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Disclosure Initiative – Subsidiaries that are SMEs

Update on the project

Objective

- 1 The objective of the session is to provide EFRAG TEG an update on the IASB's latest discussions on its project *Disclosure Initiative – Subsidiaries that are SMEs*. The next step of the IASB work plan for this project will be a public consultation in early 2021 (a Discussion Paper or an Exposure Draft). This project is part of EFRAG workplan and, when a future ED will be issued, it will be subject to endorsement.
- 2 To support the discussion, agenda paper 08-02 – *Use of IFRS in Europe* – has been provided for the session. From this table, it is clear that the majority of the European countries permit or require the use of IFRS in the annual accounts, accordingly the potential population of European entities affected by this project may be significant.

Introduction

- 3 In the 2015 Agenda Consultation, a number of respondents called for the IASB to permit subsidiaries to apply IFRS Standards but with reduced disclosure requirements. These respondents noted that the use of the *IFRS for SMEs* Standard is not attractive for subsidiaries that report to their parent for consolidation purposes and apply the recognition and measurement requirements of *IFRS Standards*. In addition, it was argued that these subsidiaries preferred to use the recognition and measurement requirements of *IFRS Standards* but with less onerous disclosure requirements. Such an approach would reduce costs, without removing information needed by the users of the subsidiaries' financial statements.
- 4 In March 2016, the IASB added a research project to its pipeline but it only became active in March 2019. In March 2019, EFRAG TEG and EFRAG CFSS discussed the IASB feasibility study on whether subsidiaries that are SMEs should be permitted to use the recognition and measurement requirements in *IFRS Standards* together with reduced disclosure requirements based on the *IFRS for SMEs*.
 - (a) Members noted that the interest in such a standard in the European Union would vary across jurisdictions, as some allow the use of IFRS Standards for the separate financial statements and some do not, and some have already developed reduced disclosure standards in national GAAP. Some members also questioned whether the *IFRS for SMEs* would be the best starting point to develop such reduced disclosure requirements. Alternatively, the starting point could be based on full IFRS Standards with reductions rather than IFRS for SMEs, which would avoid the issue of dealing with recognition and measurement differences.

- (b) Lastly some members questioned how an IFRS Standard, if published, would affect the labelling of the information and whether this would create a “third tier” of reporting standards (alongside IFRS Standards and the IFRS for SMEs).
- 5 Subsequently, the IASB discussed this project at its April 2019 ASAF meeting where those that were supportive (particularly jurisdictions that permit or require application of IFRS Standards for preparation of general purpose financial statements of non-publicly accountable entities, including those outside of Europe) of the IASB to permit subsidiaries to apply *IFRS Standards* with reduced disclosures outnumbered those that were not supportive, although some of these indicated they may consider a wider scope than subsidiaries that are SMEs.

Research Phase

- 6 Between September and December 2019, the IASB discussed the IASB’s Staff initial research results and whether it would be feasible to permit subsidiaries that are SMEs to apply the recognition and measurement requirements of *IFRS Standards* and the disclosure requirements of the *IFRS for SMEs* Standard.
- 7 The research results indicated that if developed, the new IFRS Standard for Subsidiaries that are SMEs would be finally adopted and applied in practice. In fact, many supported the project believing it would result in cost savings. In particular, it would benefit jurisdictions where a subsidiary already applies full IFRS Standards, as it would reduce application costs. Research also indicated that, due to these cost savings, the project might lead to some more voluntarily companies adopting IFRS Standards.
- 8 The IASB also concluded it would be feasible to permit subsidiaries that are SMEs to apply the recognition and measurement requirements of *IFRS Standards* and the disclosure requirements of the *IFRS for SMEs* Standard. However, the disclosure requirements of the *IFRS for SMEs* Standard would need to be tailored to reflect differences in the recognition and measurement requirements between IFRS Standards and the *IFRS for SMEs* Standard. The IASB agreed to keep the tailoring to a minimum¹ and that any tailoring would be done under the principles of paragraph BC157 of the IFRS for SMEs Standard (including when a topic is omitted from the IFRS for SMEs Standard). The IFRS Standard on reduced disclosures may need to be updated following the issue of a new IFRS Standard and when the IFRS for SMEs Standard is updated (may require continuous maintenance).

Standard Setting phase

- 9 At its meeting January 2020, the IASB discussed whether it should:
- (a) defer work on the project until the second comprehensive review is complete and the IASB has issued amendments to the *IFRS for SMEs* Standard;
 - (b) defer work on the project until the Australian Accounting Standards Board (AASB) has issued² its simplified disclosure standard and then issue that standard as an IASB exposure draft (ED); or
 - (c) develop an ED as soon as possible.

¹ make no change if there is no recognition and measurement difference; but if there is a recognition and measurement difference, consider the principles in BC157 of the IFRS for SMEs Standard and adapt the disclosures if supported by one of the principles

² Expected to be published in May 2020

- 10 After considering the different possibilities, the IASB decided to move the *Subsidiaries that are SMEs* project from the research programme to the standard-setting programme and to decide at a later stage whether the outcome of the project would be a Discussion Paper or an Exposure Draft. The IASB Board members denoted the potential cost-savings and potential growth in the use of full-IFRS.
- 11 In April 2020, the IASB agreed on the project plan and objective of the standard-setting project:
- (a) **the IASB project plan:** Ultimately, the IASB plans to discuss whether the consultation document should be an ED or a DP and seek permission to ballot in Q4 2020.

2020	Topic
Q2	Presentation: should the new IFRS Standard require presentation from <i>IFRS Standards</i> or from the <i>IFRS for SMEs Standard</i> ?
Q3	Sundry issues
Q4	Scope of the reduced disclosure standard: should the scope remain subsidiaries that are SMEs, be extended to all SMEs, or somewhere between the two?
Q4	Should the consultation document be an exposure draft or a discussion paper?
Q4	Seek permission for the staff to begin the balloting process.

- (a) **objective of the standard-setting project:** to develop a reduced disclosure IFRS Standard that would apply on a voluntary basis to subsidiaries that are SMEs. To achieve this, the disclosure requirements of the IFRS for SMEs will be used as a starting point and adapted if and where recognition and measurement differences require such adaptation. A subsidiary that is a SME that applies the IFRS Standard would be required to apply the recognition and measurement requirements of IFRS Standards.
- 12 In regard to the presentation requirements, in April 2020 the IASB discussed the following alternatives for the subsidiaries applying the new IFRS Standard:
- (a) **Use of the presentation requirements in IFRS Standards:** an entity would be required to present a full set of financial statements, including a statement of profit or loss and other comprehensive income, a statement of changes in equity, a statement of financial position and a statement of cash flows.
- (b) **Use of the presentation requirements in the IFRS for SMEs Standard:** the IFRS for SMEs' presentation requirements would be the starting point and they would be supplemented or adjusted where necessary. Such an approach may, in some cases, simplify and reduce costs of preparation of financial statements for the subsidiaries (e.g. the IFRS for SMEs Standard permits an entity to present a single statement of income and retained earnings in place of the statement of comprehensive income and statement of changes in equity). Nonetheless, it would also mean that the presentation requirements in the *IFRS for SMEs Standard* would need to be adapted for differences in recognition and measurement between *IFRS Standards* and the *IFRS for SMEs Standard*. There would be cases where implementation and preparation costs could arise if subsidiaries prefer full IFRS. Finally, including presentation requirements with disclosure requirements in the one Standard would make the IFRS Standard being developed in the project longer

- (c) **Use of adjusted presentation requirements of IFRS Standards:** the IFRS Standards' presentation requirements would be adjusted to permit, for example, an entity to present a single statement of income and retained earnings in place of the statement of comprehensive income and statement of changes in equity in specified circumstances.

IASB tentative decisions in April 2020

- 13 The IASB tentatively decided that the objective of the project is to develop a reduced disclosure IFRS Standard that would apply on a voluntary basis to subsidiaries that are SMEs. The IASB also tentatively agreed with the proposed plan for the project.
- 14 Finally, the IASB tentatively agreed that subsidiaries that are SMEs that elect to apply the IFRS Standard being developed in this project would have to apply the presentation requirements of IFRS Standards (alternative a) above).

Questions for EFRAG TEG members

- 15 Do EFRAG TEG members have any comments on the IASB project plan as described in paragraph 11(a) above?
- 16 Do EFRAG TEG members agree with the objective of the project as described in paragraph 11(b) above?
- 17 Do EFRAG TEG members have any comments on the IASB project (e.g. scope of the project or consultation document)?
- 18 Do EFRAG TEG members have any suggestion on the EFRAG preparatory activities?