IFRS

STAFF PAPER

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IASB® meeting

Project	**Second Comprehensive Review of the *IFRS for SMEs* Accounting Standard**
Paper topic	Towards an exposure draft—Guidance on public accountability

CONTACT(S) Michelle Fisher mfisher@ifrs.org

Introduction

1. This paper discusses whether to include additional guidance on the definition of public accountability in the *IFRS for SMEs* Accounting Standard and, if finalised, the draft Standard *Subsidiaries without Public Accountability: Disclosures* (draft Standard).

2. In this paper:

    (a) the term SME refers to entities that are eligible to apply the *IFRS for SMEs* Accounting Standard; and

    (b) the term draft Standard refers to the International Accounting Standards Board (IASB) proposal for a new IFRS Accounting Standard in the Exposure Draft *Subsidiaries without Public Accountability: Disclosures.*

Purpose of the paper

3. The purpose of this paper is to ask the IASB to continue its discussion from May 2022 on what additional guidance to provide on the definition of public accountability. At this meeting, the IASB will be asked to consider whether to include guidance on public accountability from Module 1 *Small and Medium-sized Entities* (the educational material on Section 1 *Small and Medium-sized Entities* of the *IFRS for SMEs* Accounting Standard) within the *IFRS for SMEs* Accounting Standard and, if finalised, the draft Standard.

Staff recommendation

4. The staff recommend that the IASB:
   (a) neither includes the guidance on public accountability from Module 1 within the *IFRS for SMEs* Accounting Standard nor, if finalised, the draft Standard *Subsidiaries without Public Accountability: Disclosures*; and
   (b) instead makes the full guidance on public accountability in Module 1 *Small and Medium-sized Entities* separately available on the IFRS Foundation website as educational material supporting the draft Standard, if finalised.

Structure of the paper

5. The paper is structured as follows:
   (a) background (paragraphs 6–15 of this paper);
   (b) staff analysis (paragraphs 16–26 of this paper);
   (c) staff recommendation and question for the IASB (paragraph 27 of this paper);
   (d) Appendix A—Staff draft of possible guidance on public accountability to include within the *IFRS for SMEs* Accounting Standard (and the draft Standard, if finalised); and

(e) Appendix B—Feedback on the description of public accountability in the draft Standard.

Background

6. This section covers the following background information from the May 2022 IASB meeting:
   (a) definition of public accountability (paragraphs 7–9 of this paper);
   (b) recent feedback on the definition of public accountability (paragraphs 10–11 of this paper); and
   (c) May 2022 IASB discussion (paragraphs 12–15 of this paper).

Definition of public accountability

7. The *IFRS for SMEs* Accounting Standard is intended for use by entities that do not have public accountability and publish general purpose financial statements for external users (SMEs).

8. Paragraph 1.3 of the *IFRS for SMEs* Accounting Standard states that an entity has public accountability if:[1]
   (a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
   (b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (most banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks would meet this second criterion).

[1] Paragraph 1.3 of the *IFRS for SMEs* Accounting Standard (and paragraph 7 of the draft Standard).

9. Paragraph 1.4 of the *IFRS for SMEs* Accounting Standard further clarifies that some entities may also hold assets in a fiduciary capacity for a broad group of outsiders because they hold and manage financial resources entrusted to them by clients, customers or members not involved in the management of the entity. However, if they do so for reasons incidental to a primary business (as, for example, may be the case for travel or real estate agents, schools, charitable organisations, co-operative enterprises requiring a nominal membership deposit and sellers that receive payment in advance of delivery of the goods or services such as utility companies), that does not make them publicly accountable.[2]

Recent feedback on the definition of public accountability

10. Only a small number of respondents to the Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard*, published in January 2020, commented on the scope of the *IFRS for SMEs* Accounting Standard. These respondents generally asked for the scope to be widened, rather than commenting on the clarity of the definition of public accountability.

11. However, in July 2021, the IASB issued Exposure Draft *Subsidiaries without Public Accountability: Disclosures*, which sets out the IASB's proposal for a new IFRS Accounting Standard (draft Standard) that would permit a subsidiary that does not have public accountability to apply reduced disclosure requirements when applying full IFRS Accounting Standards. The description of public accountability in the draft Standard is the definition and supporting guidance in paragraphs 1.3–1.4 of the *IFRS for SMEs* Accounting Standard (see paragraphs 8–9 of this paper). Respondents to the draft Standard requested further guidance on the description of public accountability (see Appendix B to this paper for a summary of the main requests for clarification).

[2] Paragraph 1.4 of the *IFRS for SMEs* Accounting Standard (and paragraph 8 of the draft Standard).

May 2022 IASB discussion

IASB tentative decisions

12. At its May 2022 meeting, responding to feedback (see paragraph 11 of this paper), the IASB tentatively decided to improve the understandability of the definition of public accountability in the *IFRS for SMEs* Accounting Standard by proposing:

    (a) to amend the statement in paragraph 1.3(b) of the *IFRS for SMEs* Accounting Standard as follows:

    (for example, ~~most~~ banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks often ~~would~~ meet this second criterion)

    (b) to include the following clarifying guidance in Section 1 of the *IFRS for SMEs* Accounting Standard:

    Characteristics of an entity with public accountability:

    (a) there is a high degree of outside interest in the entity and the existence of a broad group of primary users of the entity's financial statements (existing and potential investors, lenders and other creditors) outside the entity (other than owner-managers) who have a direct financial interest in or significant claim against the entity.

    (b) the primary users in (a) depend primarily on external financial reporting as their means of obtaining financial information about the entity. These primary users have a legitimate need for financial information about the entity but lack the power to demand the information for themselves. Financial statements and other financial reports based on full IFRS Accounting Standards are intended to meet those needs.

    The IASB also tentatively decided to make the amendments in paragraphs (a) and (b) to the description of public accountability in the draft Standard, if the draft Standard is finalised.

13. Further, in relation to the draft Standard, the IASB tentatively decided, to clarify, by using similar wording to that of paragraph 1.7 of the *IFRS for SMEs* Accounting Standard, that an intermediate parent is required to assess its eligibility to apply the draft Standard in its individual or separate financial statements on the basis of its own status.

Module 1 of the educational material on the IFRS for SMEs Accounting Standard

14. At the May 2022 IASB meeting, the staff recommended that the IASB should make the guidance on public accountability in Module 1 *Small and Medium-sized Entities* separately available on the IFRS Foundation website as guidance supporting the draft Standard, if finalised. The staff made this recommendation because some of the requests for clarification of the description of public accountability in the draft Standard (for example, requests for guidance on ‘traded in a public market’) are addressed in Module 1. Therefore, such clarification requests may have arisen on the draft Standard because the respondents are either not aware of the educational modules on the *IFRS for SMEs* Accounting Standard, or not aware that the guidance in those modules would also be relevant to the description of public accountability in the draft Standard.

15. The IASB tentatively agreed to consider how best to make the guidance on public accountability in Module 1 available to entities applying the draft Standard, if finalised. A few IASB members suggested including the guidance as part of the draft Standard (for example as application guidance or illustrative examples that would form part of the IFRS Bound Volume) rather than as educational material on the IFRS Foundation website.

Staff analysis

16. The staff analysis is set out as follows:

    (a) staff draft of guidance on public accountability (paragraphs 17–18 of this paper);

    (b) the need to include any additional guidance on public accountability in both the *IFRS for SMEs* Accounting Standard and the draft Standard (paragraphs 19–21 of this paper);

    (c) mandatory or non-mandatory guidance (paragraphs 22–23 of this paper);

    (d) exposing the guidance for public comment (paragraph 24 of this paper); and

    (e) staff view (paragraphs 25–26 of this paper).

Staff draft of guidance on public accountability

17. To assist the IASB decide how best to make the guidance on public accountability in Module 1 available to entities applying the draft Standard the staff have developed draft guidance set out in Appendix A to this paper. This draft guidance could be included within the *IFRS for SMEs* Accounting Standard (eg as guidance accompanying Section 1) and/or, if finalised, the draft Standard.

18. The guidance has been compiled by extracting text and illustrative examples from Module 1 that:

    (a) respond to the main requests for clarification from respondents to the draft Standard (see Appendix B to this paper)—so includes guidance on 'traded in a public market' and examples to illustrate application of 'broad group of outsiders' and 'primary business'; and

    (b) would be suitable as guidance accompanying an Accounting Standard (within the *IFRS for SMEs* Accounting Standard or IFRS Bound Volume), rather than as educational material on the website.

The need to include guidance in both the **IFRS for SMEs** *Accounting Standard and the draft Standard*

19. The description of public accountability in the draft Standard is the definition and supporting guidance from paragraphs 1.3 and 1.4 of the *IFRS for SMEs* Accounting Standard. Consequently, the staff think that should guidance on the description of public accountability be included in the draft Standard, if finalised, it should also be included in the *IFRS for SMEs* Accounting Standard (for example, in an appendix to Section 1).

20. Although the staff acknowledge that requests for guidance on public accountability have arisen predominantly in response to the Exposure Draft of the draft Standard, rather than on the *IFRS for SMEs* Accounting Standard, the scope of the draft Standard and the *IFRS for SMEs* Accounting Standard are linked. The IASB has tentatively decided that the description of public accountability in the draft Standard will remain the same because the draft Standard was developed using the *IFRS for SMEs* Accounting Standard as a starting point, which could only be done because eligible subsidiaries that can apply the draft Standard meet the definition of an SME.

21. The staff think any mandatory guidance on public accountability in the draft Standard would likely be considered de facto mandatory guidance on public accountability for the purposes of the *IFRS for SMEs* Accounting Standard. The staff think this is possibly true even if guidance is provided as non-mandatory guidance in the draft Standard (and in Part B of the IFRS Bound Volume). The additional due process required and the status of guidance accompanying an IFRS Accounting Standard would likely elevate the authority of that guidance above educational material on the IFRS Foundation website for the purposes of the *IFRS for SMEs* Accounting Standard.

Mandatory or non-mandatory guidance

22. Having compiled and evaluated the extracts in Appendix A to this paper, the staff think the draft guidance should be non-mandatory guidance, if it is included within the *IFRS for SMEs* Accounting Standard and/or, if finalised, the draft Standard.

23. In forming the view that the guidance should be non-mandatory, the staff note that the *IFRS for SMEs* Accounting Standard is an established Standard in many jurisdictions. Introducing mandatory guidance could disrupt the current application of the Standard, even if it is developed from existing educational material. For example, introducing mandatory guidance could create problems in jurisdictions that have already determined which types of entities in that jurisdiction have public accountability, if this is not consistent with such guidance.

Exposing the guidance for public comment

24. Including the proposed guidance as an appendix to Section 1 in the forthcoming Exposure Draft of the Third edition of the *IFRS for SMEs* Accounting Standard would provide an opportunity for public feedback before the guidance is published in a final Standard. For example, the IASB could ask respondents whether they support the additional guidance on public accountability being provided as mandatory application guidance or non-mandatory implementation guidance/illustrative examples, or whether they think the guidance should be retained only as educational material on the IFRS Foundation website.

Staff view

25. The staff have considered how best to make the guidance on public accountability in Module 1 available to entities applying the draft Standard, which included preparing a staff draft of possible guidance to include in the draft Standard. Nevertheless, the staff retain the view that it would be sufficient to make the guidance on public accountability in Module 1 separately available on the IFRS Foundation website as guidance supporting the draft Standard, if finalised, as is done for the *IFRS for SMEs* Accounting Standard (for example, in the webpages containing supporting material for individual IFRS Accounting Standards). The staff view takes into consideration:

    (a) the *IFRS for SMEs* Accounting Standard is established in many jurisdictions and so adding detailed guidance on the scope now might confuse rather than assist;

(b) the guidance on public accountability in Module 1 has functioned well as educational material since it was first published to support the first edition of the *IFRS for SMEs* Accounting Standard issued in 2009; and

(c) the IASB has not received significant concerns on the need to clarify the definition of public accountability within the *IFRS for SMEs* Accounting Standard (see paragraph 10 of this paper).

26. Finally, the staff acknowledge there are benefits of exposing the guidance for public comment in the Exposure Draft of the Third edition of the *IFRS for SMEs* Accounting Standard (see paragraph 24 of this paper). However, in the staff's view there is no compelling need for the guidance in Appendix A to this paper to be included in the *IFRS for SMEs* Accounting Standard or the draft Standard, if finalised, and therefore it would be inappropriate to publish the guidance for comment.

Staff recommendation and question for the IASB

27. The staff recommend that the IASB:

(a) neither includes the guidance on public accountability from Module 1 within the *IFRS for SMEs* Accounting Standard nor, if finalised, the draft Standard *Subsidiaries without Public Accountability: Disclosures*; and

(b) instead makes the full guidance on public accountability in Module 1 *Small and Medium-sized Entities* separately available on the IFRS Foundation website as educational material supporting the draft Standard, if finalised.

Question for the IASB
Does the IASB agree with the staff recommendation in paragraph 27 of this paper?

Appendix A—Staff draft of possible guidance on public accountability to include within the *IFRS for SMEs* Accounting Standard (and the draft Standard, if finalised[3])

Appendix to Section 1: Guidance on public accountability

This Appendix accompanies, but is not part of, Section 1. It provides guidance for applying the requirements in paragraphs 1.3-1.4.

Traded in a public market

1A.1. 'Public market' is not restricted to recognised and/or regulated stock exchanges. It includes all markets that bring together entities that seek capital and investors who are not involved in managing the entity. For a market to be public, it must be accessible by a broad group of outsiders. If the instruments can only be exchanged between parties involved in the management of the entity, such as key management personnel or shareholders, the instruments are not traded in a public market.

1A.2. If a shareholder of an entity is permitted by law to publicly advertise shares it holds in the entity for sale, for example, on a website or in a newspaper, without any active involvement (or sometimes without even the knowledge) of the entity issuing those shares. Because the entity did not take an affirmative step to permit public trading of shares (such as, but not limited to, share registration), such advertising by a shareholder does not, by itself, create an over-the-counter public market and would not prevent an entity that otherwise meets the criteria in Section 1 from applying the *IFRS for SMEs* Accounting Standard.

1A.3. Furthermore, the availability of a published price does not necessarily mean that an entity's debt or equity instruments are traded in a public market. For example, in some countries over-the-counter shares have a quoted price, but the market has no facility for trading, and so buyers and sellers deal with each other directly. This would not constitute trading in a public market. However, if trading occurs only occasionally in a public market, even only a few times a year, this would constitute trading in a public market.

1A.4. The assessment of whether an entity's debt or equity instruments are traded in a public market, or are in the process of being issued for trading in a public market, should be an ongoing one.

Holding assets in a fiduciary capacity for a broad group of outsiders

Example 1 – Captive insurance subsidiaries.

1A.5. A captive insurance company is typically an insurance company that insures only the risks of a single entity (often its parent company), or only the risks of entities within the same group of entities as the captive insurance company (such as fellow subsidiaries or parent entities). Where this is the case, the captive insurance company holds assets in a fiduciary capacity only for other group entities, which would not be considered a broad group of outsiders. Consequently, the captive insurance subsidiary is not publicly accountable. Furthermore, the group will not be publicly accountable solely as a result of the captive insurance subsidiary.

[3] If this guidance is included in the draft Standard, if finalised, minor redrafting would be necessary (for example, replacing owner manager with parent entity in example 3).

Example 2 – Investment funds with only a few participants.

1A.6. Mutual funds and similar institutions, such as unit trusts, undertakings for collective investments in transferable securities (UCITS), and other professionally managed collective investment programmes, typically take investment funds from the general public. Doing so makes those entities publicly accountable. However, if an entity holds and manages financial resources for only a few investors, or only for investors that are not considered to be outsiders (for example, the investors all participate in the investment decisions), then this would not constitute a broad group of outsiders. Examples of entities that are not holding assets in a fiduciary capacity for a broad group of outsiders include:

- a venture capital fund with a few investors all of whom are directly involved in the fund's investment and management decisions;
- a pooled investment fund whose participants are limited to a parent, its subsidiaries and a few of its associates; and
- a pooled investment fund, closed to the general public and with only a few specifically selected participants.

Example 3 – Money lender

1A.7. An entity's only business is earning interest on money that it lends to its clients. The entity obtains all of its funds direct from its two owner-managers (ie the entity does not take deposits from customers).

1A.8. The entity is not publicly accountable—its instruments are not traded in a public market and it does not hold assets in a fiduciary capacity for a broad group of outsiders. The business of lending money to the general public does not itself give rise to public accountability. Banks typically have public accountability because of their deposit-taking activities rather than their lending activities. The entity in this example does not take deposits from a broad group of outsiders—it holds assets only for its two owner-managers.

Incidental to a primary business

Example 4 – Supermarket with deposit-taking business

1A.9. An entity's main business is operating a supermarket. In the current reporting period, the entity extended its operations to include taking deposits from its customers in return for a promise to return to each customer their capital plus a return of 2% of the amount deposited 90 days after receiving the cash from the customer. At the end of the reporting period, the deposit-taking business represents less than 1% of the entity's assets and liabilities. It also represented less than 1% of the entity's profit for the current year.

1A.10. The entity is publicly accountable—in the current reporting period the entity started a banking operation in which it holds assets in a fiduciary capacity for a broad group of outsiders (its banking customers). The banking business is not incidental to its supermarket operations (ie it is a second primary business). Because the entity operates a banking business it is publicly accountable. (Note: The entity is publicly accountable even if the deposit-taking activities are not subject to banking regulations in that jurisdiction.)

Appendix B—Feedback on the description of public accountability in the draft Standard[4]

Feedback from the comment letters on the draft Standard

B1. Some respondents sought further guidance on the description of 'public accountability':

(c) guidance on 'fiduciary capacity':

(i) an auditor noted that the IASB has guidance on this term in one of its educational modules supporting the application of the *IFRS for SMEs* Accounting Standard (Module 1). Some entities may be unfamiliar about the existence of this educational material.

(ii) some respondents, including insurers and non-insurers, raised concerns about the statement in paragraph 7(b) of the draft Standard that most insurers hold assets in a fiduciary capacity. Some of these respondents asserted that premiums collected belong to the insurance entity in exchange for the promise to compensate the customer if an insured event occurs (for example property and casualty (P&C) insurance contracts). The premiums are not held in a fiduciary capacity by the insurance entity, neither in legal terms nor in economic perspective.

(d) guidance about 'public market'. For example, a standard-setter noted that many entities now raise funds in alternative markets apart from the traditional public market (stock exchange). For example, some funds are raised through crowdfunding and peer-to-peer financing.

(e) guidance about how public accountability is assessed if a subsidiary is also a parent and prepares consolidated financial statements (an intermediate parent). Whether it is assessed at the parent entity level (on its own) or at the sub-group level (intermediate parent and its subsidiaries).

[4] See also Agenda Paper 31A *Feedback from comment letters* of the April 2022 IASB meeting and Agenda Paper 31B *Feedback from outreach events* of the April 2022 IASB meeting.

Feedback from outreach events on the draft Standard

B2. Some participants to outreach events sought guidance on ‘public accountability’:

(a) guidance about ‘public market’. Some participants said that entities raise funds in alternative markets apart from the traditional public market (stock exchange). For example, crowdfunding and peer-to-peer financing. These participants think these alternative markets should be considered as a public market.

(b) guidance about ‘fiduciary capacity’. Some participants asked for guidance on what constitutes a ‘broad group of outsiders’ or ‘primary business’, and also whether an intermediate parent considers the business of its subsidiary when assessing the criteria.