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STAFF PAPER

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

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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. This paper is structured as follows:

   (a) Background to the project (paragraphs 3–6);

   (b) Should the scope be widened beyond subsidiaries that are SMEs:

      (i) Interaction of project objective and scope of a reduced-disclosure IFRS Standard (paragraphs 7–16);

      (ii) Possible options to widen the scope (paragraphs 17–24);

      (iii) Staff recommendation and question for the Board (paragraphs 25–31);

   (c) Scope issues if the scope remains subsidiaries that are SMEs:

      (i) Possible limitations (paragraph 32);

      (ii) Should the scope be limited to single entity financial statements (paragraphs 33–37);

(iii) Should the scope be limited to subsidiaries with a parent presenting consolidated financial statements applying IFRS Standards (paragraphs 38–45);

(iv) Should the scope specify at which point the entity should be a subsidiary to be within the scope of the proposed Standard (paragraphs 46–49).

(v) Staff recommendation and question for the Board (paragraph 50);

(d) Appendix A—Australia and the United Kingdom reduced disclosure accounting standards; and

(e) Appendix B—Extract from AP31 considered by the Board at its September 2019 meeting.

Background to the project

3. 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.

4. 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 developing the disclosure requirements in the reduced-disclosure IFRS Standard.

5. This approach recognises that this group of subsidiaries is eligible to apply the *IFRS for SMEs* Standard and consequently the Board can be satisfied that the disclosure requirements from the *IFRS for SMEs* Standard are sufficient to meet the needs of users when there is no recognition and measurement difference.

6. 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 can be satisfied that the disclosure requirements in the reduced-disclosure IFRS Standard would be sufficient to meet user needs.

Widening the scope beyond subsidiaries that are SMEs

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

7. 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).

8. 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 are required 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.

9. The project objective recognises that removing some disclosure requirements makes it simpler for preparers to produce financial statements tailored 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

10. 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 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.

11. 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.

12. In addition, because the reduced-disclosure IFRS Standard will be part of IFRS Standards some believe that it cannot create a third tier. The reduced-disclosure IFRS Standard, like IFRS 8 *Operating Segments* and IAS 33 *Earnings per Share*, would be an IFRS Standard with a scope that is applicable to a subsection of preparers (those that do not have public accountability), and thus not creating a third tier.

A third tier is created

13. 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.

14. 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.

15. 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 available to all SMEs, 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

16. 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.

Possible options to widen the scope

17. The Board could widen the scope of the reduced-disclosure IFRS Standard beyond subsidiaries that are SMEs to one or more of 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, that are not subsidiaries, 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.

Paragraph 17(a) and (b)

18. The argument in favour of extending the scope to the entities in paragraph 17(a) and (b), would be for cost-saving reasons similar to subsidiaries, that is, if the joint venture, joint operation or associate needs to submit financial information prepared applying IFRS Standards to its joint venturer, joint operator or investor 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 categories of entities.

Paragraph 17(c)

19. In some jurisdictions the ultimate parent entity is required to present separate financial statements in addition to consolidated financial statements. The argument in favour of extending the scope to the separate financial statements of parent entities that are SMEs but not subsidiaries (paragraph 17(c)), when the consolidated financial statements are presented, or required to be presented, applying IFRS Standards, would be for cost-saving reasons similar to subsidiaries.

20. 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 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.

21. An argument against an extension to parent entities that are SMEs in their separate financial statements 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. However, some jurisdictions permit parent entities to apply different Standards in their separate financial statements to those applied in their consolidated financial statements. An argument in favour of extending the scope to parent entities that are SMEs in their separate financial statements is that applying different Standards in the parent entity's separate financial statements than those applied in the consolidated financial statements could increase the lack of comparability between the consolidated financial statements and the parent entity's separate financial statements compared to the lack of comparability caused by the difference in disclosure that would be created if the reduced-disclosure IFRS Standard were applied in the separate financial statements.

Paragraph 17(d) and (e)

22. Arguments in favour of extending the scope as in paragraph 17(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 preparing disclosures is not effective. Extending the scope of the reduced-disclosure IFRS Standard would address this concern as the cost of applying IFRS Standards would be reduced. Similarly, in a jurisdiction that permits IFRS Standards and the *IFRS for SMEs* Standard to be applied, a first-time adopter moving from local GAAP might prefer to apply IFRS Standards, not the *IFRS for SMEs* Standard, if the reduced-disclosure IFRS Standard was available.

(c) 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 reduced-disclosure IFRS Standard, like IFRS 8 *Operating Segments* and IAS 33 *Earnings per Share*, would be an IFRS Standard with a scope that is applicable to a subsection of preparers (those that do not have public accountability). As such, and because it sits within IFRS Standards, it would not create a third tier.

(e) In a jurisdiction that does not permit the *IFRS for SMEs* Standard to be applied, applying the reduced-disclosure IFRS Standard, rather than local GAAP, might enable an entity to reduce its cost of capital.

(f) 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 more simplified *IFRS for SMEs* Standard.

(g) 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.

23. Arguments against extending the scope as in paragraph 17(d) or (e) are:

(a) Even though it would be part of IFRS Standards, extending the scope of the 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 confusion for users understanding which option has been applied. It might ultimately lead to calls for the reduced-disclosure IFRS Standard to include other relaxations, not just disclosure requirements, and further extensions in scope.

(b) The Board has already considered what is the appropriate accounting for SMEs in the light of the needs of users of the financial statements of SMEs and cost-benefit considerations; the solution is the *IFRS for SMEs* Standard, not the reduced-disclosure IFRS Standard. It is a solution that is widely accepted.

(c) 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. Research has not been undertaken on a wider scope, including all SMEs, or on possible implications for the *IFRS for SMEs* Standard if the scope were widened. To widen the scope without research could lead to unforeseen consequences.

(d) It is difficult to understand the rationale of an SME that wants to prepare financial statements applying IFRS Standards but does not apply IFRS Standards because it considers the costs of preparing 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. Subsidiaries that are SMEs that have to report to their parent applying IFRS Standards are ***required*** to apply the recognition and measurement requirements of IFRS Standards, and in their own financial statements reduced disclosures are preferred because it reduces costs whilst satisfying the needs of SME users. The same cannot be said of an SME that ***wants*** to apply recognition and measurement requirements of IFRS Standards but with reduced disclosures.

(e) Based on feedback the Board has decided to update the *IFRS for SMEs* Standard periodically. Amendments to the *IFRS for SMEs* Standard are not expected to be more frequent than approximately once every three years—this provides SMEs with a stable platform. If the scope of the reduced-disclosure IFRS Standard is extended to all SMEs there is a concern that the Board will receive similar feedback for the effective date of changes to the recognition and measurement, as well as disclosure, requirements to be later for SMEs than for publicly accountable entities, or even for all entities. Subsidiaries that are SMEs will want to apply the changes at the same time as their parent to avoid the need for additional accounting records, that is they will not want a delayed effective date.

(f) 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 22(g)) 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 considers 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.

(g) If the reduced-disclosure IFRS Standard can be applied by any SME, it may be seen as a competing Standard to jurisdictions considering adopting the *IFRS for SMEs* Standard, and ultimately, may result in some jurisdictions not adopting the *IFRS for SMEs* Standard.

(h) Retaining the original scope does not preclude the Board revisiting the scope of the reduced-disclosure IFRS Standard at a later date.

24. 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.

Staff recommendation and question for the Board

25. In developing the staff recommendation, we have reviewed the decisions of Australia and the United Kingdom (UK) national standard-setters which have both issued an accounting standard that permits entities to apply IFRS Standards with reduced disclosures. The Australian standard is not limited to subsidiaries whereas the UK standard is limited to subsidiaries and ultimate parents. Appendix A to this paper sets out some of the background to the development of the two standards.

26. The staff note that the IFRS Foundation Adoption Guide states:

> We are often asked whether the IASB has a standard approach that adopting countries can follow. The simple answer is "no". Every country is different. Each has its own mix of expertise, professional infrastructure and regulatory interests.

27. The decisions of the Australian and UK national standard-setters we believe demonstrate this point. In developing the reduced disclosure standards, the national

standard-setters were guided by the framework for financial reporting of their jurisdiction and took into consideration the strategic implications of the standard for their jurisdiction.

28. The staff have also reconsidered agenda paper 31 of the September 2019 Board meeting; Appendix B to this paper is an extract of that agenda paper. It sets out extracts taken from responses to the March 2018 EU consultation document *Fitness check on the EU framework for public reporting by companies*. The extracts from responses demonstrate that there is some interest within the EU for applying IFRS Standards with reduced disclosures. They also demonstrate mixed views on scope, although the EU's summary report refers to groups.

29. For the reasons outlined in paragraph 23, the staff believe that the scope of the reduced-disclosure IFRS Standard should not be extended to all SMEs nor to the consolidated financial statements of the ultimate parent entity.

30. 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.

31. The staff recommend that in the consultative document (see agenda paper 31C of this meeting) the scope of the proposed reduced-disclosure IFRS Standard should be restricted to subsidiaries that are SMEs and the Board consults on widening the scope of the proposed Standard.

Question for the Board

Question for the Board
Does the Board agree with the staff that the scope of the proposed reduced-disclosure IFRS Standard should be restricted to subsidiaries that are SMEs and that the Board consults on widening the scope of the proposed Standard?

Scope issues if the scope remains subsidiaries that are SMEs

Possible limitations

32. If the Board agrees with the staff recommendation that the scope of the reduced-disclosure IFRS Standard should be subsidiaries that are SMEs, the staff have identified three possible limitations on the scope:

(a) limiting application to single entity financial statements (paragraphs 33–37);

(b) limiting application to subsidiaries with a parent presenting consolidated financial statements applying IFRS Standards (paragraphs 38–45); and

(c) specifying at which point the entity should be a subsidiary (paragraphs 46–49).

Should the scope be limited to single entity financial statements?

33. 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)).

34. 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.

35. 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.

36. 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.

37. 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 its 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

38. 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.

39. 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.

40. There are, however, two 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 41–44); and

    (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 45).

41. 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.

42. 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.

43. 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.

44. 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.

45. 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.

Should the scope specify at which point the entity should be a subsidiary?

46. If the reduced-disclosure IFRS Standard applies to subsidiaries with a parent presenting consolidated financial statements applying IFRS Standards, preparers may ask at which point is it required to be a subsidiary of a parent presenting consolidated financial statements applying IFRS Standards. This will only be of relevance in a year when there is a change: an entity becomes a subsidiary, ceases to be a subsidiary or the parent adopts, or stops applying, IFRS Standards when preparing its consolidated financial statements.

47. The Board could consider enabling the reduced-disclosure IFRS Standard to be applied by an entity that was a subsidiary of a parent presenting consolidated financial

statements applying IFRS Standards at any point during the entity's reporting period, at the start of its reporting period, at the end of its reporting period, or when preparing its financial statements. If the proposed Standard applied to entities that, when preparing their financial statements, were subsidiaries of a parent presenting consolidated financial statements applying IFRS Standards, it could be applied by an entity that was not a subsidiary, or was a subsidiary but of a parent not applying IFRS Standards, during its reporting period.

48. If the proposed Standard applied to entities that, at the end of their reporting period, were subsidiaries of a parent presenting consolidated financial statements applying IFRS Standards, then an entity that ceases to be a subsidiary close to its year end would be required to give full disclosures if it continued to apply IFRS Standards. To avoid this consequence the proposed Standard could apply to entities that were subsidiaries at any point during the reporting period. If this were the scope, the reduced-disclosure IFRS Standard could be applied by an entity that was no longer a subsidiary at the end of its reporting period or was a subsidiary in a different group of entities; it may therefore wish, or be required, to apply different accounting standards or it may wish to continue to apply IFRS Standards but without reduced disclosures. Such entities would not be precluded from applying IFRS Standards without reduced disclosures as the intention is that the proposed standard is voluntary to entities within its scope.

49. The staff therefore recommend that the scope of the reduced-disclosure IFRS Standard should be entities that, at any point during their reporting period were subsidiaries of a parent presenting consolidated financial statements applying IFRS Standards.

Staff recommendation and question for the Board

50. For the reasons outlined above, the staff recommend that the reduced-disclosure IFRS Standard should apply to entities that, at any point during their reporting period, are subsidiaries of a parent presenting consolidated financial statements applying IFRS Standards and that the scope *not* be limited to single entity financial statements.

Question for the Board

Question for the Board
Does the Board agree with the staff recommendation that the reduced-disclosure IFRS Standard should apply to entities that, at any point during their reporting period, are subsidiaries of a parent presenting consolidated financial statements applying IFRS Standards and that the scope *not* be limited to single entity financial statements.?

Appendix A

Australia and the United Kingdom reduced disclosure accounting standards

A1. Australia and the United Kingdom (UK) have both issued an accounting standard that permits entities to apply IFRS Standards with reduced disclosures. The Australian standard is not limited to subsidiaries whereas the UK standard is limited to subsidiaries and ultimate parent companies.

Australia—overview of the financial reporting framework

A2. Since the early 1990s Australia had a differential reporting regime based on the 'reporting entity concept'. Entities had to determine whether they were a 'reporting entity' or not. A reporting entity is defined as:

> An entity in respect of which it is reasonable to expect the existence of users who rely on the entity's general purpose financial statement for information that will be useful to them for making and evaluating decisions about the allocation of resources. A reporting entity can be a single entity or a group comprising a parent and all of its subsidiaries.

A3. Originally there were two levels of reporting which applied to all entities that were required to prepare financial statements that complied with Australian Accounting Standards:

a. Reporting entities—required to prepare general purpose financial statements that comply with all relevant accounting standards; and

b. Non-reporting entities—not required to comply with any of the accounting standards; these financial statements were known as special purpose financial statements.

A4. The Australian Accounting Standards Board (AASB) has not set recognition and measurement requirements for special purpose financial statements because special purpose financial statements should only be prepared where users can tailor the financial statements to their own information needs and therefore do not need a standard-setter or regulator to specify the accounting policies or require disclosure of the information for them.

A5. However, in 2005, the Australian Securities & Investments Commission (ASIC) determined that those non-reporting entities that are required to prepare financial statements in accordance with Chapter 2M of the Corporations Act 2001 would need to comply with the recognition and measurement requirements of all accounting standards to ensure that the financial give a true and fair view and thus comply with the requirements of the *Corporations Act 2001*.

A6. These entities were further required to comply with the disclosure requirements of (the equivalent of) IAS 1 *Presentation of Financial Statements*, IAS 7 *Statement of Cash Flows* and IAS 8 *Accounting policies, Changes in Accounting Estimates and Errors* but none of the other accounting standards. This was the result of moving legacy regulations out of legislation into Australian Accounting Standards. The AASB had formed no view on the suitability or otherwise of these requirements for users of special purpose financial statements.

A7. Other non-reporting entities (those not required to prepare financial statements in accordance with Chapter 2M of the *Corporations Act* 2001) had to consider the purpose for which the financial statements were prepared, the requirements of other regulators (if any) and the needs of the members or beneficiaries when determining the extent to which the financial statements comply with Australian Accounting Standards.

A8. The main concerns with the above approach were:

   a. the costs of preparing general purpose financial statements for some entities were greater than benefits for the users of those general purpose financial statements, because the framework resulted in requirements for general purpose financial statements that were overly burdensome for many entities; and

b. user needs were not being satisfied for other entities, because the framework was being applied in a way that some entities (which should prepare general purpose financial statements) were being treated as non-reporting entities and preparing only special purpose financial statements.

A9. Consequently, in 2013 a new tiered approach was introduced. The new approach resulted in three levels of financial reporting:

a. Tier 1 general purpose financial statements—Reporting entities *with* public accountability—required to comply with all accounting standards including all disclosure requirements;

b. Tier 2 general purpose financial statements—Reporting entities *without* public accountability—required to apply the recognition and measurement requirements of all accounting standards but could choose to apply reduced disclosures (selected disclosures from all of the standards) or full disclosures; and

c. Special purpose financial statements—Non-reporting entities—could prepare special purpose financial statements which, if lodged with ASIC, had to comply with the recognition and measurement requirements of all standards and the disclosure requirements of the equivalent of IAS 1, IAS 7 and IAS 8 and a further standard with disclosure requirements specific to Australia.

A10. Following continuing concerns about the preparation of special purpose financial statements, from 1 July 2021 for-profit private sector entities that are required by legislation, their constituting document or other document to prepare financial statements that comply with Australian Accounting Standards will no longer be permitted to prepare special purpose financial statements. As a consequence, these entities will only have the following two options:

a. Tier 1—Entities *with* public accountability—required to comply with all accounting standards including all disclosure requirements; and

b. Tier 2—Entities *without* public accountability—required to apply the recognition and measurement requirements of all standards but can choose to apply a new simplified disclosure standard (these disclosures are less extensive than in the 2013 approach) or full disclosures.

A11. Other for-profit private sector entities can continue preparing special purpose financial statements if they are not required by legislation or otherwise to prepare financial statements that comply with Australian Accounting Standards and they are not a reporting entity. The AASB is currently revisiting the financial reporting frameworks for not-for-profit private sector entities and for public sector entities.

A12. When the *IFRS for SMEs* Standard was being developed the AASB considered whether to adopt it rather than retain the full IFRS recognition and measurement requirements and identify disclosures that can be omitted under the reduced disclosure regime that became its 2013 Tier 2. The reasons for developing the reduced disclosure regime rather than adopting the *IFRS for SMEs* Standard are set out in BC66–BC75 of AASB1053 *Application of Tiers of Australian Accounting Standards*.

A13. Paragraph BC73 states that:

> The AASB discussed the *IFRS for SMEs* with a view to assessing its suitability as Tier 2 requirements. The AASB noted that there are concerns about adopting the *IFRS for SMEs* in Australia for the following reasons:
>
> (a) some of the accounting policy options that have been removed would be the favoured accounting policies for many Australian entities;
>
> (b) changes to full IFRS recognition and measurement requirements under the *IFRS for SMEs* and the absence of some accounting policy options from the *IFRS for SMEs* would force subsidiaries to adjust accounting policies for consolidation purposes when parents apply full IFRSs;
>
> (c) entities applying the *IFRS for SMEs* would be deprived of improvements and simplifications as they become available at the full IFRS level because

the IASB has stated that it will only update the *IFRS for SMEs* once there have been two years of broad adoption and, thereafter, every three years;

(d) possible benefits that might result from comparability with overseas entities applying the *IFRS for SMEs* would:

   (i) depend on how widely adopted it becomes;

   (ii) be limited because entities seeking to access international capital markets would generally apply full IFRSs; and

   (iii) be mitigated due to a loss of comparability across all types of entities' general purpose financial statements within Australia;

(e) having different streams of recognition and measurement requirements involves different streams of knowledge, such that education and training at the tertiary level and within the accounting profession would become more costly;

(f) there would be start up costs because entities preparing general purpose financial statements have already made the effort to apply full IFRSs;

(g) adoption of the IFRS for SMEs may be seen as a retrograde step in a country that has already adopted full IFRS recognition and measurement accounting policy options;

(h) the actual changes in recognition and measurement requirements in the IFRS for SMEs would not produce any real economies for Australian SMEs; and

(i) in the event that an entity moves to, or from, full IFRSs, there would be costs involved in migrating from the recognition and measurement requirements of one Tier of reporting to another.

A14. In developing the 2020 Tier 2 simplified disclosure standard (which is the project very similar to the IASB's *Disclosure Initiative—Subsidiaries that are SMEs* project), the AASB re-evaluated the suitability of the *IFRS for SMEs* Standard and reconfirmed that it continues *not* to be a preferred option for the for-profit private sector in Australia. The reasons are set out in paragraph BC110 of AASB2020-2 *Amendments to Australian Accounting Standards—Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities*. The first two reasons are reproduced below and the eight other reasons can be accessed by following the link:

(a) users specifically identified the comparability of the R&M requirements in AAS [Australian Accounting Standards] as a key concern. The IFRS for SMEs Standard has different R&M requirements compared to AAS, and to meet user needs for comparability, all for-profit private sector entities within the scope of this Standard would need to apply the IFRS for SMEs Standard (with it being the only Tier 2 GPFS framework), or a third tier of GPFS reporting would need to be created;

(b) to achieve a consistent Tier 2 GPFS framework, additional transitional costs would be expected to arise because based on the data in paragraph BC20, it is estimated that a majority of ASIC regulated entities currently lodging SPFS are already complying with the R&M requirements in AAS. To achieve a consistent Tier 2 GPFS framework and implement the IFRS for SMEs Standard, all of these entities, approximately 8,800 of the 10,500 specified for-profit entities lodging financial statements with ASIC (subsequent to Treasury increasing the thresholds used from determining what constitutes a large proprietary company) would need to change their accounting policies to adjust for the different R&M requirements contained in the IFRS for SMEs Standard. That is, all of the specified for-profit entities preparing Tier 1 GPFS, Tier 2 GPFS or SPFS which comply with the R&M requirements in AAS.

In comparison only the 10% that currently don’t comply with the R&M requirements in AAS and potentially the 14% where it’s unclear whether or not they have complied with the R&M requirements in AAS (approximately up to 1,700 entities in total) would be required to change their accounting policies to align with the R&M requirements in AAS. Therefore, a larger population of preparers would see an increase in the costs associated with the transition from SPFS to GPFS if the Tier 2 GPFS framework were based on different R&M requirements;

United Kingdom—overview of the financial reporting framework

A15. In the United Kingdom (UK) all companies are required to prepare financial statements which give a true and fair view. Until the issue of the Financial Reporting Standard for Smaller Entities (FRSSE) in 1997, companies’ financial statements had to comply with all accounting standards.

A16. The FRSSE was a stand-alone accounting standard applying to small entities. Applying the FRSSE was optional for entities within its scope. As well as its scope containing size criteria, the FRSSE did not apply to certain entities, including public companies, companies that were authorised insurance companies, and banking companies. For the generality of small entities the recognition and measurement requirements in the FRSSE were the same as or a simplified version of those in the UK's other standards. The disclosure requirements in the FRSSE were reduced compared to those required applying the other standards.

A17. In 2005 the consolidated financial statements of companies whose securities are traded on a regulated market were required to be prepared applying IFRS Standards (as adopted in the EU). Other financial statements could be prepared applying IFRS Standards or UK accounting standards, including the FRSSE if permitted.

A18. The UK standard-setter embarked on a phased approach to base its UK accounting standards on IFRS Standards. However, this phased approach created complications and anomalies; for example, an individual IFRS Standard was not an exact replacement for the UK accounting standard it was replacing, and so many consequential amendments were required for the IFRS Standard to sit with the other UK accounting standards. In addition, UK accounting standards were no longer applied by quoted groups (as such groups were required to apply IFRS Standards). The standard-setter therefore investigated other options and the timing of this coincided with the IASB's project to develop the *IFRS for SMEs* Standard.

A19. In 2009 the standard-setter proposed a three-tier approach:

a. Tier 1—publicly accountable entities—apply IFRS Standards as adopted in the EU;

b. Tier 2—Entities *without* public accountability and not small—apply a UK standard based on the *IFRS for SMEs* Standard; and

c. Tier 3—small companies—apply the FRSSE or the Tier 2 requirements.

A20. Respondents to an earlier consultation had asked that subsidiaries be permitted to apply reduced disclosure requirements; this was not reflected in the above because the ASB (the then standard-setter) had yet to be convinced that significant cost savings were available from a reduced disclosure framework. The ASB reversed this decision taking into account the feedback received. In addition, there were other concerns with some aspects of the proposals, most notably with the scope of the proposed tier 1.

A21. After further consultations, the following became effective for 2015 and later:

a. Consolidated financial statements of companies whose securities are traded on a regulated market—apply IFRS Standards as adopted in the EU;

b. All other financial statements—apply IFRS Standards as adopted in the EU or apply UK GAAP. UK GAAP was:

   i. The single-entity financial statements of the companies in (a) and of a subsidiary whose parent prepares publicly available consolidated financial statements—apply IFRS Standards as adopted in the EU with reduced disclosures (FRS 101 *Reduced Disclosure Framework*) or apply FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*;

   ii. Small entities*—apply the FRSSE or FRS 102 or FRS 101;

   iii. All other entities—apply FRS 102, which is based on the *IFRS for SMEs* Standard and includes reduced disclosure requirements for the single-entity financial statements of subsidiaries and ultimate parents.

   * For small entities, the FRSSE has since been withdrawn. Micro entities apply either FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*, which is based on FRS 102 but with very few disclosure requirements, or FRS 102 or FRS 101. Small entities that are not micro-entities are now in the ‘all other entities’ category if they have not applied FRS 101.

A22. One of the four principles that guided the Financial Reporting Council (FRC), the then standard-setter, (and its predecessor) during the consultations was:

> The framework must be proportionate, so that preparing entities are not unduly burdened by costs that outweigh the benefit to them and to the primary users of information in their financial statements. The FRC believes that the proposals will produce a lower cost regime, while enhancing user benefits. It has carried out a consultation stage impact assessment with input from interested parties, and will continue to assess cost-benefit issues.

A23. In paragraph 5.4 of the impact assessment issued with the UK accounting standards FRS 100, FRS 101 and FRS 102, the FRC, the then standard-setter, explained that it had issued FRS 101:

> to promote efficiency within groups, taking into account the often limited use for subsidiary entity financial statements, or the separate financial statements of the parent entity when presented with consolidated accounts.

A24. Paragraphs 6.16–6.19 of that impact assessment discuss the benefits associated with implementing FRS 101 as follows:

> 6.16 FRS 101 allows entities within listed groups to apply the recognition and measurement requirements of EU-adopted IFRS whilst reducing disclosure requirements and therefore costs of preparing accounts.
>
> 6.17 At present where entities within listed groups prepare individual accounts in accordance with UK accounting standards, they must also prepare financial information for group consolidation purposes that is consistent with EU-adopted IFRS. FRS 101 will eliminate the need to prepare financial information on two different accounting bases (albeit that there is a degree of commonality) and efficiencies will arise in applying a single set of recognition and measurement criteria to all financial reporting.
>
> 6.18 For those groups that have chosen to prepare individual accounts in accordance with EU-adopted IFRS, FRS 101 offers a cost saving due to the reduced number of disclosures that require preparing and auditing. Feedback from listed groups supported the introduction of FRS 101, highlighting the benefits of consistent reporting across the group, and noting that the cost of producing full EU-adopted IFRS disclosure for

individual group entities would be disproportionate to the use made of subsidiary financial statements, which often have few users that are external to the group.

> *''We [therefore] fully supported the ASB's proposals in FREDs 43 and 44 for a separate regime for subsidiaries of entities applying EU-adopted IFRS and welcome its inclusion in the latest FREDs. Placing the Reduced Disclosure Framework (RDF) into a separate self-contained accounting standard will provide clarity for preparers, therefore benefitting both the future implementation process and on-going reporting. We believe that the approach proposed by the ASB will clearly achieve the stated objective of promoting efficiency within groups...'' – Shell International comment letter dated 30 April 2012*

6.19 The FRC believes that FRS 101 provides proportionate disclosures for group entities and generates opportunities for cost savings, particularly for those entities required to prepare accounts in accordance with EU-adopted IFRS. These cost savings should imply greater returns for investors.

Appendix B

Extract from AP31 considered by the Board at its September 2019 meeting

B1. In March 2018, the EU issued the consultation document *Fitness check on the EU framework for public reporting by companies*. Although none of the questions referred to a reduced disclosure framework, one question asked whether the EU should establish a 'pan-EU GAAP', with such pan-EU GAAP being IFRS, IFRS for SMEs or another standard commonly agreed at the EU level. Several responses to the EU on the consultation document recommended recognition and measurement from full IFRS Standards with reduced disclosure. The following extracts are taken from responses to the fitness check:

Respondent	Extract from response
Dutch Accounting Standards Board	In the Netherlands, non-listed companies have the option to use IFRS, but this is not the case in all EU member states. We believe that non-listed companies in Europe that wish to do so, should have the option to use IFRS instead of national GAAP. … For wholly owned subsidiaries of listed companies, we recommend to introduce a set of "IFRS disclosure light" reporting standards. These standards would exactly follow the recognition and measurement criteria of IFRS, but would inherit only a limited part of the disclosure requirements. The decisions on which disclosure requirements will remain should be taken by the IASB. The impact would be less administrative burden for these subsidiaries of listed companies. We do not prefer the option to use IFRS for SMEs, as this could lead to measurement differences with consolidated financial statements that are based on IFRS.

Respondent	Extract from response
PwC	We believe the use of IFRS can be further extended. We recommend the Commission allows the following approach: — All non-listed entities prepare IFRS consolidated financial statements (currently allowed only subject to Member State option) and, — Parent companies and their subsidiaries prepare IFRS individual financial statements when the parent issues consolidated financial statements in IFRS under the Member State option. — SMEs have the option to adopt IFRS for SMEs or IFRS with a limited disclosure framework for consolidated financial statements as this would be an easy path for a further harmonization of the accounting practices across the European Countries.
Confederation of Danish Industry	EU should introduce options that allows business to make use of one of the following to reporting options: 1) IFRS for SME's or 2) IFRS (Recognition and measurement), but with reduced disclosure requirements This would ease the compliance burden, support the internal market and improve the transparency for smaller and medium sized entities engaging in cross-border activity.
Deutsche Bank	We believe that it would be beneficial if preparers of individual financial statements were given the option to produce IFRS Financial Statements or for smaller entities a Reduced Disclosure version of IFRS. This would allow preparers to report efficiently as this would minimise the need for maintaining two different set of books under different

Respondent	Extract from response
	GAAPs. In addition this would allow for shorter reporting timelines. …
BDO	If a pan EU GAAP is to be implemented for use by any company that belongs to a group, we are strongly of the view that this should be IFRS. … However, full IFRS brings a significant range of disclosure requirements which may not be necessary for subsidiaries of a group where the parent prepares consolidated financial statements. Consequently, we would favour an approach similar to that taken by the UK and Australia, which is full IFRS measurement with reduced disclosure requirements.

B2. The EU's summary report of the public consultation includes the following:

> … However if the EU were to address these, a number of respondents recommended reducing Member State options as a potential way forward, and/or using the IFRS as an anchor point. For instance, it could be envisaged to further align the Accounting Directive with the IFRS; to grant a right to companies, in particular groups, to apply the IFRS (or IFRS "light") instead of national GAAP (in which case, issues with taxation or other rules would have to be addressed); to impose the IFRS in specific situations, such as for individual financial statements of listed companies. …