additional effort and the limited benefit of this information (i.e. showing mainly financing activities within the group), we propose that such a reconciliation should not be required by the draft Standard.

Response to 4 (b) (ii):
Current local GAAP in Austria do not require the disclosure of a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities, neither for consolidated nor for individual financial statements.

Question 5—Disclosure requirements about transition to other IFRS Standards

Any disclosure requirements specified in an IFRS Standard or an amendment to an IFRS Standard about the entity's transition to that Standard or amended Standard would remain applicable to an entity that applies the Standard.
Paragraphs BC57–BC59 of the Basis for Conclusions explain the Board's reasons for this proposal.
Do you agree with this proposal? Why or why not? If not, what approach would you suggest and why?

We agree. If new or amended IFRS Standards provide for specific disclosures with respect to the initial application of the Standard we assume that these disclosures are necessary to enable users of financial statements to properly understand the effects of the change in accounting policies.

Question 6—Disclosure requirements about insurance contracts

The draft Standard does not propose to reduce the disclosure requirements of IFRS 17 Insurance Contracts. Hence an entity that applies the Standard and applies IFRS 17 is required to apply the disclosure requirements in IFRS 17.

Paragraphs BC61–BC64 of the Basis for Conclusions explain the Board's reasons for not proposing any reduction to the disclosure requirements in IFRS 17.

> *(a) Do you agree that the draft Standard should not include reduced disclosure requirements for insurance contracts within the scope of IFRS 17? Why or why not? If you disagree, from which of the disclosure requirements in IFRS 17 should an entity that applies the Standard be exempt? Please explain why an entity applying the Standard should be exempt from the suggested disclosure requirements.*
>
> *(b) Are you aware of entities that issue insurance contracts within the scope of IFRS 17 and are eligible to apply the draft Standard? If so, please say whether such entities are common in your jurisdiction, and why they are not considered to be publicly accountable.*

Response to 6 (a):
As described in BC62, insurance companies will typically not be eligible to apply the draft Standard. BC63 states that there are some entities that would fall within the scope of the draft Standard, like entities which issue insurance contracts within the scope of IFRS 17 outside their primary businesses or captive insurers. Given the specific circumstances of these entities (e.g., not their primary businesses, or insurance contracts only within the group) we suggest that the Board reconsiders the requirement for full IFRS 17 disclosures. Especially for the companies mentioned above full IFRS 17 disclosures may be burdensome while the benefits of the additional information may be limited. We do not support the argument in BC64 (d) that the disclosures required by IFRS 17 may help insurance regulators, since regulators obtain more detailed and relevant information from insurance companies due to their regulatory reporting requirements.

Response to 6 (b):
In addition to the examples mentioned above there are insurance entities in Austria which may be eligible to apply the draft Standard. This is mainly the case for life insurers which do not hold assets for their customers (i.e., in fiduciary capacity), but hold them as their own investments at their risk. In our understanding, such entities would also be within the scope of the draft Standard.

Question 7—Interaction with IFRS 1 *First-time Adoption of International Financial Reporting Standards*

Paragraphs 23–30 of the draft Standard propose reduced disclosure requirements that apply to an entity that is preparing its first IFRS financial statements and has elected to apply the Standard when preparing those financial statements.

If a first-time adopter of IFRS Standards elected to apply the draft Standard, the entity would:

- *apply IFRS 1, except for the disclosure requirements in IFRS 1 listed in paragraph A1(a) of Appendix A of the draft Standard; and*
- *apply the disclosure requirements in paragraphs 23–30 of the draft Standard.*

This approach is consistent with the Board's proposals on how the draft Standard would interact with other IFRS Standards.

However, IFRS 1 differs from other IFRS Standards—IFRS 1 applies only when an entity first adopts IFRS Standards and sets out how a first-time adopter of IFRS Standards should make that transition.

(a) Do you agree with including reduced disclosure requirements for IFRS 1 in the draft Standard rather than leaving the disclosure requirements in IFRS 1?
Paragraphs 12–14 of the draft Standard set out the relationship between the draft Standard and IFRS 1.

(b) Do you agree with the proposals in paragraphs 12–14 of the draft Standard? Why or why not? If not, what suggestions do you have and why?

Response to 7 (a):
We agree as the proposed reduced requirements for first-time adopters of IFRS, that elect to apply the draft Standard, are in line with the general concept of this project.

With respect to para. 23, we note that this paragraph could be understood as a disclosure objective and not a specific requirement (refer to question 4 and BC42). Especially the wording "To comply with paragraph 23, …"

may support that understanding. We suggest changing the wording of these paragraphs to avoid potential misunderstandings.

Response to 7 (b):
We support the Board's approach that a transition from full IFRS (applied in the immediately preceding period) to the draft Standard is not a first-time application and not a change in accounting principles in accordance with IAS 8.

The same applies for the transition in the reverse direction, i.e., revoking the application of the draft Standard and applying full IFRS. At first glance, the latter might appear unreasonable, as preparers could avoid full IFRS 1 disclosure by first adopting the draft Standard, with a transition to full IFRS in the following period. However, such an approach could only be used by entities within the scope of the draft Standard. If these entities elect or are required to apply full IFRS in later periods, this step does not lead to changes in recognition and measurement principles and, consequently, to changes in their primary financial statements. As disclosures included in IFRS 1, but not in the draft Standard, mainly relate to recognition and measurement issues (e.g., disclosures about the application of "shortcuts" available in IFRS 1), such disclosures may not be relevant in later periods.

Question 8—The proposed disclosure requirements

Paragraphs 22–213 of the draft Standard set out proposed disclosure requirements for an entity that applies the Standard. In addition to your answers to Questions 4 to 7:

> *(a) Do you agree with those proposals? Why or why not? If not, which proposals do you disagree with and why?*
>
> *(b) Do you recommend any further reduction in the disclosure requirements for an entity that applies the Standard? If so, which of the proposed disclosure requirements should be excluded from the Standard and why?*
>
> *(c) Do you recommend any additional disclosure requirements for an entity that applies the Standard? If so, which disclosure requirements from other IFRS Standards should be included in the Standard and why?*

Response to 8 (a):
As outlined in our response to question 3, we generally agree with these proposals. The disclosure requirements are as far as possible in line with disclosures required in the IFRS for SMEs and, thus, are based on the experience gained during their application.

Response to 8 (b):
Based on a review of selected paragraphs we have identified the following potential reductions:

- Para. 92 (Contract Balances): We suggest eliminating disclosure requirement (b) (revenue recognised in the reporting period that was included in the contract liability balance at the beginning of the period). This disclosure may be burdensome for entities, especially in cases where a significant portion of the revenues results from inter-group activities, if such information does not need to be reported to the parent.

- Para. 152 (Employee Benefits): As explained in the response to question 4 (a) we do not see the reason for an exception to the general approach and suggest using the disclosure requirements of IFRS for SMEs.

Response to 8 (c):
We have not identified additional disclosure requirements which should be included in the draft Standard. For statutory purposes, local law will require specific additional disclosures, as this already applies for IFRS preparers in Austria at present.

Question 9—Structure of the draft Standard

Paragraphs 22–213 of the draft Standard set out proposed disclosure requirements for an entity that applies the Standard. These disclosure requirements are organised by IFRS Standard and would apply instead of the disclosure requirements in other IFRS Standards that are listed in Appendix A. Disclosure requirements that are not listed in Appendix A that remain applicable are generally indicated in the draft Standard by footnote to the relevant IFRS Standard heading. Paragraphs BC68–BC70 explain the structure of the draft Standard.

Do you agree with the structure of the draft Standard, including Appendix A which lists disclosure requirements in other IFRS Standards replaced by the disclosure requirements in the draft Standard? Why or why not? If not, what alternative would you suggest and why?

In principle, we agree that the disclosure requirements of the paragraphs 22 - 213 replace those of the full IFRS. However, as suggested in our response to question 3 , we propose considering the issuance of a comprehensive document (Standard) which consolidates the requirements of this draft Standard and the paragraphs from full IFRS remaining in force, which are now addressed by footnote. This would significantly facilitate the application of the draft Standard in practice.

Question 10—Other comments

Do you have any other comments on the proposals in the draft Standard or other matters in the Exposure Draft, including the analysis of the effects (paragraphs BC92–BC101 of the Basis for Conclusions)?

We have no further comments.