IFRS

STAFF PAPER

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IASB® Meeting

Project	**Subsidiaries that are SMEs**		
Paper topic	Research results – additional issues		
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Introduction

1. As part of the Subsidiaries that are SMEs project, the Board has discussed:

   (a) September 2019—whether a Standard, if developed, would be adopted by jurisdictions and applied by subsidiaries that are SMEs; and

   (b) October 2019—research outcomes on whether the disclosure requirements of the *IFRS for SMEs* Standard could be utilised with only minimal tailoring.

2. This agenda paper addresses two issues from the September meeting:

   (a) how the project can benefit subsidiaries (paragraphs 4–12); and

   (b) scope of the project (paragraphs 13–16).

3. At the end of the paper the Board is asked:

   (a) whether it has any questions about the matters in this paper; and

   (b) whether it agrees with the staff recommendation to discuss the scope of the project once most of the analysis has been completed.

How the project can benefit subsidiaries

Background

4. Assuming that a jurisdiction requires entities that are not publicly accountable to prepare general purpose financial statements, the choice for subsidiaries that are SMEs, would typically be to apply:

   (a) IFRS Standards (option 1), or

   (b) the *IFRS for SMEs* Standard (option 2); or

   (c) local GAAP (option 3).

5. The objective of this project is to consider providing relief for subsidiaries that are SMEs, as defined in *IFRS for SMEs* Standard, and that report to a parent, for consolidation purposes, numbers that apply the recognition and measurement requirements of IFRS Standards.

6. When such subsidiaries choose to apply option 1, they are required to comply with the full disclosure requirements of IFRS Standards, even though these requirements were developed with users in mind whose needs are different to those of a user of financial statements of an SME. If such subsidiaries adopt option 2 or option 3, they will need to maintain accounting records applying requirements of both (i) IFRS Standards; and (ii) either the *IFRS for SMEs* Standard or local GAAP. They will incur additional costs because of the need to maintain additional accounting records.

7. This project considers providing cost relief to such subsidiaries by eliminating the requirement to maintain additional accounting records, but to achieve this in a way that permits the subsidiaries not to have to give all the disclosures required by IFRS Standards.

8. A resulting Standard would permit the recognition and measurement requirements of IFRS Standards to be applied by subsidiaries that are SMEs with the limited disclosures required by the *IFRS for SMEs* Standard. When the UK standard-setter

issued FRS 101, its reduced disclosure standard (that applies when the recognition and measurement requirements of IFRS Standards are applied), the accompanying impact assessment explained that ‘efficiencies will arise in applying a single set of recognition and measurement criteria to all financial reporting’.

How does the project enable subsidiaries to reduce costs when they are still required to report to their parent?

9. The question that has arisen is how subsidiaries’ costs are reduced, and therefore what is the benefit from the project, if they are in any case required to report to their parent sufficient information to enable the parent to produce consolidated financial statements applying IFRS Standards.

10. The list below provides examples of how the project should enable subsidiaries that are SMEs to reduce costs, despite reporting to their parent for consolidation purposes:

    (a) Group materiality may be considerably higher than the materiality level applicable to the subsidiary’s financial statements. Consequently, if the subsidiary does not require the information for its own financial statements it could gather the necessary information to a higher materiality threshold.

    (b) A subsidiary may be so small that it is not required to report detailed disclosures to the parent for consolidation purposes. Each additional disclosure required in its financial statements will give rise to additional cost and effort to prepare.

    (c) A parent is unlikely to want details of intra-group transactions that are eliminated on consolidation included in disclosures reported to it. For example, Subsidiary A may lease a property to Subsidiary B; the transactions would cancel out on consolidation, so the parent is likely to want Subsidiary A and Subsidiary B to exclude the leases from the leasing disclosures that they submit to the parent. However, the subsidiaries would be required to give disclosures about the lease, one as lessee and one as lessor, in their individual financial statements.

(d) A group may employ the services of one or more specialists to assist in the preparation of group level disclosures, for example, disclosures at a group level about group share-based payments. Any disclosures required at a lower level of granularity in the financial statements of individual entities in the group is likely to result in the specialists' fees being higher.

(e) Fewer disclosures reduce the time and effort required to prepare the subsidiary financial statements.

(f) All these incremental costs flow through to the audit work for the subsidiary.

11. The impact assessment that accompanied the issue of the UK's FRS 101 includes an example of a parent that applies IFRS Standards in its consolidated financial statements while its subsidiaries apply UK GAAP in their individual financial statements. The example explains that if the subsidiaries changed to apply FRS 101, (that is, recognition and measurement from IFRS Standards and reduced disclosures):

> 'The application of FRS 101 will save time and costs in the subsidiaries, the group finance function and the audit process. All group entities' individual financial statements will need revising for compliance with FRS 101 but this will be based on information already prepared for the group financial statements. This should be relatively straightforward to implement and the savings from not having to prepare financial information on two different bases [will] outweigh the costs'.

If a subsidiary moved from the *IFRS for SMEs* Standard or from local GAAP (that is, from option 2 or option 3), the same benefits would result.

12. The impact assessment also includes an example of a parent and its subsidiaries adopting FRS 101 in their individual financial statements after previously applying IFRS Standards. The example explains that 'Taking advantage of reduced disclosures will reduce the cost of preparing the financial statements of [the parent] and its subsidiaries'.

Scope of the project

13. During the Board discussion in September, it was suggested that the scope of the project could possibly be widened to a broader group of SMEs.

14. The staff note that in adding the project to the research pipeline, the Board intended an approach that limited the amount of development time and effort needed from both the Board itself, and from its constituents. In addition, the approach was intended to avoid the risk of appearing to create a third tier (alongside IFRS Standards and the *IFRS for SMEs* Standard). The staff are concerned that any expansion of scope may risk making the project more complex than originally intended.

15. Consequently, the staff recommend that:
    (a) the project proceeds based on the scope as originally determined when the Board added the project to the research pipeline, that is, considering only subsidiaries that are SMEs; and
    (b) once the staff and Board have completed the analysis comparing each Standard within IFRS Standards with the relevant section in the *IFRS for SMEs* Standard, the Board then discusses whether the scope can be expanded without significantly affecting the conclusions already reached.

16. The staff believe that this approach would allow a more informed decision to be made as it can be based on a more complete feel for any potential Standard.

Questions for the Board

Questions for the Board
1. Does the Board have any questions about the matters in this paper? 2. Does the Board agree with the staff recommendation to discuss the scope of the project once most of the analysis has been completed?