IFRS

STAFF PAPER

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IASB® Meeting

Project	**Disclosure Initiative—Subsidiaries that are SMEs**
Paper topic	Scope of the reduced-disclosure IFRS Standard

CONTACT Elizabeth Buckley ebuckley@ifrs.org +44 (0)20 7246 6410

Introduction

1. This agenda paper examines the scope of a possible reduced-disclosure IFRS Standard and whether the scope should remain subsidiaries that are small and medium-sized entities (SMEs) or should be expanded to a wider group of entities and, if so, which entities.

2. The Board will not be asked to make any decisions at this meeting. The objective is for the Board to hold an exploratory discussion of the matters raised in this paper. The staff will bring a decision-making paper to the Board in January 2021.

Structure of this paper

3. This paper is structured as follows:

   (a) Subsidiaries that are SMEs

      (i) Background to the project (paragraphs 4–8);

      (ii) Should the scope be limited to single entity financial statements (paragraphs 9–13);

(iii) Should the scope be limited to subsidiaries with a parent presenting consolidated financial statements applying IFRS Standards (paragraphs 14–22);

(b) Widening the scope beyond subsidiaries that are SMEs (paragraphs 23–37);

(c) Staff preliminary view (paragraphs 38 and 39).

Subsidiaries that are SMEs

Background to the project

4. The Board is undertaking this project following suggestions, received in response to the Request for Views: *2015 Agenda Consultation*, that the Board permits subsidiaries to apply IFRS Standards with reduced disclosure requirements. Respondents to the Request for Views argued that applying the *IFRS for SMEs* Standard is unattractive to some of these subsidiaries because they need to report to their parent, for consolidation purposes, applying the recognition and measurement requirements of IFRS Standards. For their own financial statements, those subsidiaries would prefer to use the same recognition and measurement requirements as IFRS Standards, but with less onerous disclosure requirements.

5. In adding the project to the research pipeline the Board decided on an approach limited to:

   (a) subsidiaries that meet the definition of an SME (a non-publicly accountable entity); and

   (b) using the disclosure requirements from the *IFRS for SMEs* Standard as the starting point for the disclosure requirements in the reduced-disclosure IFRS Standard.

6. One of the reasons for this approach is that this group of subsidiaries is eligible to apply the *IFRS for SMEs* Standard and so the Board could be satisfied that the

disclosure requirements from the *IFRS for SMEs* Standard would be sufficient to meet user needs when there is no recognition and measurement difference.

7. Similarly, when there are recognition and measurement differences, applying the principles in paragraph BC157 of the *IFRS for SMEs* Standard to identify adaptations to the disclosure requirements of the *IFRS for SMEs* Standard, the Board could be satisfied that the disclosure requirements in the reduced-disclosure IFRS Standard would be sufficient to meet user needs.

8. If the Board decides to retain the focus on subsidiaries that are SMEs for the reduced-disclosure IFRS Standard, the staff have identified two possible limitations on the scope:

   (a) limiting application to single entity financial statements (paragraphs 9–13); and

   (b) limiting application to subsidiaries with a parent presenting consolidated financial statements applying IFRS Standards (paragraphs 14–22).

Should the scope be limited to single entity financial statements?

9. Paragraph 4 of IFRS 10 *Consolidated Financial Statements* permits subsidiaries that are themselves parents not to present consolidated financial statements if four conditions are met. Two of the conditions (paragraph 4(a)(ii) and (iii)) will be met by a subsidiary meeting the definition of an SME. The other two conditions are:

   - it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements (paragraph 4(a)(i)); and
   - its ultimate or any intermediate parent produces financial statements that are available for public use and comply with IFRSs, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with this IFRS (paragraph 4(a)(iv)).

10. The staff believe that most subsidiaries applying IFRS Standards, and eligible to apply the reduced-disclosure IFRS Standard, would not be required to present consolidated financial statements by IFRS 10. However, legal requirements in some jurisdictions may require some subsidiaries that are parents to present consolidated financial statements.

11. Paragraph 17 of IAS 28 *Investments in Associates and Joint Ventures* permits subsidiaries meeting the same conditions as in IFRS 10 not to apply the equity method to its investment in an associate or a joint venture. It is possible that a subsidiary that has an associate or joint venture, but no subsidiaries, may be required to present financial statements in which it has applied the equity method to its associate or joint venture.

12. If the scope of the reduced-disclosure IFRS Standard referred to subsidiaries that are SMEs, without any limiting conditions, the Standard could be applied by a subsidiary preparing single entity financial statements, consolidated financial statements and/or financial statements in which the investments in associates or joint ventures are required by IAS 28 to be accounted for applying the equity method.

13. The staff believe there is no reason to exclude a subsidiary from applying the reduced-disclosure IFRS Standard if it is required to present consolidated financial statements or financial statements in which the investments in associates or joint ventures are required by IAS 28 to be accounted for applying the equity method. Consequently, the staff recommend that the reduced-disclosure IFRS Standard is not limited to single entity financial statements.

Should the scope be limited to subsidiaries with a parent presenting consolidated financial statements applying IFRS Standards

14. Respondents to the Request for Views: *2015 Agenda Consultation* argued that applying the *IFRS for SMEs* Standard is unattractive to some subsidiaries because they need to report to their parent, for consolidation purposes, applying the recognition and

measurement requirements of IFRS Standards and so would incur additional costs, such as monitoring recognition and measurement differences. Consequently, for their own financial statements, those subsidiaries would prefer to use the same recognition and measurement requirements as IFRS Standards.

15. The requests to the Board for reduced disclosure requirements were therefore about subsidiaries with a parent presenting consolidated financial statements applying IFRS Standards. It would therefore be logical for the Board to restrict application of the reduced-disclosure IFRS Standard to subsidiaries with a parent presenting consolidated financial statements applying IFRS Standards.

16. There are, however, alternatives the Board could consider:

    (a) not restricting the scope of the reduced-disclosure IFRS Standard to subsidiaries with a parent applying IFRS Standards and so permit the Standard to be applied by a subsidiary with a parent applying a different GAAP (paragraphs 17–20);

    (b) permit the reduced-disclosure IFRS Standard to be applied only if the parent's consolidated financial statements are *required* to be presented applying IFRS Standards (paragraph 21);

    (c) permit the reduced-disclosure IFRS Standard to be applied by an entity that, at the start of its reporting period, at any time during its reporting period, or at the end of its reporting period was a subsidiary of a parent presenting consolidated financial statements applying IFRS Standards (paragraph 22).

17. If the Board does not restrict the scope to subsidiaries with a parent presenting consolidated financial statements applying IFRS Standards, the subsidiaries choosing to apply the reduced-disclosure IFRS Standard might generally be those with a parent presenting consolidated financial statements applying IFRS Standards. That is, in practice a similar outcome may be achieved without restricting the scope of the reduced-disclosure IFRS Standard.

18. However, if the scope is not restricted, the reduced-disclosure IFRS Standard could be applied by a subsidiary with a parent applying a different GAAP.

19. Arguably, such a subsidiary would incur additional costs, such as monitoring recognition and measurement differences, that the project aims to eliminate. Despite the additional costs, there could be reasons why a subsidiary would choose to apply the reduced-disclosure IFRS Standard, for example, IFRS Standards may be required to be applied by all entities in its jurisdiction (its parent being domiciled in a different jurisdiction); in this instance the additional costs would be incurred anyway and by applying the reduced-disclosure IFRS Standard the costs could be reduced.

20. The staff believe that to remain true to the project objective, the Board should restrict the scope of the reduced-disclosure IFRS Standard to subsidiaries with a parent presenting consolidated financial statements applying IFRS Standards.

21. The scope could be narrowed by permitting the reduced-disclosure IFRS Standard to be applied only if the parent's consolidated financial statements are *required* to be presented applying IFRS Standards. This would exclude subsidiaries of a parent that has chosen, rather than been required, to apply IFRS Standards. The staff do not believe there would be a valid basis for this approach.

22. The Board could consider enabling the reduced-disclosure IFRS Standard to be applied by an entity that was a subsidiary at any point during its reporting period, at the start of its reporting period, or at the end of its reporting period, of a parent presenting consolidated financial statements applying IFRS Standards. If the relief were for entities that were subsidiaries at any point during the reporting period or at the start of its reporting period, the reduced-disclosure IFRS Standard could be applied by an entity that was no longer a subsidiary at the end of its reporting period. The staff believe that the scope of the reduced-disclosure IFRS Standard should be entities that, at the end of their reporting period, were subsidiaries of a parent presenting consolidated financial statements applying IFRS Standards.

Widening the scope beyond subsidiaries that are SMEs

23. If the Board wished to consider widening the scope of the reduced-disclosure IFRS Standard beyond subsidiaries that are SMEs, it could consider extending the scope to the following entities that meet the definition of an SME:

    (a) joint ventures and joint operations structured through a separate vehicle of a joint venturer or joint operator that presents financial statements, that are not separate financial statements, applying IFRS Standards;

    (b) associates of an investor that presents financial statements, that are not separate financial statements, applying IFRS Standards;

    (c) parent entities in their separate financial statements when the consolidated financial statements are presented, or required to be presented, applying IFRS Standards;

    (d) parent entities in their consolidated financial statements when those parents are not themselves subsidiaries;

    (e) all SMEs.

24. The argument in favour of extending the scope as in paragraph 23(a), ie to joint ventures and joint operations that are SMEs structured through a separate vehicle of a joint venturer or joint operator that prepares financial statements that are not separate financial statements applying IFRS Standards, and as in paragraph 23(b), ie to associates that are SMEs of an investor that presents financial statements, that are not separate financial statements, applying IFRS Standards, would be for cost-saving reasons similar to subsidiaries, that is, if the joint venture or joint operation needs to submit financial information prepared applying IFRS Standards to its joint venturer or joint operator then it might also prefer to prepare its financial statements applying IFRS Standards. However, the staff have not heard a demand for extending the scope to these two categories of entities.

25. The argument in favour of extending the scope as in paragraph 23(c), ie to parent entities that are SMEs in their separate financial statements when the consolidated

financial statements are presented, or required to be presented, applying IFRS Standards, would be for cost-saving reasons similar to subsidiaries. An argument against this extension would be the lack of comparability it would create between the disclosures in the consolidated financial statements and the parent entity's separate financial statements. An extension to a parent's separate financial statements could be limited to parents that are *required* to apply IFRS Standards, on the grounds that it seems odd to choose to apply IFRS Standards but then want to give reduced disclosures. However, limiting it to parents that are required to apply IFRS Standards would appear to penalise parent entities that choose to apply IFRS Standards.

26. Arguments in favour of extending the scope as in paragraph 23(d) or (e) are:

(a) Although the request to the Board was in respect of subsidiaries with parents presenting consolidated financial statements, and was to reduce costs for the group, the project is eliminating disclosure requirements that are not designed for the users of SME financial statements. Eliminating such disclosure requirements could be of benefit to all SMEs, not just subsidiaries.

(b) Permitting the reduced-disclosure IFRS Standard to be applied by all SMEs might be welcome by those SMEs that want to prepare financial statements applying IFRS Standards but argue the costs of developing disclosures is not effective. Extending the scope of the reduced-disclosure IFRS Standard might therefore encourage some to apply IFRS Standards as the cost of applying IFRS Standards would be reduced.

(c) Similarly, extending the scope to all SMEs could be particularly beneficial for SMEs that plan in the medium term to issue financial instruments that will be traded in a public market.

(d) The *IFRS for SMEs* Standard is based on IFRS Standards. Although the Board has received support for continuing to base the *IFRS for SMEs* Standard on IFRS Standards, an option for SMEs to apply IFRS Standards with reduced disclosures may allow the Board to focus on a simplified *IFRS for SMEs* Standard.

(e) Extending the scope of the reduced-disclosure IFRS Standard would permit jurisdictions to decide on a financial reporting framework, ie a jurisdiction could require the reduced-disclosure IFRS Standard and the *IFRS for SMEs* Standard for different types/sizes of entities.

27. Arguments against extending the scope as in paragraph 23(d) or (e) are:

(a) Extending the scope of reduced-disclosure IFRS Standard would create a third tier of accounting: (i) IFRS Standards; (ii) IFRS Standards with reduced disclosure requirements (with broader application); and (iii) the *IFRS for SMEs* Standard. Creating a third tier would create confusion about which Standard is appropriate for entities to apply and might ultimately lead to calls for the reduced-disclosure IFRS Standard to include other relaxations, not just disclosure requirements.

(b) When adding the project to its research pipeline the Board's objective was to reduce costs for subsidiaries that are SMEs by eliminating disclosure requirements that are not designed for the users of SME financial statements. Consequently, the research work the staff undertook addressed a project to provide relief for subsidiaries. The staff have not consulted on a wider scope, including all SMEs, or possible implications for the *IFRS for SMEs* Standard.

(c) It is difficult to understand the view of an SME that wants to prepare financial statements applying IFRS Standards but does not apply IFRS Standards because it considers the costs of developing disclosures is not effective. The reason for wanting to apply IFRS Standards in preparing financial statements is usually driven by users' needs; if preparing financial statements applying IFRS Standards is important to an SME's users then disclosures that are required by IFRS Standards must be equally important.

(d) Permitting all SMEs to apply the reduced-disclosure IFRS Standard might result in some jurisdictions permitting the reduced-disclosure IFRS Standard to be applied and not permitting the *IFRS for SMEs* Standard to be applied (as referred to in paragraph 26(e)) or might result in some lenders/investors requiring that the reduced-disclosure IFRS Standard be applied by an SME because they perceive it to be superior to the *IFRS for SMEs* Standard. However, applying the reduced-disclosure IFRS Standard rather than the *IFRS for SMEs* Standard could be more costly for some SMEs as the *IFRS for SMEs* Standard takes into account the costs to SMEs and the resources of SMEs to prepare financial information and contains several simplifications to the recognition and measurement principles in IFRS Standards. This could impede the quality of application of the financial statements.

28. By limiting the scope to subsidiaries of a parent presenting consolidated financial statements applying IFRS Standards, some may believe that the reduced disclosure requirements are permitted solely because full disclosures (about the subsidiary) would be available in the parent's consolidated financial statements. However, this is not correct:

    (a) consolidated financial statements are prepared applying a materiality appropriate for the group, whereas the subsidiary financial statements are prepared applying a materiality appropriate for the subsidiary; and

    (b) the principles applied to establish disclosure requirements for the reduced-disclosure IFRS Standard are those in paragraph BC157 of the *IFRS for SMEs* Standard—these principles do not assume that consolidated financial statements will be available.

Interaction of project objective and scope of a reduced-disclosure IFRS Standard

29. The project that the Board added to its research pipeline in May 2016 was to assess whether it would be feasible to permit SMEs that are subsidiaries to use the recognition and measurement requirements in IFRS Standards and the disclosure requirements in the *IFRS for SMEs* Standard. The research pipeline noted (Agenda Paper 8 for the December 2018 Board meeting) that for this project the research would involve:

    > Investigating how much tailoring the existing disclosure requirements of the *IFRS for SMEs* Standard would need to make them dovetail with the recognition

> and measurements of IFRS Standards, **without establishing a new third regime (alongside IFRS Standards and the *IFRS for SMEs* Standard)** (emphasis added).

30. If the scope of the project remains subsidiaries of a parent presenting consolidated financial statements applying IFRS Standards the project objective is to improve cost-benefit. That is, the project would permit subsidiaries that need to report to their parent, for consolidation purposes, applying the recognition and measurement requirements of IFRS Standards, to reduce the costs of preparation of their financial statements while enabling them to provide information appropriate for users of the subsidiaries' financial statements.

31. Removing some disclosure requirements makes it simpler for preparers to produce financial statements tailored more specifically for their users. It might therefore appear logical to extend this benefit to all SMEs. However, this could be seen as creating a third tier: (i) IFRS Standards; (ii) IFRS Standards with reduced disclosure requirements (with application available to all SMEs); and (iii) the *IFRS for SMEs* Standard. There are, however, two views on whether a third tier is created.

A third tier is not created

32. A viewpoint that a third tier is not created is that because the proposed disclosure requirements have been developed by considering the principles in paragraph BC157 of the *IFRS for SMEs* Standard, the disclosure requirements that will be required by the reduced-disclosure IFRS Standard make it simpler for preparers to produce financial statements tailored more specifically for their users' needs. That is, some of the disclosures that may not be relevant to the users of an SME's financial statements will not be required by the reduced-disclosure IFRS Standard, making it easier for an SME to apply materiality judgement when preparing its financial statements.

33. If this was available to all SMEs, the Board would not be creating a third tier. Instead it would be developing an IFRS Standard that reflects the user needs for those entities, within IFRS Standards.

A third tier is created

34. A viewpoint that a third tier is created is that the Board has already taken account of SME users' needs in developing and issuing the *IFRS for SMEs* Standard. Furthermore, in developing the *IFRS for SMEs* Standard the Board takes into consideration the resources of SMEs to prepare financial information.

35. In issuing both IFRS Standards and the *IFRS for SMEs* Standard, which is based on the principles of IFRS Standards but with modifications to reflect SME users' needs and cost-benefit considerations, the Board has created two tiers within its single set of financial reporting standards.

36. Extending the scope of the reduced-disclosure IFRS Standard to all SMEs would create confusion with the *IFRS for SMEs* Standard and, by being an alternative, would create a third tier, whereas limiting the scope to a subset of SMEs that, although eligible to apply the *IFRS for SMEs* Standard, need to report to their parent applying IFRS Standards and hence prefer to apply IFRS Standards in their own financial statements, would sit within IFRS Standards and be an application of cost-benefit considerations.

Relationship with scope of the reduced-disclosure IFRS Standard

37. Whether expanding the scope of the reduced-disclosure IFRS Standard is seen as creating a third tier or not, the Board could choose to change the focus of the project objective if it wished to pursue a scope option that it thought did not fit with the present project objective.

Staff preliminary views

38. For the reasons outlined in paragraph 27, the staff think that the scope of the reduced-disclosure IFRS Standard should not be extended to all SMEs, but be restricted to entities that, at the end of their reporting period, are subsidiaries of a parent presenting consolidated financial statements applying IFRS Standards

(paragraphs 14–22) and that the scope *not* be limited to single entity financial statements (paragraph 13).

39. The staff have not heard a demand for extending the scope to joint ventures and joint operations structured through a separate vehicle of a joint venturer or joint operator that prepares financial statements that are not separate financial statements applying IFRS Standards or to associates of an investor that presents financial statements, that are not separate financial statements, applying IFRS Standards, but think the Board could ask about this in the consultation document.

Question for the Board

Question for the Board
Does the Board have any comments on the staff preliminary views?