STAFF PAPER

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IASB® Meeting

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

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Introduction

1. This agenda paper discusses how a subsidiary would make the transition to a possible reduced-disclosure IFRS Standard. Three matters are addressed:

   (a) First-time application of the reduced disclosure IFRS Standard (paragraphs 3–16);

   (b) Could the reduced disclosure IFRS Standard be applied for the 'first time' more than once (paragraphs 17–18); and

   (c) Whether first-time application of the reduced-disclosure IFRS Standard is an accounting policy choice (paragraphs 19–22).

Staff recommendations

2. The staff are recommending that if the International Accounting Standards Board (Board) proposes a reduced-disclosure IFRS Standard:

   (a) there is no need to amend IFRS 1 *First-time Adoption of International Financial Reporting Standards* or include transition provisions in the reduced-disclosure IFRS Standard (paragraphs 12 and 14);

(b) in the year after a subsidiary ceases to apply the reduced-disclosure IFRS Standard, and continues to apply IFRS Standards, comparatives should be required for the disclosures that it had not included in its previous year's financial statements (paragraph 16);

(c) the reduced-disclosure IFRS Standard could be applied for the 'first time' more than once by a reporting entity (paragraph 18); and

(d) the reduced-disclosure IFRS Standard should clearly state that the Standard is optional and an entity may reverse its decision to apply the Standard (paragraph 22).

First-time application of the reduced-disclosure IFRS Standard

3. When a subsidiary applies the reduced-disclosure IFRS Standard for the first time, its previous financial statements (assuming it is not the subsidiary's first year of preparing general purpose financial statements) will have been prepared applying either:

   (a) local GAAP; or

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

   (c) IFRS Standards.

Transitioning from local GAAP or the IFRS for SMEs *Standard to IFRS Standards and electing to apply the reduced disclosure IFRS Standard*

4. If the subsidiary has previously applied either local GAAP or the *IFRS for SMEs* Standard, it will apply IFRS 1 as the financial statements will be its 'first IFRS financial statements'.

5. An entity's first IFRS financial statements are defined in Appendix A to IFRS 1 as:

> The first annual financial statements in which an entity adopts International Financial Reporting Standards (IFRSs), by an **explicit and unreserved statement of compliance with IFRSs** (emphasis added).

6. At the Board's October 2020 meeting, the Board tentatively decided that the reduced-disclosure IFRS Standard would require a subsidiary to disclose that it had applied that Standard, and require this disclosure to be located with the statement required by paragraph 16 of IAS 1 *Presentation of Financial Statements*. The 'explicit and unreserved statement of compliance with IFRSs' referred to in the definition of an entity's first IFRS financial statements is the statement required by paragraph 16 of IAS 1 (hereafter referred to as the compliance statement).

7. Requiring a subsidiary to disclose that it has applied the reduced-disclosure IFRS Standard is to aid comparability when a user of financial statements is comparing financial statements. Requiring that disclosure to be located with the compliance statement was to further aid comparability so that the two statements are located in the same place by all subsidiaries for which it is relevant and therefore it would be clear from that one location whether the reduced-disclosure IFRS Standard had been applied.

8. The staff therefore believe that a subsidiary can still be considered to have stated compliance as required by IFRS 1 even though the subsidiary has stated that it is applying the reduced-disclosure IFRS Standard.

9. Consequently, the staff believe that if the subsidiary has previously applied either local GAAP or the *IFRS for SMEs* Standard, it will apply IFRS 1 in its first financial statements applying IFRS Standards and state it has elected to apply the reduced-disclosure IFRS Standard.

10. IFRS 1 contains mandatory exceptions and optional exemptions from full retrospective application of IFRS Standards and requires disclosures that explain an entity's transition to IFRS Standards. Section 35 *Transition to the IFRS for SMEs* of the *IFRS for SMEs* Standard is the *IFRS for SMEs* Standard's equivalent to IFRS 1.

The staff have therefore used the disclosure requirements from Section 35 and adapted them applying the agreed approach.

11. When applying IFRS Standards for the first time and simultaneously electing to apply the reduced-disclosure IFRS Standard, a subsidiary will apply the disclosure requirements of the reduced-disclosure IFRS Standard which will include both disclosure requirements about the subsidiary's transition to IFRS Standards and the disclosure requirements for the recognition and measurement IFRS Standards the subsidiary applies.

12. Consequently, the staff believe that there is no need to amend IFRS 1 or add transition provisions to the reduced-disclosure IFRS Standard for when a subsidiary applies IFRS Standards for the first time and elects to apply the reduced-disclosure IFRS Standard.

Electing to apply the reduced-disclosure IFRS Standard when the previous financial statements were prepared applying IFRS Standards

13. When a subsidiary elects to apply the reduced-disclosure IFRS Standard for the first time and its previous annual financial statements had been prepared applying IFRS Standards the subsidiary will have applied IFRS 1 in a previous period. The impact on the subsidiary's financial statements of applying the reduced-disclosure IFRS Standard for the first time will be that its financial statements will contain fewer disclosures than in the previous year; comparatives will be restated.

14. Consequently, the staff believe there is no need to add transition provisions to the reduced-disclosure IFRS Standard or require additional disclosure requirements for when a subsidiary previously applied IFRS Standards and decides to apply the reduced-disclosure IFRS Standard for the first time.

Ceasing to apply the reduced-disclosure IFRS Standard

15. Although not part of transition to the reduced-disclosure IFRS Standard, the staff are adding this section for completeness. A subsidiary could choose to discontinue applying the reduced-disclosure IFRS Standard or may no longer qualify, ie if the subsidiary no longer meets the definition of an SME or is no longer a subsidiary.

16. When a subsidiary discontinues applying the reduced-disclosure IFRS Standard and continues to apply IFRS Standards, the subsidiary would apply the disclosure requirements of IFRS Standards, including the requirement for comparatives. The staff believe that in this situation the subsidiary should be required to give comparatives for the disclosures that it had not included in its financial statements for the previous year. This would be consistent with IFRS 1 which does not provide an exemption or exception from giving comparatives to notes in an entity's first IFRS financial statements.

Could the reduced-disclosure IFRS Standard be applied for the 'first time' more than once?

17. An eligible subsidiary may wish to apply the reduced-disclosure IFRS Standard for the 'first time' more than once. For example, a subsidiary may apply the reduced-disclosure IFRS Standard, but after a period of time is sold to a group that does not apply IFRS Standards. The subsidiary may report applying the local GAAP of the new group. However, suppose the new group later moves to IFRS Standards; the subsidiary may wish to apply IFRS Standards and the reduced-disclosure IFRS Standard again.

18. The Board permits IFRS 1 to be applied more than once. Consequently, the staff recommend that the Board permits the reduced-disclosure IFRS Standard to be applied for the 'first time' more than once.

Is first-time application of the reduced-disclosure IFRS Standard an accounting policy choice?

19. The staff have been asked to address the question of whether first-time application of the reduced-disclosure IFRS Standard is an accounting policy choice. There is an important distinction because IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* contains requirements about changing an accounting policy.

20. Paragraph 14 of IAS 8 provides that:

> An entity shall change an accounting policy only if the change:
>
> (a) is required by an IFRS; or
>
> (b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

21. However, whether applying the reduced-disclosure IFRS Standard for the first time or ceasing to apply the reduced-disclosure IFRS Standard is an accounting policy choice or not, the disclosures in the financial statements will be no different (assuming the reduced-disclosure IFRS Standard is to be applied or no longer applied). For example, assume a subsidiary applied IFRS Standards in 20X1 and in each of the next ten years:

    (i) In 20X2 the reduced-disclosure IFRS Standard is issued and the subsidiary applies it in its 20X2 financial statements.

    The subsidiary would exclude from its 20X2 financial statements any note disclosures, including comparatives, it had included in 20X1 that are not required by the reduced-disclosure IFRS Standard (and are not required to ensure the financial statements give a fair presentation of the financial position, financial performance and cash flows of the entity). This could be thought of as restating comparatives.

    (ii) In 20X8 the group starts to prepare to list the subsidiary's equity shares on a recognised exchange so the subsidiary is no longer eligible to apply the reduced-disclosure IFRS Standard.

In its financial statements for 20X8 it applies IFRS Standards, but not the reduced-disclosure IFRS Standard.

Assuming the Board agrees with the staff view in paragraph 16, the subsidiary would include in its 20X8 financial statements disclosures, including comparatives, required (subject to materiality considerations) by IFRS Standards *even if* some of these had not been included in its 20X7 financial statements. That is, in providing disclosures in 20X8 that were omitted in 20X7 because they were not required by the reduced-disclosure IFRS Standard (and were not required to ensure the financial statements gave a fair presentation of the financial position, financial performance and cash flows of an entity), the subsidiary would include the comparative information for 20X7. This could be thought of as restating comparatives.

Recommendation

22. The staff recommend that, for the avoidance of doubt, the reduced-disclosure IFRS Standard clearly states the Standard is optional and an entity may reverse its decision to apply the Standard.

Questions for the Board

Questions 1–4
Does the Board agree with the staff recommendations that if the Board proposes a reduced-disclosure IFRS Standard: (1) there is no need to amend IFRS 1 or include transition provisions in the reduced disclosure IFRS Standard? (2) in the year after a subsidiary ceases to apply the reduced disclosure IFRS Standard, and continues to apply IFRS Standards, comparatives should be required for the disclosures that it had not included in its previous year's financial statements? (3) the reduced-disclosure IFRS Standard could be applied for the 'first time' more than once by a reporting entity? (4) the reduced-disclosure IFRS Standard should clearly state the Standard is optional and an entity may reverse its decision to apply the Standard.