IFRS Accounting

Staff paper

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IASB® meeting

Date	**October 2022**
Project	**Disclosure Initiative—Subsidiaries without Public Accountability: Disclosures**
Topic	**Objective of the draft Standard**
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Purpose of this paper

1. This paper discusses the feedback on the proposed objective of the draft IFRS Accounting Standard (draft Standard) set out in Exposure Draft *Subsidiaries without Public Accountability: Disclosures* (Exposure Draft) and asks the International Accounting Standards Board (IASB) to confirm the proposed objective of the draft Standard.

Summary of staff recommendation

2. The staff recommend the IASB confirms the proposed objective of the draft Standard.

Structure of the paper

3. This paper is structured as follows:
   - (a) background (paragraphs 4–9);
   - (b) summary of feedback on the objective of the draft Standard (paragraphs 10–13);
   - (c) staff analysis (paragraphs 14–18):
     - (i) costs and benefits to subsidiaries and the group;
     - (ii) effects on users of the financial statements; and
     - (iii) staff view;
   - (d) staff recommendation and question for the IASB (paragraph 19);
   - (e) Appendix A: Potential effects of the proposals (extract from the Basis for Conclusions on the Exposure Draft); and
   - (f) Appendix B: Feedback from comment letters and outreach meetings.

Background

Question in the Invitation to Comment

4. Question 1 of the Invitation to Comment on the Exposure Draft asked for feedback on the objective set out in paragraph 1 of the draft Standard. Respondents were asked if they agreed with the objective. If not, what objective they would suggest and why?

Objective of the draft Standard

5. The Exposure Draft proposed:

> The objective of the draft Standard is to permit eligible subsidiaries to apply the disclosure requirements in this [draft] Standard and the recognition, measurement and presentation requirements in IFRS Standards.

6. The IASB added the *Subsidiaries without Public Accountability: Disclosures* project to its research pipeline in response to feedback on the *Request for Views—2015 Agenda Consultation*. Respondents to that Request for Views said permitting subsidiaries with a parent that applies IFRS Accounting Standards to apply IFRS Accounting Standards with reduced disclosures would eliminate unnecessary costs in preparing general purpose financial statements, while maintaining information needed by users of those subsidiaries' financial statements. Respondents said unnecessary costs would be eliminated because the disclosure requirements in IFRS Accounting Standards are designed for publicly accountable entities. Reducing the disclosure requirements and having the same recognition and measurement requirements in individual financial statements and information reported to the group for consolidation purposes would reduce the costs of preparing subsidiaries' general purpose financial statements.

7. Those respondents said that applying the *IFRS for SMEs* Accounting Standard, which is developed for entities without public accountability, can be unattractive to subsidiaries. This is because there are recognition and measurement differences between the *IFRS for SMEs* Accounting Standard and IFRS Accounting Standards therefore, applying the *IFRS for SMEs* Accounting Standard (or similarly a local accounting standard (local GAAP)) requires two sets of accounting records to be maintained.

8. The objective as proposed in the draft Standard responded to feedback on the *Request for Views—2015 Agenda Consultation* and sets out proposals to enable eligible subsidiaries to apply IFRS Accounting Standards with reduced disclosure requirement.

Potential effects of the draft Standard

9. Appendix A of this agenda paper is an extract from the Basis for Conclusions to the Exposure Draft on the likely benefits and costs of implementing the proposals set out in the exposure draft, and the likely ongoing benefits and application costs of those proposals (collectively referred to as 'effects'). The effects analysis for the draft Standard differs from that undertaken by the IASB when an IFRS Accounting Standard is required to be applied, because the draft Standard is optional. A preparer electing to apply the draft Standard is therefore able to satisfy itself that the benefits of applying the draft Standard outweigh the costs.

Summary of feedback on the objective of the draft Standard

10. Most respondents agreed with the objective proposed in the draft Standard. Many respondents reiterated the expected benefits of the proposals—reducing costs and simplifying the preparation of financial statements for eligible subsidiaries.

11. Although most respondents agreed with the objective, some respondents said that the benefits of the draft Standard are limited in certain circumstances and might not justify the application of the draft Standard, such as when a subsidiary currently applies IFRS Accounting Standards or if a subsidiary is material to the group and therefore applies the disclosure requirements in IFRS Accounting Standards.

12. A few respondents disagreed with the objective. These respondents said that if a subsidiary applies IFRS Accounting Standards, the transition to 'reduced' disclosures would result in a loss of information in the subsidiaries' financial statements.

13. A summary of the feedback on the objective (as reported to the IASB at its April 2022 meeting) is set out in Appendix B to this agenda paper.

Staff analysis

Costs and benefits to subsidiaries and the group

14. The cost–benefit assessment of applying the draft Standard will vary depending on a subsidiary's circumstances. In deciding whether to apply the Standard an eligible subsidiary would consider:

    (a) its current financial reporting framework. A subsidiary that applies local GAAP or the *IFRS for SMEs* Accounting Standard might incur higher implementation costs than a subsidiary that applies IFRS Accounting Standards. This is because there would be implementation costs arising from transition from local GAAP (or the *IFRS for SMEs* Accounting Standard) to IFRS Accounting Standards. However, the ongoing benefit from eliminating the costs of maintaining two sets of accounting records (both local GAAP and IFRS-compliant financial records) should exceed these upfront implementation costs.

    (b) its significance to the group. More information may be needed from material subsidiaries in order to prepare the parent's consolidated financial statements, including for disclosure requirements in IFRS Accounting Standards that are not required by the draft Standard. Therefore, the cost–benefit assessment for 'smaller' subsidiaries may be different to that for 'larger' subsidiaries.

    (c) the financial reporting processes of the subsidiary and the group. Sometimes the statutory reporting of the subsidiary is undertaken by the group, instead of the subsidiary having its own financial reporting process. For example, if the statutory reporting and group reporting are undertaken in a shared-service centre.

15. There may also be other factors to consider, for example if the local GAAP is aligned with local tax laws and legislation. Different combinations of these factors could result in a different cost–benefit assessment for the subsidiary and the group. Nevertheless, applying the draft Standard is optional. If the costs of applying the draft Standard do not justify the benefits, given the subsidiary's specific circumstances, the subsidiary could choose to not apply the draft Standard.

Effects on users of the financial statements

16. The main concern of respondents on the objective of the draft Standard relates to subsidiaries that are applying IFRS Accounting Standards (rather than the *IFRS for SMEs* Accounting Standard or local GAAP). Some respondents said that, for these subsidiaries, transitioning to the draft Standard would result in a loss of information for the subsidiary's parent and other users of the subsidiary's financial statements. Some respondents said there would be a deterioration in the quality of information included in the financial statements for these subsidiaries. A few of these respondents suggested not permitting these subsidiaries to apply the draft Standard[1]. However, the staff observe that:

    (a) paragraph BC93 of the Basis for Conclusions on the Exposure Draft (reproduced in Appendix A of this Agenda Paper) explained a subsidiary applying the draft Standard applies the recognition, measurement and presentation requirements of IFRS Accounting Standards. The IASB's approach to developing the proposed disclosure requirements (see Agenda Paper 31B *Approach to developing the proposed disclosure requirements*) uses the same set of principles that identifies information that users of non-publicly accountable entities' financial statements find useful. These principles have been subjected to reviews as part of the comprehensive reviews of the *IFRS for SMEs* Accounting Standard. Because subsidiaries eligible to apply the draft Standard are a sub-set of entities eligible to apply the *IFRS for SMEs* Accounting Standard, applying that approach, the IASB can be satisfied that the disclosure requirements in the draft Standard are sufficient to meet the needs of users of eligible subsidiaries' financial statements. Only disclosure requirements that are not intended for such users have been eliminated in the draft Standard. The IASB expects that the draft Standard will retain the usefulness of the financial statements for users of these eligible subsidiaries' financial statements.

    (b) further:

        (i) a parent can request additional information from its subsidiaries at any time.

        (ii) based on interviews with lenders during the development of the Exposure Draft, lenders use financial statements as a verification tool when making lending decisions about entities without public accountability and can request additional information (eg about future cash flow information).

[1] In its May 2022 meeting, the IASB tentatively decided to confirm the scope of the draft Standard as proposed in the Exposure Draft.

Staff view

17. In response to concerns raised by respondents, the staff have explained that:

    (a) the cost-benefits assessment may differ depending on the circumstances of the eligible subsidiary. If the costs of applying the draft Standard do not justify the benefits, the subsidiary would choose to not apply the draft Standard.

    (b) the proposed disclosure requirements in the draft Standard are developed to address the needs of users of subsidiaries' financial statements. Transition from IFRS Accounting Standards to the draft Standard will eliminate disclosure requirements designed for publicly accountable entities.

18. Most respondents agreed with the objective as proposed in the draft Standard and reiterated the expected benefits of the proposals. Consequently, the staff think that the feedback supports retaining the objective in the draft Standard.

Staff recommendation and question for the IASB

19. Considering the analysis in paragraphs 14–18, the staff recommend that the IASB confirms the proposed objective of the draft Standard.

Question for IASB members
Does the IASB agree with the staff recommendation in paragraph 19?

Appendix A: Potential effects of the proposals (extract from the Basis for Conclusions)

BC92. New or amended IFRS Standards, which change financial reporting requirements, entail costs justified by the benefits of the better information they lead entities to provide. However, the draft Standard would result in ongoing reduced costs for those subsidiaries applying it because it is not changing recognition and measurement requirements in IFRS Standards; it provides some subsidiaries with the option to provide fewer disclosures, tailored for their users' needs while applying IFRS Standards. Some subsidiaries may incur initial implementation costs, but these are expected to be outweighed by the ongoing savings (see paragraphs BC95–BC98).

BC93. The Board added the project to its work plan in response to feedback from preparers. The project aims to reduce the costs of preparing financial statements for subsidiaries permitted to apply the draft Standard—subsidiaries without public accountability with a parent that produces consolidated financial statements that comply with IFRS Standards. At present, a subsidiary that is required to provide information for consolidation to a parent entity that applies IFRS Standards would need to maintain additional accounting records when, in its own financial statements, it applied either the *IFRS for SMEs* Standard or a national GAAP whose recognition and measurement requirements differ from those in IFRS Standards. If the subsidiary applied IFRS Standards in its financial statements to minimise consolidation costs, it would be required to apply the disclosure requirements in IFRS Standards, although some disclosures provide information not intended for users of those financial statements if the subsidiary is not publicly accountable. The Board is seeking to reduce costs by eliminating the disclosure requirements that provide information not intended for such users of financial statements and eliminate the need to maintain additional accounting records. The Board expects that the draft Standard will retain the usefulness of the financial statements for the users of these subsidiaries' financial statements as the approach taken by the Board in developing the disclosure requirements considered users' needs.

BC94. The effects analysis for the draft Standard differs from that undertaken by the Board when an IFRS Standard is required to be applied, because the draft Standard is optional. A preparer electing to apply the draft Standard is therefore able to satisfy itself that the benefits of applying the draft Standard outweigh the costs.

BC95. The first-time implementation costs of applying the draft Standard would depend on whether a subsidiary's financial statements were previously prepared applying:

(a) a national GAAP (paragraph BC96);
(b) the *IFRS for SMEs* Standard (paragraph BC97); or
(c) IFRS Standards (paragraph BC98).

BC96. A subsidiary that applied a national GAAP and elects to apply the draft Standard would incur first-time implementation costs (including the cost as a first-time adopter of IFRS Standards). These costs would depend on the differences between the national GAAP that the subsidiary uses and IFRS Standards including the draft Standard. The ongoing benefits are expected to outweigh the implementation costs, because the subsidiary is no longer required to maintain additional accounting records. That is, efficiencies should arise when the parent and the subsidiary apply the same reporting standards.

BC97. A subsidiary that applied the *IFRS for SMEs* Standard and elects to apply the draft Standard would incur first-time implementation costs because recognition and measurement requirements differ between IFRS Standards and the *IFRS for SMEs* Standard, and there are some differences in the disclosure requirements between the draft Standard and the *IFRS for SMEs* Standard. These costs are expected to be outweighed by the benefits of the subsidiary not being required to maintain additional accounting records.

BC98. A subsidiary that applies IFRS Standards and elects to apply the draft Standard would benefit from significantly fewer disclosure requirements. Such a subsidiary could incur first-time implementation costs—for example, in identifying which disclosures are no longer required. However, these costs would be outweighed by the expected ongoing benefits of the subsidiary not having to produce the identified disclosures, including the associated operational costs a subsidiary would save from having to develop and maintain processes around preparation of those disclosures.

BC99. The Board's approach is intended to set disclosure requirements in the draft Standard that are sufficient to meet the needs of users of the subsidiary's financial statements. In the circumstances described in paragraphs BC96–BC98, if a parent requires information for its consolidated financial statements that the draft Standard does not require a subsidiary to disclose, the need to provide that information is unchanged by the draft Standard because the subsidiary would be required to provide such information regardless of the accounting standards it applies.

BC100. The Board has developed the disclosure requirements in a manner that should not result in the loss of useful information for the users of the subsidiary's financial statements. By considering paragraph BC157 of the *IFRS for SMEs* Standard in tailoring the disclosure requirements, the Board has considered the needs of users of the financial statements of subsidiaries within the proposed scope (see paragraphs BC32–BC34).

BC101. The Board also noted that in developing the disclosure requirements:

(a) lenders and other creditors to a subsidiary can request information beyond that in the subsidiary's financial statements. Lenders and other creditors can request such additional information regardless of whether financial statements are prepared applying IFRS Standards with full disclosures, the *IFRS for SMEs* Standard or a national GAAP.

(b) education and translation costs are inherent in applying any new or amended IFRS Standard, including implementing the (draft) Standard. In the long term, the benefits of application would justify these costs. The Board's approach to developing the requirements in the draft Standard should minimise such costs, because the approach uses disclosure requirements in the *IFRS for SMEs* Standard and in IFRS Standards as the basis for the proposed disclosure requirements.

(c) fewer disclosures would be provided in the financial statements subject to audit, so the audit effort should be reduced compared to financial statements applying IFRS Standards without applying the draft Standard. The auditor could also leverage on the work performed for the statutory audit (for example, the subsidiary's reporting in its own financial statements) and group reporting (for example, reporting to the parent company).

Appendix B: Feedback from comment letters and outreach events

Feedback from comment letters (Extract from Agenda Paper 31A, April 2022, IASB meeting)

12. Most respondents who commented agreed with the objective of the draft Standard. Many observed that the draft Standard will simplify and reduce costs of preparing financial statements of eligible subsidiaries. Some points raised by some respondents included:

    (a) the proposals would also benefit the parent entity through reduced costs for subsidiaries and streamlined group reporting because eligible subsidiaries could align their accounting policies with their parent;

    (b) fewer disclosures would reduce the amount of audit work required; and

    (c) the proposals would encourage wider application of IFRS Accounting Standards.

13. The International Organization of Securities Commissions said:

> … We think that the Board's proposals would have the benefit of encouraging subsidiaries within the scope to apply IFRS standards rather than another (local) GAAP because of the reduced complexities in doing so, and that such an approach could reduce costs for subsidiaries to prepare financial statements under IFRS. As well, the Board's proposal would result in subsidiaries within scope applying IFRS recognition and measurement requirements, and we think this could reduce the risk of errors occurring in the IFRS consolidation package prepared by the subsidiary for the parent and thus promote the overall quality of the consolidated financial statements of the parent, all while maintaining the information needed by the users of the subsidiaries' financial statements.

14. Although in agreement with the objective, some respondents raised the following concerns:

    (a) subsidiaries that currently apply IFRS Accounting Standards have systems in place to comply with IFRS Accounting Standards, and consequently the incremental benefits of applying the proposals may not justify moving to the draft Standard.

    (b) if subsidiaries provide disclosures to their parent for consolidation purposes that are otherwise not required by the draft Standard, the benefits of reduced disclosures would be less.

    (c) permitting eligible subsidiaries that currently apply IFRS Accounting Standards to apply the draft Standard would reduce information provided to users and hence the quality of financial reporting.

Feedback from outreach meetings (Extract from Agenda Paper 31B, April 2022, IASB meeting)

11. Many participants agreed with the objective of the draft Standard and that the proposals will reduce the costs and complexity of financial reporting of eligible subsidiaries. Other benefits identified by participants:

    (a) would eliminate the need to maintain another set of accounting records;

    (b) conglomerates with local and overseas subsidiaries could align their accounting policies which could reduce the costs of group reporting;

    (c) the risk of errors caused by adjustments to reconcile a subsidiary's own accounting records and accounting records used for consolidation purposes would be reduced; and

    (d) the proposals could lead to wider application of IFRS Accounting Standards.

12. Some participants noted that the benefits of the proposals (particularly paragraphs 11(a)–(c)) would be greatest for subsidiaries applying a reporting framework other than IFRS Accounting Standards. Some participants observed that for subsidiaries already applying IFRS Accounting Standards, the benefits might be limited. This is because, depending on how significant the subsidiary is to the group, the subsidiary may still need to provide all IFRS Accounting Standards disclosure requirements to the parent for consolidation purposes.

13. Some participants said they are concerned that the benefits of the proposals may not justify the loss of information for users of subsidiaries' financial statements, particularly for subsidiaries that currently apply IFRS Accounting Standards.

14. Some participants said that in jurisdictions where the local GAAP is aligned with tax laws and legislation, the benefits of adoption of the draft Standard are reduced.

15. Other comments on the objective of the draft Standard during outreach events:

    (a) concerns that the draft Standard would constitute a third framework (or third tier) in addition to IFRS Accounting Standards and the *IFRS for SMEs* Accounting Standard.

    (b) concerns that preparers and users might be confused because eligible subsidiaries could choose between two versions of IFRS Accounting Standards— full-disclosure or reduced-disclosure—and that this would lead to lack of comparability between entities without public accountability.

    (c) permitting push-down accounting in the subsidiary's financial statements would also eliminate the need to maintain another set of accounting records as an alternative to the draft Standard.

    (d) how non-adoption of the draft Standard would be reflected in IFRS jurisdiction profiles.