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—definition of public accountability
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Introduction

1. This paper discusses whether the definition of public accountability in the *IFRS for SMEs* Accounting Standard (and the draft Standard *Subsidiaries without Public Accountability: Disclosures*) is still fit for purpose or needs further clarification.

2. In this paper, the term SMEs refers to entities that are eligible to apply the *IFRS for SMEs* Accounting Standard—entities that do not have public accountability (as defined in paragraph 8 of this paper) and that publish general purpose financial statements for external users.

Purpose of the paper

3. The purpose of this paper is to ask the International Accounting Standards Board (IASB) to:

   (a) consider feedback on the definition of public accountability; and

   (b) decide whether the definition of public accountability in the *IFRS for SMEs* Accounting Standard (and the draft Standard *Subsidiaries without Public Accountability: Disclosures*) is still fit for purpose or needs further clarification.

4. The description of public accountability in the draft Standard *Subsidiaries without Public Accountability: Disclosures* (see paragraph 20 of this paper) is the definition and supporting guidance from paragraphs 1.3 and 1.4 of the *IFRS for SMEs* Accounting Standard. Consequently, any decisions made to clarify the definition of public accountability and supporting guidance would also need to be reflected in that draft Standard.

Summary of staff recommendations

5. The staff recommend the IASB should:

   (a) clarify the definition of public accountability (as described in paragraph 29(a)–(b) of this paper) in the *IFRS for SMEs* Accounting Standard (and also in the Standard *Subsidiaries without Public Accountability: Disclosures*, if the IASB finalises the draft Standard) to improve understanding and avoid specifying how often the entities listed in paragraph 1.3(b) of the *IFRS for SMEs* Accounting Standard hold assets in a fiduciary capacity for a broad group of outsiders as one of their primary businesses;

   (b) clarify in the Standard *Subsidiaries without Public Accountability: Disclosures*, if finalised, that an intermediate parent assesses its eligibility to use that Standard in its separate financial statements on the basis of its own status without considering whether other group entities have, or the group as a whole has, public accountability, using similar wording to that of paragraph 1.7 of the *IFRS for SMEs* Accounting Standard; and

   (c) make the guidance on public accountability in 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) available on the IFRS Foundation website as guidance supporting the Standard *Subsidiaries without Public Accountability: Disclosures*, if finalised.

Structure of this paper

6. This paper is structured as follows:

   (a) background (paragraphs 7–18 of this paper);

   (b) recent feedback on the definition of public accountability (paragraphs 19–23 of this paper);

   (c) staff analysis (paragraphs 24–36 of this paper);

   (d) staff recommendation and question for the IASB (paragraph 37 of this paper); and

   (e) Appendix: Extracts from Module 1, the educational material on Section 1 of the *IFRS for SMEs* Accounting Standard).

Background

Definition of public accountability

7. In the IASB's judgement the *IFRS for SMEs* Accounting Standard is appropriate for an entity that does not have public accountability.[1]

8. Paragraph 1.3 of the *IFRS for SMEs* Accounting Standard state that an entity has public accountability if:[2]

   (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

[1] Paragraph BC56 of the Basis for Conclusions on the *IFRS for SMEs* Accounting Standard.

[2] Paragraph 1.3 of the *IFRS for SMEs* Accounting Standard (and paragraph 7 of the draft Standard *Subsidiaries without Public Accountability: Disclosures*).

brokers/dealers, mutual funds and investment banks would meet this second criterion).

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.[3]

10. During the development of the *IFRS for SMEs* Accounting Standard, the IASB considered that an entity has public accountability if:[4]

    (a) there is a high degree of outside interest in the entity from non-management investors or other stakeholders and the existence of a substantial group of stakeholders outside the entity (ie persons other than owner-managers) who have a direct financial interest in or claim against the entity; and

    (b) the stakeholders in (a) depend primarily on external financial reporting as their means of obtaining financial information about the entity. These stakeholders have a legitimate need for financial information about the entity but lack the power to demand the information for themselves. Financial statements and

[3] Paragraph 1.4 of the *IFRS for SMEs* Accounting Standard (and paragraph 8 of the draft Standard *Subsidiaries without Public Accountability: Disclosures*).

[4] Based on the IASB's preliminary view 3.2 in the 2004 Discussion Paper *Preliminary Views on Accounting Standards for Small and Medium-sized Entities* (see paragraphs 28–30 of that Discussion Paper). In the 2004 Discussion Paper the IASB also initially considered that an entity has public accountability if the entity has an essential public service responsibility because of the nature of its operations. The staff have not included this discussion in this paper because, in response to feedback on the 2004 Discussion Paper, the IASB ultimately concluded that the nature of the users of the financial statements, rather than the nature of the business activity, should determine whether full IFRS Accounting Standards should be required (see paragraphs BC60–BC61 of the Basis for Conclusions on the *IFRS for SMEs* Accounting Standard).

other financial reports based on full IFRS Accounting Standards are intended to meet those needs.

11. The IASB concluded that, regardless of the size, an entity's decision to enter a public capital market makes it publicly accountable, and it must provide the outside debt and equity investors with a broader range of financial information than may be needed by users of financial statements of entities that obtain capital only from private sources. Public investors often provide longer-term risk capital, but they do not have the power to demand the financial information they might find useful for investment decision-making.[5]

12. Similarly, a primary business of many 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. The IASB concluded that because such an entity acts in a public fiduciary capacity, it is publicly accountable.[6]

Clarifications of the definition of public accountability after issuance of the **IFRS for SMEs** *Accounting Standard*

SMEIG Q&As issued in 2011

13. In 2011, the SME Implementation Group (SMEIG) issued two Q&As providing non-mandatory guidance in response to implementation questions raised on the definition of public accountability:

    (a) Q&A 2011/02 *Entities that typically have public accountability*. The 2009 *IFRS for SMEs* Accounting Standard identified banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks as

[5] Paragraph BC58 of the Basis for Conclusions on the *IFRS for SMEs* Accounting Standard.

[6] Paragraph BC59 of the Basis for Conclusions on the *IFRS for SMEs* Accounting Standard.

examples of the type of entity that 'typically' holds assets in a fiduciary capacity for a broad group of outsiders as a primary business (ie meets the second criterion in the definition of public accountability – see paragraph 8(b) of this paper). Q&A 2011/02 addressed the question of whether 'all' entities of those types should automatically be assumed to have public accountability.

(b) Q&A 2011/03 *Interpretation of 'traded in a public market' in applying the IFRS for SMEs*. This Q&A addressed the question of how broadly 'traded in a public market' should be interpreted in the first criterion in the definition of public accountability (see paragraph 8(a) of this paper).

14. During the first comprehensive review of the *IFRS for SMEs* Accounting Standard (2012–2015), the IASB considered whether to incorporate the SMEIG Q&As into the *IFRS for SMEs* Accounting Standard or into its educational materials. For these two Q&A, the IASB decided to:

(a) reword the second criterion in the definition of public accountability as follows with the aim of incorporating the SMEIG conclusion in Q&A 2011/02 that the types of entities listed in paragraph 1.3(b) of the *IFRS for SMEs* Accounting Standard are not automatically publicly accountable and hence judgement is required to assess whether those entities have public accountability:

> 1.3 An entity has public accountability if:
>
> (a) …
>
> (b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (most ~~This is typically the case for~~ banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks will meet this second criterion).

(b) include in Module 1 *Small and Medium-sized Entities* the following guidance because the IASB considered this guidance to be educational in nature (see Appendix to this paper):

(i) from Q&A 2011/02, examples of circumstances in which an entity of the type listed in paragraph 1.3(b) of the *IFRS for SMEs* Accounting Standard does not have public accountability; and

(ii) Q&A 2011/03 as written.

Clarification of the meaning of fiduciary capacity[7]

15. During the first comprehensive review of the *IFRS for SMEs* Accounting Standard, some respondents to the 2012 Request for Information said that the meaning of 'fiduciary capacity' in the definition of public accountability is unclear, because it is a term that has different implications in different jurisdictions. However, respondents generally did not suggest alternative ways of describing public accountability or indicate what guidance would help to clarify the meaning of fiduciary capacity. Consequently, the IASB included a question in the 2013 Exposure Draft *Proposed amendments to the IFRS for SMEs* asking respondents if they are aware of circumstances where the term has created uncertainty or diversity in practice and whether the term needs to be clarified or replaced.

16. Most respondents to the 2013 Exposure Draft said that there was no need to clarify or replace the term fiduciary capacity. No respondent provided examples of where the term had resulted in diversity in practice. However, a small number of respondents said that the term had created uncertainty on the implementation of the *IFRS for SMEs* Accounting Standard in their jurisdictions.

17. Some respondents said the IASB should add a definition of fiduciary capacity to the Glossary of the *IFRS for SMEs* Accounting Standard and add examples to illustrate the term 'fiduciary capacity'. However, other respondents said that the meaning of 'fiduciary capacity' is a legal concept and should be left to each jurisdiction to provide additional guidance on its interpretation in that jurisdiction.

18. The IASB observed that it would be difficult to provide a definition of the term fiduciary capacity and/or provide guidance that would be applicable in all jurisdictions applying the *IFRS for SMEs* Accounting Standard because of the different legal

[7] Based on paragraphs BC182–BC183 of the Basis for Conclusions on the *IFRS for SMEs* Accounting Standard and Agenda Paper 15A *Feedback from comment letters on the October 2013 ED* of the May 2014 IASB meeting.

requirements and types of entities in different jurisdictions. Furthermore, the IASB noted that local legislative and regulatory authorities, and standard-setters in individual jurisdictions, may be best placed to identify the kinds of entities in their jurisdiction that hold assets in a fiduciary capacity for a broad group of outsiders as a primary business. By this, the IASB does not mean that those authorities and standard-setters are best placed to choose which entities in their jurisdiction meet the criterion in paragraph 1.3(b) of the *IFRS for SMEs* Accounting Standard. Instead, the IASB's intention was to ensure that the definition in paragraph 1.3 is applied consistently in accordance with the intended scope of the *IFRS for SMEs* Accounting Standard in their jurisdiction. Furthermore, the IASB noted that those local authorities and standard-setters are also best placed to decide whether other factors may mean that, in their jurisdiction, full IFRS Accounting Standards may be more for certain SMEs rather than the *IFRS for SMEs* Accounting Standard. Consequently, the IASB decided not to provide guidance on applying the term fiduciary capacity.

Recent feedback on the definition of public accountability

19. As noted in Agenda Paper 30A *Towards an exposure draft—scope and name of the IFRS for SMEs Accounting Standard* of this meeting, the IASB did not ask for views on the scope of the *IFRS for SMEs* Accounting Standard in the Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard*, published in January 2020, and only a small number of respondents commented on the definition of public accountability, which is used to describe the scope. These respondents asked for the scope to be widened, in particular to relax or remove the second criterion from the definition of public accountability, rather than commenting on the clarity of the definition itself.

20. However, in July 2021, the IASB issued Exposure Draft ED/2021/7 *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 based on the definition and supporting guidance in paragraphs 1.3 and 1.4 of the *IFRS for SMEs* Accounting Standard (see paragraphs 8–9 of this paper). Feedback on the draft Standard indicates there are some concerns about the application of the description of public accountability in the draft Standard. In the light of this feedback, the staff think the IASB should revisit the definition of public accountability in the *IFRS for SMEs* Accounting Standard and the supporting guidance to assess whether it is still fit for purpose or needs clarification.

Feedback on the draft Standard Subsidiaries without Public Accountability: Disclosures[8]

Feedback from the comment letters

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

(a) 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

[8] 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.

contracts). The premiums are not held in a fiduciary capacity by the insurance entity, neither in legal terms nor in economic perspective.

(b) 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.

(c) 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).

22. Furthermore, in commenting on the disclosure requirements for insurance contracts, respondents made the following observations:

(a) some respondents said that they consider some subsidiaries that issue insurance contracts do not have public accountability, including captive insurers, credit guarantee insurers and P&C insurers.

(b) some respondents based in Europe considered unlisted life insurance entities are eligible to apply the draft Standard. These respondents asserted that premiums received are invested at the insurers' own risk with the aim to ensure that the customers' contractual obligations are met whenever specified insured events occur. These respondents observed that this does not mean that insurance entities are holding assets in a fiduciary capacity for their customers.

(c) a few respondents said most, if not all, subsidiaries issuing insurance contracts within the scope of IFRS 17 are likely to be considered as having public accountability and therefore not eligible to apply the draft Standard.

Feedback from outreach events

23. 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.

Staff analysis

24. The staff analysis is set out as follows:

(a) holding assets in a fiduciary capacity (see paragraphs 25–31 of this paper);

(b) traded in a public market (see paragraphs 32–34 of this paper); and

(c) other guidance (see paragraphs 35–36 of this paper).

Holding assets in a fiduciary capacity

25. Some respondents to the draft Standard *Subsidiaries without Public Accountability: Disclosures* disagreed with the statement in paragraph 7 of that draft Standard (based on paragraph 1.3(b) of the *IFRS for SMEs* Accounting Standard) that ‘most’ banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks hold assets in a fiduciary capacity for a broad group of outsiders as a primary business. It was also noted that the legal meaning of fiduciary capacity in some jurisdictions may result in a narrower application than this statement. These concerns were raised mainly in relation to insurance companies.

26. There appear to be two views about whether insurance companies hold assets in a fiduciary capacity:

    (a) View 1 (expressed by the respondents in paragraph 22 of this paper): premiums collected by the insurance company in exchange for a contractual promise to indemnify the customer in the case of a future event belong to the insurance company. The premiums are not held and managed in a fiduciary capacity by the insurance entity, neither in legal terms nor in economic perspective.

    (b) View 2 (expressed by the SMEIG in the Basis for Conclusions accompanying Q&A 2011/02): There is a public interest in the financial reports of all non-captive insurance companies because:

        (i) the policyholders risk financial loss (and perhaps ruin) if an insured event occurs and the insurance company is unable to pay the claim.

        (ii) 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—insurance companies are regulated.

27. The staff observe that those that hold View 1 may think paragraph 1.3(b) of the *IFRS for SMEs* Accounting Standard should state ‘some’ rather than ‘most’ insurance companies meet the second criterion in the definition of public accountability. However, those that hold View 2 may think most insurance companies would meet that second criterion.

28. The staff think that the *IFRS for SMEs* Accounting Standard was developed in line with View 2, based on the IASB’s preliminary view in paragraph 10 of this paper and because the *IFRS for SMEs* Accounting Standard does not include specific requirements for insurance contracts or complex financial instruments and consequently, may not be suitable for more complex financial institutions.

29. Nevertheless, the staff do not think specifying how often entities listed in paragraph 1.3(b) of the *IFRS for SMEs* Accounting Standard hold assets in a fiduciary capacity

for a broad group of outsiders as one of their primary businesses is helpful within the definition of public accountability. Instead, the staff think it would be better to clarify why those entities are often considered to have public accountability. Consequently, the staff recommend the following clarifying amendments to the *IFRS for SMEs* Accounting Standard (and hence also to the draft Standard *Subsidiaries without Public Accountability: Disclosures*, if finalised):

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

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

(b) include the following guidance (considering paragraph 10 of this paper) in Section 1 of the *IFRS for SMEs* Accounting Standard (and in the draft Standard, if finalised) to supplement the definition of public accountability to enable jurisdictions to better understand the basis for the definition of public accountability and apply that definition appropriately and consistently:

> 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.

30. The staff do not recommend the IASB should try to develop a definition of fiduciary capacity or change the existing definition of public accountability. The staff continue

to support the IASB's observations in paragraph 18 of this paper (and paragraph BC183 of the Basis for Conclusions on the *IFRS for SMEs* Accounting Standard) that:

(a) it would be difficult to develop guidance on the definition of 'fiduciary capacity' that would be applicable, translatable and transferable across all jurisdictions applying the *IFRS for SMEs* Accounting Standard because of the different legal requirements and types of entities in different jurisdictions; and

(b) authorities and standard-setters in individual jurisdictions are best placed to identify the types of entities in their jurisdiction that have public accountability and to decide whether other factors may mean that, in their jurisdiction, full IFRS Accounting Standards may be more suitable for certain entities than the *IFRS for SMEs* Accounting Standard.

31. The staff also note that the *IFRS for SMEs* Accounting Standard is an established Standard in many jurisdictions. Consequently, including a definition of fiduciary capacity or changing the definition of public accountability in the Standard now 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 any new definition.

Traded in a public market

32. Some respondents to the draft Standard *Subsidiaries without Public Accountability: Disclosures* asked for guidance on whether alternative markets, such as crowdfunding and peer-to-peer financing, should be considered as a public market in the first criterion of the definition of public accountability (see paragraph 8(a) of this paper). The staff observe that the definition of public accountability notes that a public market includes 'a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets', ie public market should be interpreted wider than the traditional public market (stock exchange).

33. Q&A 2011/03 provided further guidance on how widely 'traded in a public market' should be interpreted and notes that:

> A '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.
>
> 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.

34. The staff think this request for guidance 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, which include the guidance from Q&A 2011/03, or not aware that the guidance in those modules would also be relevant to the description of public accountability in the draft Standard.[9] The staff think the guidance from Q&A 2011/03 is better retained as separate educational guidance (as decided by the IASB during the first comprehensive review – see paragraph 14 of this paper) rather than including it in the *IFRS for SMEs* Accounting Standard or the draft Standard (if finalised) for similar reasons to paragraph 31 of this paper. However, the staff think the relevant guidance on public accountability in Module 1 *Small and Medium-sized Entities* (the educational material on Section 1 of the *IFRS for SMEs* Accounting Standard) should be made more accessible on the IFRS Foundation website for entities applying the draft Standard (for example, by issuing that material as educational material on the draft Standard) because those entities should not be expected to look to the educational material on the *IFRS for SMEs* Accounting Standard.

[9] These modules are available on the IFRS Foundation website: IFRS - IFRS for SMEs modules (English language)

Other guidance

35. Some respondents to the draft Standard *Subsidiaries without Public Accountability: Disclosures* asked for guidance on what constitutes a ‘broad group of outsiders’ or ‘primary business’ in the second criterion in the definition of public accountability. The staff observe that guidance on these terms is provided through illustrative examples in Module 1 *Small and Medium-sized Entities*, which include those examples from Q&A 2011/03. Therefore, as noted in paragraph 34 of this paper, the staff think that these concerns can be addressed by making that educational material more accessible to entities applying the draft Standard, if finalised.

36. Some respondents to the draft Standard asked for guidance about how public accountability is assessed if a subsidiary is also a parent and prepares consolidated financial statements (an intermediate parent). Paragraph 1.7 of the *IFRS for SMEs* Accounting Standard explains how public accountability is assessed by a parent entity in its separate financial statements, and clarifies that the parent entity might not have public accountability on the basis of its own status even if the group of entities controlled by the parent has public accountability considered as a whole. Therefore, these requests for guidance could be addressed by including a similar paragraph, tailored to only refer to intermediate parent companies (parent companies that are also subsidiaries), in the Standard *Subsidiaries without Public Accountability: Disclosures*, if finalised. For example:

> An intermediate parent assesses its eligibility to apply this Standard in its separate financial statements on the basis of its own status without considering whether other group entities have, or the group as a whole has, public accountability. If a parent entity by itself does not have public accountability, it may present its separate financial statements in accordance with this Standard, even if it is not eligible to present its consolidated financial statements in accordance with this Standard.

Staff recommendations and question for the IASB

37. The staff recommend the IASB should:

   (a) clarify the definition of public accountability (as described in paragraph 29(a)–(b) of this paper) in the *IFRS for SMEs* Accounting Standard (and also in the Standard *Subsidiaries without Public Accountability: Disclosures,* if the IASB finalises the draft Standard) to improve understanding and avoid specifying how often the entities listed in paragraph 1.3(b) of the *IFRS for SMEs* Accounting Standard hold assets in a fiduciary capacity for a broad group of outsiders as one of their primary businesses;

   (b) clarify in the Standard *Subsidiaries without Public Accountability: Disclosures,* if finalised, that an intermediate parent assesses its eligibility to use that Standard in its separate financial statements on the basis of its own status without considering whether other group entities have, or the group as a whole has, public accountability, using similar wording to that of paragraph 1.7 of the *IFRS for SMEs* Accounting Standard; and

   (c) make the guidance on public accountability in Module 1 *Small and Medium-sized Entities* (the educational material on Section 1 of the *IFRS for SMEs* Accounting Standard) available on the IFRS Foundation website as guidance on the Standard *Subsidiaries without Public Accountability: Disclosures*, if finalised.

Question for the IASB

Does the IASB agree with the staff recommendations in paragraph 37 of this paper?

Appendix

Extracts from the educational material on Module 1 *Scope of the* IFRS for SMEs *Accounting Standard*

Extract 1 Public Accountability

Extract taken from Module 1 educational material that incorporates examples from Q&A 2011/02 Entities that typically have public accountability.

Financial institutions

In most cases, financial institutions are regulated by laws and government agencies. A primary business of most 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. The *IFRS for SMEs* Standard prohibits such an entity's financial statements from being described as conforming to it (see paragraph 1.5).

In limited circumstances an investment entity or insurance company may not have public accountability. Examples could include:

- 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.

Extract 2 Traded in a public market

Extract from Module 1: educational material that incorporates Q&A 2011/03 Interpretation of 'traded in a public market' in applying the IFRS for SMEs

Q&A 2011/03 - Interpretation of 'traded in a public market' in applying the *IFRS for SMEs*

As part of the 2012 Comprehensive Review of the *IFRS for SMEs* Standard the Board decided that the then existing Q&As should be deleted, with the content either incorporated into the *IFRS for SMEs* Standard or IFRS Foundation education material. Q&A 2011/3 was not incorporated into the *IFRS for SMEs* Standard, and only a summary is presented.

Issue

How broadly should 'traded in a public market' be interpreted in the definition of public accountability? For example in Europe does it include only those markets that are defined as 'regulated markets' for the purpose of EU accounting regulations or does it also include other markets such as growth share markets and over-the-counter markets? In addition, would a listing of convenience, ie a market in which a 'net asset value' price is published but no trading occurs in that market, make an entity publicly accountable?

Response

'Public market' is defined in paragraph 1.3 as 'a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets'. A '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.

In some jurisdictions, a shareholder of a small or medium-sized entity is permitted by law to publicly advertise those shares 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 using the *IFRS for SMEs* Standard.

continued...

...continued

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.

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.

The Basis for Conclusions to the Q&A made it clear that this Q&A was not intended to modify in any way the application of full IFRS Standards.