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Q&A 2011/02

IFRS for SMEs Section 1

Entities that typically have public accountability

Q&As are published by the SME Implementation Group (SMEIG), which assists the IASB[1] in supporting the implementation of the *International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)*. The Q&As are intended to provide non-mandatory and timely guidance on specific accounting questions that are being raised with the SME Implementation Group by users implementing the *IFRS for SMEs*.

A draft of this Q&A was issued for public comment on 14 April 2011. The comment deadline was 15 June 2011.

Draft and Final Q&As, and comments on draft Q&As, may be downloaded without charge from the IASB's website at http://go.ifrs.org/IFRS+for+SMEs+QandA.

Issue

1 Entities with public accountability are not eligible to use the *IFRS for SMEs*. An entity has public accountability if it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. Paragraph 1.3(b) identifies banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks as examples of the type of entity that 'typically' holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. Does that mean that all entities of those types should automatically be assumed to have public accountability?

Response

2 No. Judgement is required to assess whether entities of those types have public accountability. The *IFRS for SMEs* defines public accountability as 'accountability to those existing and potential resource providers and others external to the entity who make economic decisions but are not in a position to demand reports tailored to meet their particular information needs'. Typically, depositors in banks and credit unions, insurance policyholders, holders of shares in mutual funds and unit trusts, and those who have accounts with securities brokers and dealers are not in a position to demand reports tailored to meet their particular information needs. In those cases, the entity is presumed to have public accountability. This is true even if the entity only holds the assets in a fiduciary capacity for a relatively short period of time, for example short term deposits held by a bank and short duration insurance contracts, such as some casualty or property insurance provided by an insurance company.

1 International Accounting Standards Board (IASB)
The IASB is the independent standard-setting body of the IFRS Foundation

3 There may be some circumstances, however, in which an entity of this type does not have public accountability. For example:

- **Captive insurance subsidiaries**. 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, and the group will not be publicly accountable solely as a result of the captive insurance subsidiary.
- **Investment funds with only a few participants**. 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/joint venture; and
  - a pooled investment fund, closed to the general public and with only a few specifically selected participants.

Basis for Conclusions

BC1 An entity has public accountability if its debt or equity instruments are traded in a public market, or if it is in the process of issuing such instruments for trading in a public market, or if it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (paragraph 1.3). The intention under paragraph 1.3 is to capture those entities that hold and manage financial resources that have been entrusted to them by a broad group of outsiders.

BC2 The notion 'broad group' implies that entities that hold assets in a fiduciary capacity for only a few individuals would not be considered to be publicly accountable. However, the *IFRS for SMEs* does not provide a bright-line rule on what would be considered a broad group and so judgement will be necessary.

BC3 Paragraph 1.4 states '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'. This implies that outsiders would not be involved in the management of the entity. Judgement will be required to determine whether a party is an outsider.

BC4 Paragraph BC59 of the Basis for Conclusions that was issued with the *IFRS for SMEs* states that 'a primary business of banks, insurance companies, securities brokers/ dealers, pension funds, mutual funds and investment banks is to hold and manage financial resources entrusted to them by a broad group of clients, customers or members who are not involved in the management of the entities. Because such an entity acts in a public fiduciary capacity, it is publicly accountable. In most cases, these institutions are regulated by laws and government agencies.'

BC5 Paragraph 1.3(b)[2] lists insurance companies as an example of entities that *typically* hold assets in a fiduciary capacity for a broad group of outsiders as one of their primary businesses. This is because insurance companies usually operate by taking insurance premiums from customers in exchange for a contractual promise to compensate (indemnify) the customer in the case of a future financial or other loss. There is a public interest in the financial reports of all non-captive insurance companies because (a) the policyholders risk financial loss (and perhaps ruin) if an insured event occurs and the insurance company is unable to pay the claim and (b) the policyholders are outsiders who cannot demand information for themselves. That is why—in common with banks, mutual funds, securities brokers and dealers, and other financial institutions—all insurance companies are regulated by government. The Board concluded that all such entities should use full IFRSs, which are designed to provide accounting and disclosure requirements that are suitable for entities with public accountability.

BC6 A captive insurance company typically holds assets only for its parent and fellow subsidiaries, not for a broad group of outsiders. Furthermore, the captive insurance business of the subsidiary would not exist in the parent's consolidated financial statements, because transactions with the captive would be eliminated on consolidation.

2 reference was updated on 8 March 2012