ICAEW REPRESENTATION
140/14

UK IMPLEMENTATION OF THE EU ACCOUNTING DIRECTIVE

ICAEW welcomes the opportunity to comment on the consultation paper *UK Implementation of the EU Accounting Directive* published by the Department for Business Innovation and Skills on 29 August 2014, a copy of which is available from this link.

This response of 27 October 2014 has been prepared on behalf of ICAEW by the Financial Reporting Faculty. Recognised internationally as a leading authority on financial reporting, the Faculty, through its Financial Reporting Committee, is responsible for formulating ICAEW policy on financial reporting issues and makes submissions to standard setters and other external bodies on behalf of ICAEW. The Faculty provides an extensive range of services to its members including the provision of practical assistance with common financial reporting problems.

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MAJOR POINTS

Consultation and due process

1. Despite some areas of concern, we are pleased to note that the consultation paper is of generally good quality and identifies the key issues that stakeholders need to focus on. BIS has been in close contact with an expert group throughout the development of the consultation paper, in which we were pleased to participate. While this has clearly been a valuable exercise, we do not believe that this justifies the very short 8 week consultation period. In our view, this timescale is woefully inadequate for an exercise of this importance and complexity. It has meant that the extent of our consultation with ICAEW members has had to be somewhat curtailed, and the time available has not allowed us to consider in sufficient depth some of the broader issues raised by the consultation, discussed below, to allow us to reach definitive conclusions.

2. In the same vein, this consultation paper must not be considered the end of the process. We believe it is also important for the draft regulations to be subject to full and proper consultation. We therefore urge BIS to publish the draft regulations as soon as possible to allow for effective scrutiny.

Principles underlying our responses

3. Our responses to the specific policy questions posed by BIS have been determined by reference to a number of general principles.

4. Firstly, the UK already has in place a highly effective financial reporting regime, proportionate and tailored to company size. Changes to company law should only be made where it is necessitated by the Directive or where a new option is available that is widely agreed to be significantly advantageous to UK companies and users of their financial reporting. On the contrary, many of the options under the new Directive are not new, and for the majority of these the UK already has a well-established position, widely-understood by both preparers and users of financial reports.

5. Secondly, the new regulations should in general be as permissive and flexible as possible, enabling the Financial Reporting Council in its role as the UK's accounting standard setter to provide further detail, restrictions and guidance as appropriate.

6. Thirdly, in our opinion there is a risk that deregulation of small company reporting could damage the UK economy. ICAEW is strongly supportive of government efforts to remove disproportionate regulatory requirements and to cut 'red tape' for small companies. Unnecessary or unduly onerous regulation can represent a real barrier to these innovative and growing companies, stymieing development and distracting management. But the view that accounting represents a very significant burden on UK small companies is a pernicious myth. Good quality financial reporting equips directors, as well as other users of the financial statements, to make better, well-informed business decisions which ultimately contribute to economic growth and prosperity.

7. We are therefore very concerned that initiatives aiming to cut 'red tape' for small companies appear unerringly to be based on the assumption that 'less is always better' when it comes to financial reporting, a view that, unchecked, may have an adverse impact on small companies and users of their accounts. For example, many small businesses already find access to credit challenging, and it is generally accepted that this is inimical to economic growth. Simplification of accounts may, over time, act to exacerbate this problem. The extension of credit depends upon confidence in the counterparty. If lenders and trade creditors have any concerns at all that they will not be able to obtain reliable information during the course of the credit period, they may be less willing – and not just at the margin - to lend or trade on credit. Although additional information or security will sometimes be requested by finance providers in these circumstances, albeit at additional cost to the company, trade counterparties may not be in a

position to do so and may be disadvantaged as a result. In any case, such a mechanism is not a complete substitute for readily available and well understood financial information.

The role of incorporation in the UK economy

8. In our November 2011 submission (ICAEW REP 105/11) on the BIS consultation paper *Simpler Reporting for the Smallest Businesses*, we commented at some length on the role of incorporation in the UK economy. We explained that, while some commentators believe that incorporation is a right and therefore should not carry incremental reporting obligations, others hold that incorporation is a privilege which allows investors the opportunity to develop a business proposition and in doing so, only puts at risk the cash introduced - thereby protecting their other assets from the company's creditors. Current UK law supports this latter interpretation, by requiring limited liability companies to file accounts, whereas unlimited liability companies need not do so, as creditors are not prejudiced by the lack of information.

9. We support the view that incorporation is a privilege and that a certain amount of valuable information should therefore be on the public record in order to assist the operation of the market, for example in terms of access to credit and protection for those trading with a limited company. It is within this context that we have considered the BIS proposals for the small companies' regime.

True and fair view

10. Throughout the EU legislative process and discussions over the draft Directive, we strongly opposed maximum harmonisation for small company reporting, and argued that member states should have the flexibility to consult on and determine a small company regime appropriate for the national environment. We also argued, with more success, for an expansion on the very short initial list of permissible disclosure requirements for small company accounts.

11. We acknowledge that in implementing the Directive, the UK Government has limited flexibility with regards to the number of the mandatory notes in small company accounts, and support the proposal to mandate the maximum possible number of notes permitted under EU law. We are however concerned about the statement in the consultation paper that the restriction imposed by the Directive also extends to accounting standards published by the FRC.

12. Our concern is as follows. A very limited set of disclosure requirements set out in law and standards has major implications for the responsibility of directors to ensure that accounts show a true and fair view, the foundation of UK financial reporting. At present, compliance with accounting standards would in most cases ensure sufficient disclosures were made for the accounts to show a true and fair view. However, this will no longer be the case once the Directive has been transposed into UK law. This is likely to result in uncertainty for directors, the risk of legal challenge to companies at a later date, a possible deterioration in the overall quality of small company financial reporting, and an increase in the costs and efforts associated with accounts preparation.

13. At the very least BIS should confirm that the FRC, as a private sector organisation, is entitled under the law to provide appropriate authoritative guidance, perhaps within FRS 102, on how the directors of a small company might consider the additional disclosures that are required in the context of providing a true and fair view. This guidance might for example recommend that the directors of a small company apply the full set of FRS 102 disclosure requirements as a starting point. This suggestion requires further debate and consultation, but we would expect that bridging the gap between the disclosures required by full FRS 102 and the thirteen mandatory notes proposed by BIS would not prove an unduly onerous task. UK accounting standards were after all created and developed with the intention of bringing together established practice and guidance on the information necessary for the accounts to show a true and fair view.

14. Ideally however, we believe BIS should challenge robustly the European Commission's questionable interpretation of the law in this context, perhaps obtaining a QC's opinion on the matter.

15. These issues are discussed below in more detail in our response to question 13.

Accounting and audit exemption thresholds

16. **Accounting thresholds** - as explained in more detail below under question 7, ICAEW has in the past been in favour of periodic increases to accounting thresholds to ensure as far as possible that the costs of producing financial statements are commensurate with the benefits to those who use them. Indeed, we remain in favour of such an increase in principle but have identified several serious concerns which would need to be resolved satisfactorily before we could wholeheartedly support the proposed increase in the small company thresholds. These include:

    - The lack of authoritative guidance for the directors of small companies on how to ensure the accounts show a true and fair view (discussed in question 7 below);
    - The proposal that small companies be permitted to *prepare* only abbreviated accounts (discussed further in questions 15 to 17); and
    - The extension of the current option for small companies to *file* abbreviated accounts to companies of significant size which do not currently qualify as small, but would do so should the accounting thresholds increase (discussed further under questions 15 to 17).

17. **Audit exemption threshold** -as discussed in more detail below under question 31, ordinarily we prefer decisions on small company accounting thresholds and audit exemption thresholds to be made together, as this avoids multiple changes to regulations within a short space of time. However, given the tight deadline for implementation of the Directive and the complexity of the issues surrounding any increase in audit exemption thresholds, we accept this is impractical on this occasion. Therefore we support BIS's decision to leave the audit exemption thresholds unchanged for the time being. However, we encourage BIS to consult as soon as possible on whether to adjust the audit exemption thresholds, involving a wide outreach to stakeholders, so that, if the decision is taken to raise the audit exemption thresholds, any increase can be made effective from the same date as the change to the accounting thresholds. We also recommend that BIS consult on the audit exemption thresholds matter separately ie, not as part of the wider consultation on the implementation of the Audit Directive, as it is likely to impact a different set of stakeholders.

18. The Financial Reporting Faculty hosted an event for around 120 ICAEW members with BIS and the FRC on 15 September 2014 to discuss the forthcoming changes to small company reporting. During the discussions, delegates were asked to vote in a number of electronic polls. One asked whether the Government should maximise the accounting thresholds for small companies: 61% voted yes, 26% no and 13% voted for an unspecified intermediate figure. Views were more divided regarding the audit exemption threshold, with 44% voting for the threshold to remain unchanged, while 54% voted for an increase to match the small company accounting threshold.

The scope of the BIS consultation

19. We believe further consideration is needed regarding the range of entities which are covered in this consultation, as explained below.

    LLPs

20. Most of the BIS consultation paper refers to companies. Given that the LLP accounting framework normally follows company law, we suggest that a clear commitment is made that

any changes in the company accounting framework will also be extended to the separate LLP regulations without significant delay. Having different rules for LLPs and companies, even temporarily, would represents an additional burden on businesses and be most unwelcome. Therefore the updating of the LLP regulations should not, as sometimes seems to be the case, be an after-thought. We would be happy to assist in this process as we believe that in general there is a strong demand for a more comprehensive and accessible set of LLP regulations. We therefore suggest the UK Government should begin work as soon as possible on providing a more cohesive and accessible framework.

21. We note that the micro-entity provisions have not, as yet, been extended to LLPs. We would support this extension and believe it could be addressed as a first step in a much-needed review and improvement of the LLP regulations. Furthermore, we see no reason why the effective date for LLPs choosing to adopt the micro-entity provisions should not be aligned with the existing micro-entity regulations.

Co-operative and Community Benefit Societies (CBS)

22. Whilst the scope of the Directive does not extend to Co-operatives and CBS (formerly Industrial and Provident Societies – IPSs), the accounting framework in IPS law has always been based on the requirements for companies. But IPS law is often not updated to reflect changes in company law – or not until some years later – causing difficulty and confusion as the rules for different types of entity become more fragmented.

23. As the Directive will require some significant changes in the accounting framework in UK law, we suggest that BIS works with HM Treasury to align at an early date the accounting requirements for Co-operatives and CBS with company law. In the past such alignment was seen as ‘too difficult’ due to the complex state of IPS legislation, but following consolidation of the latter in the Co-operative and Community Benefit Societies Act 2014, such difficulties no longer exist. Straightforward amendments to the 2014 Act could be made in line with changes to the Companies Act 2006.

Charitable companies

24. The scope of the Directive in the UK does not extend to charitable companies, as confirmed by paragraph 10.5 of the consultation document. ICAEW believes that the time is right to consider lifting from charitable companies the dual accounting and auditing requirements which arise through the interaction of company law and charity law, and enable them to report purely in accordance with charity law. Our rationale for this – including the complex interactions which currently arise between charity law and company law – is set out in our Appendix to this response. We would encourage BIS to consult further on this.

An end to abbreviated accounts?

25. We explain below in our response to question 15 why we are strongly opposed to the proposal that small companies be permitted to *prepare* only abbreviated accounts. Indeed, it would be our preference to revisit the lively debate that took place during the company law review some 10 years ago about the merits of allowing small companies to *file* abbreviated accounts. This perhaps ought to be considered as well in connection with the Government’s initiative around ‘trust and transparency’; it is unhelpful to have financial statements on the public record that, for example, give no details of transactions between the company and its shareholders and the deficiency in this regard ought to be debated.

26. Our recent discussions about the new limitations imposed on the contents of small company accounts have highlighted the very limited value of current abbreviated accounts for, for example, trade creditors who access accounts filed at Companies House to gain information about the solvency and creditworthiness of customers and potential customers. Indeed, anecdotal evidence suggests that the filing of abbreviated accounts can in fact have an

adverse effect on a small company's credit rating. It therefore seems questionable whether this concession – in particular the non-disclosure of turnover, a key metric for anyone wishing to understand the performance and prospects of a business - is appropriate for entities enjoying limited liability, especially in a business environment where trust and transparency are seen as critical to renewed economic confidence and growth.

27. This issue was not, understandably, explored in the current BIS consultation paper, although the proposed increase in the scope of the small company regime has made the issue more pressing. Similarly, ICAEW has not consulted its members at this stage about the pros and cons of permitting small companies to continue to file abbreviated accounts. Many will have strong views on either side of the debate. We suggest that BIS looks back to the considerable body of evidence assembled on this matter during the company law review and considers the case for consulting again on the issues in the near future.

Time for a holistic review of company law

28. In our view, BIS has not always made a convincing case for change within the current consultation, with some changes seemingly proposed in isolation rather than within the wider context of the law and practice in the UK. We suggest that BIS goes on to carry out a separate, holistic review of UK company law, as amended by the forthcoming regulations. This would enable BIS to reconsider both the new and existing options available under the Directive, possibly identifying further opportunities for deregulation, not considered or considered inadequately during this consultation. In carrying out this review it may be useful to look at the experience of other jurisdictions with regards to small company reporting requirements, for example the United States.

29. Another area that might be addressed as part of a holistic review is how different elements of the law apply to what is now a confusing array of types of company (micro/small/medium/large, private/public, quoted/with securities traded on a regulated market/PIEs, etc). If there are options to make the approach more internally consistent or simpler, they should be considered in more depth with a coherent evidence base presented as there are other areas of the Act where the categorisation is relevant, not just in relation to financial reporting.

30. In this context we would also welcome further consideration of the medium-sized company regime. In our view, there now remain few meaningful exemptions for a medium-sized company in the UK. Indeed, it might be argued that the differences are now so few and in some places lacking in value (for example the exemption from presentation of non-financial KPIs in a medium-sized company's strategic report) that they are more likely to result in confusion than to provide any significant cost savings in the preparation of the financial statements. Removing the medium-sized company category may in fact simplify the UK regime without adding significantly to the reporting obligations of such companies. Accordingly, we would support further consultation and debate on this matter.

RESPONSES TO SPECIFIC QUESTIONS

The Government's approach to implementation

Question 1

Do you agree that the Government should maintain the UK's existing approach to financial reporting and only introduce changes where imposed by the Directive or where new options have been introduced?

31. Yes, as a starting point we agree with the Government's strategy of making changes to UK company law only where this is necessitated by the Directive or where useful new options are available. The UK already has in place a highly effective accounting regime, proportionate and tailored to company size. Furthermore, as noted by BIS, many of the options previously

available under the 4th and 7th directives have been carried over to the new Directive, and for the majority of these the UK already has a well-established and widely understood position.

32. Having said that, we have identified in our responses below a number of areas where we do not believe that the Government should introduce change simply because a new option is available under the Directive.

33. In addition, our discussions have highlighted some areas where we believe improvements could be made to the UK's existing approach. These include:

- The current option for small companies to *file* abbreviated accounts (discussed in questions 15 to 17);
- The medium-sized company regime (discussed in question 2); and
- The ongoing issue caused by paragraph 13(a) of The Large and Medium-sized Companies Regulations. That is, we believe that reference to the term 'profits realised' should be replaced with the term 'profits made', consistent with the terminology used in the Directive. This change would eliminate the anomaly that, while unrealised profits arising from the use of the fair value accounting rules can be included in the profit and loss account, other unrealised profits cannot. This causes complications for accounting standards and prevents alignment with IFRSs in some respects. The change would not change the circumstances under which distributions can be made but would rather simplify the accounting requirements as set out in the law. We would be happy to provide further details to BIS on this point.

Question 2

Do you agree that the Government should maintain the current position of providing discrete regulations for small companies and for large and medium-sized companies?

34. Yes, we agree that the Government should maintain the current position of providing discrete regulations for small companies and for large and medium-sized companies. In our view, this is the most useful way to present the relevant requirements for a company, according to size and status. Combining these regulations would not be deregulatory. Indeed, we believe it would reduce their accessibility and usability, and go against the 'think small first' principle upon which the Directive is said to be based.

35. To take it one step further, we question whether it is still worthwhile having a medium-sized company regime in the UK. There now remain few meaningful exemptions for a medium-sized company. Indeed, it might be argued that the differences are now so few and in some places lacking in value (for example the exemption from presentation of non-financial KPIs in a medium-sized company's strategic report) that they are more likely to result in confusion than to provide any significant cost savings in the preparation of the financial statements. With this in mind, we believe that removing the medium-sized company category may clarify the UK regime without adding significantly to the reporting obligations of such companies. We would support further consultation and debate on this matter; perhaps as part of a separate holistic review of UK company law as discussed in our major points section above.

Question 3

Do you agree it would be helpful to have a new set of Small Companies and Group Regulations which set out the new small company regime and incorporate both the small companies' exemption and the micro-entities exemptions clearly and in one place?

36. No, we do not agree that it would be useful to have one set of regulations which incorporate both the small companies' exemptions and the micro-entities' exemptions in one place. In our opinion it would be far more useful to provide an additional discrete set of regulations which clearly set out in one place all the relevant reporting requirements for micro-entities. As noted in our response to question 2 above, we support the use of discrete regulations which offers

the most accessible and user-friendly way of outlining the relevant requirements for companies, according to size and status.

Question 4

Do you have suggestions for other regulation that might reasonably be consolidated as part of the implementation of this Directive? If so, please provide references to the relevant regulations with an explanation for your proposal and the benefits you expect this would deliver

37. No, we are not aware of any other regulations that might reasonably be consolidated as part of the UK implementation of the Directive.

Timetable for implementation

Question 5

Do you agree that the new regulations should apply to financial statements for financial years commencing on or after 1 January 2016?

38. Yes, as the requirements of the Directive must be in force for financial years commencing on or after 1 January 2016, it is appropriate for the Government to adopt this as the mandatory effective date for the new regulations.

Question 6

Should companies be able to access the new financial reporting regime (increased thresholds and revised reporting requirements) ahead of the mandatory application date of 1 January 2016?

39. Yes, we believe that early adoption of the new financial reporting regime should be permitted. This will be particularly relevant for both new companies and any expecting to fall within a different size category under the new regulations and therefore able to take advantage of a simpler reporting regime. Also, in light of the new UK GAAP regime effective from 1 January 2015, early adoption may be particularly advantageous for those medium-sized companies expecting to be reclassified as small in 2016. Otherwise they may face two consecutive years of change to their financial reporting regime. We see no reason why these companies and any others that may have good reasons for wishing to adopt early, should not have the option to do so, and as soon as possible.

40. We note that in order to achieve this, careful consideration will be required when drafting the effective date for the final regulations. Unless there are specific legal reasons to restrict early adoption to any particular financial years, the regulations should permit early adoption by companies which deliver their accounts to the Registrar on or after the date on which the regulations come into force. There is a precedent for this with the micro-entities regulations although, in that case, adoption was not permitted for any financial year ending before 30 September 2013.

41. We acknowledge that there are likely to be a number of practical challenges for companies wishing to adopt early. For example, it is not yet clear when UK accounting standards, updated for the changes to company law, will be finalised and available for use. Furthermore, many companies use accounting software in the production of their accounts and this software will need to be updated in time for those companies choosing to early adopt. Notwithstanding these challenges, we believe that early adoption of the new regime should be permitted for the few companies that may wish to do so.

Small company thresholds

Question 7

Do you agree with the Government's proposal to maximise the small company thresholds and provide as many eligible companies as possible with the opportunity to access the small company regime?

42. ICAEW is strongly supportive of government efforts to remove disproportionate regulatory requirements for small companies and has in the past been in favour of periodic increases to accounting thresholds to ensure as far as possible that the costs of producing financial statements is commensurate with the benefits to those who use them. Indeed, we remain in favour of such an increase in principle, but have identified several serious concerns, as outlined below, which would need to be resolved satisfactorily before we could wholeheartedly support the proposed increase in the small company thresholds.

Lack of authoritative guidance for directors of small companies

43. Our previous support for increases in accounting thresholds has been predicated on, amongst other things, the understanding that the FRC has the power to set accounting standards deemed appropriate for unlisted UK companies, including small companies. We are therefore concerned about the statement in the consultation paper that the new restriction on the mandation of disclosures by small companies extends to accounting standards published by the FRC. As discussed under question 13 below, we believe that the limited disclosure requirements set out in law and standards will have major implications for the responsibility of directors to ensure that the accounts show a true and fair view. At the very least BIS should confirm that the FRC, as a private sector organisation, is entitled under law to provide authoritative guidance on how the directors of a small company might consider the additional disclosures required in the context of providing a true and fair view. UK accounting standards were after all created and developed with the intention of bringing together established practice and guidance on the information necessary for the accounts to show a true and fair view.

Proposal for small companies to prepare abbreviated accounts

44. As outlined under questions 15-17 below, we have serious concerns over the proposal to permit small companies to prepare only abbreviated accounts.

Filing of abbreviated accounts

45. In addition, concerns regarding the current option for small companies to *file* abbreviated accounts have resurfaced during this consultation. We would prefer a separate consultation on this matter, perhaps at the same time as the forthcoming consultation on the implementation of the Audit Directive. However, in the meantime we suggest that BIS consider not extending the option to *file* abbreviated accounts to those companies that currently do not qualify as small but would do so should the accounting thresholds be increased to the maximum permitted.

46. We acknowledge that this approach might in the short run add a layer of complexity in the law. This would be unfortunate. However, we believe this to be preferable to the option of permitting these larger companies to file accounts of limited value without further consultation. It might in any case be possible to implement any changes arising from a separate consultation alongside those outlined in the current BIS consultation (ie, for accounting periods beginning on or after 1 January 2016). This matter is discussed in more detail below under questions 15-17.

Question 8

We have been able to draw on academic studies and responses to earlier consultations but we would welcome any additional information/evidence you are able to provide to support your response. What benefits or costs do you think will arise from raising the company size thresholds? (Information may relate to both monetised and non-monetised benefits and costs.)

47. We do not have any additional comments in this context.

Question 9

Do you agree that the Government should continue to measure a company's size by reference to its balance sheet total, net turnover and average number of employees?

48. Yes, subject to our specific comments below regarding charities, we agree that the Government should maintain the existing measures (balance sheet total, net turnover and average number of employees) for determining a company's size. We note however that the term 'balance sheet total' is often open to misinterpretation. We would prefer that is replaced with the term 'total balance sheet assets' which is a more accurate description of the measure.

49. As discussed under question 10 below, the question of how net turnover is calculated may merit further, separate consideration and consultation.

Question 10

Do you consider that there are circumstances where the Government should include other sources of income as net turnover for the purposes of determining company size?

Please provide details of the circumstances in which you consider the option should be applied, indicating the problem to be addressed and the costs/benefits that would arise. Information about the number of companies affected would be useful in assessing the impact of any change.

50. We agree that for certain sub-categories of company it may be sensible to include other sources of income as net turnover for the purpose of determining a company's size. However, clear boundaries would first need to be set, establishing precisely what income should or should not be included. This may be possible for charities, but would in other cases be less straightforward to achieve in practice, as explained below.

51. We do not believe turnover is an appropriate measure for charities, as discussed in our response to question 44 below. One other particular challenge relates to property companies. That is, while we would expect rental income to be included in net turnover, we would not expect the inclusion of income generated from a one-off fixed asset sale. There may also be other sources of income that should be considered where net turnover is not regarded as a 'relevant' number (the test set out in the Directive) in this context, for example dividend or interest receipts.

52. If changes were made in this area, it would also be important to ensure consistency in application across different categories of company. It may also be necessary to consider how a particular source of income has been generated. For example, a distinction may need to be drawn between interest generated through investment activities and that generated as a result of an entity's normal operating activities.

53. It is apparent, therefore, that there are a number of important boundary issues which need to be assessed and understood thoroughly before changes could be made to the law in this area. As these issues have not been articulated with sufficient clarity in this consultation paper, we have concluded that there is insufficient information at this stage to make an informed decision on the merits of amending the current regime. We suggest that BIS explores this matter more thoroughly and develops detailed proposals at a later date that set out the case for change.

Questions 11 and 12

Do you consider that there are circumstances (beyond those already in the UK accounting framework) where it would be appropriate to require:

(a) parent undertakings to calculate their thresholds on a consolidated basis rather than an individual basis; or

(b) "affiliated undertakings" to calculate their thresholds on a consolidated or aggregated basis?

Do you consider that there are circumstances where the Government should adopt either or both of the above provisions?

54. The basis for these questions is very unclear and we are unsure what information BIS is seeking to obtain. Having said that, we do not believe that there is any evidence to suggest that it would appropriate to change the way in which a parent undertaking or affiliated undertaking calculates its thresholds as described here.

Mandatory notes in small company accounts

Question 13

The Accounting Directive offers an option to reduce from 13 to 8 the number of mandatory notes required from small companies. Do you agree with the Government position to continue to require the five notes listed at paragraph 8.18?

55. Throughout the EU legislative process and discussions over the Directive, we strongly opposed maximum harmonisation for small company reporting. As discussed above, we are concerned that initiatives aiming to cut 'red tape' for small companies appear to be based on the assumption that 'less is always better' when it comes to financial reporting, and accordingly we argued that member states should have the flexibility to consult on and determine a small company regime appropriate for their national environments. We also argued, with more success, for an expansion on the very short initial list of permissible disclosure requirements for small company accounts to include, for example, disclosure of related party transactions.

56. We acknowledge that in implementing the Directive, the UK Government has limited flexibility with regards to the number of the mandatory notes required directly by law in small company accounts, and we support the proposal to mandate the maximum possible number of notes permitted by the Directive. As mentioned above, we are however concerned about the statement in the consultation paper that the restriction imposed by the Directive extends to accounting standards published by the FRC.

57. These concerns are as follows. We believe that the limited disclosure requirements set out in law and standards will have major implications for the responsibility of directors to ensure that accounts show a true and fair view. Whereas at present compliance with accounting standards would in most cases ensure sufficient disclosures were made for the accounts to show a true and fair view, this will no longer be the case, resulting in:

- Uncertainty for directors, and the risk of legal challenge to companies at a later date;
- A possible deterioration overall in the quality of small company financial statements; and
- An increase in the costs and efforts associated with accounts preparation - for example, any material transactions entered into by a small company and not covered by the 13 mandatory notes will require the directors to consider whether any additional disclosures are required in order for the accounts to show a true and fair view.

58. These are serious risks for companies and users of their financial reporting. In our view, the proposals create an unacceptable gap between the legal requirement for directors to ensure the accounts are true and fair and the disclosure regime that supports this assessment. At the very least, BIS should confirm that the FRC is entitled under the law to provide

appropriate authoritative guidance, perhaps within FRS 102, on how the directors of a small company might consider the additional disclosures required in the context of providing a true and fair view. This guidance might for example recommend that the directors of a small company apply the full set of FRS 102 disclosure requirements as a starting point. This suggestion requires further debate and consultation, but we would expect that bridging the gap between the additional the disclosures required by full FRS 102 and the thirteen mandatory notes proposed by BIS would not prove an unduly onerous task.

59. Ideally however, we believe BIS should challenge robustly the European Commission's questionable interpretation of the law in this context, perhaps obtaining a QC's opinion on the matter.

Question 14

Should the requirement for these notes be set out in regulations or should the need for notes be set out in accounting standards?

60. If deemed possible under the Directive, we recommend that the requirements for the mandatory notes (excluding the administrative requirement to disclose the registered office) be set out in accounting standards, along with the additional guidance needed to assist directors prepare accounts that are true and fair.

Abbreviated accounts

Questions 15, 16 and 17

Do you agree that small companies should have the choice of preparing an abbreviated balance sheet and profit and loss account if they wish?

If small companies were permitted to prepare an abbreviated balance sheet and profit and loss account, please indicate if there are any line items which you would consider it essential to retain to support the presentation of a true and fair view of a company's financial position? Please explain.

What benefits or costs might a small company see from deciding to prepare an abbreviated balance sheet and P&L? Evidence in support of your views would be helpful.

61. As explained above, ICAEW is strongly supportive of government efforts to remove disproportionate regulatory requirements and to cut 'red tape' for small companies. Unnecessary or unduly onerous regulation can represent a real barrier to these innovative and growing companies, stymieing development and distracting management. However, that accounting represents a very significant burden on UK small companies is, in our view, a pernicious myth. Good quality financial reporting equips directors, as well as other users of the financial statements, to make better and well-informed decisions, and it is with this in mind that we have considered the proposal that small companies be permitted to prepare *only* abbreviated accounts.

62. We have stressed above that there is a risk of damage to the UK economy arising from radical simplification of small company accounts. For example, many small businesses already find access to credit challenging, and it is generally accepted that this is inimical to economic growth. The simplification of accounts may, over time, act to exacerbate this problem. The extension of credit depends upon confidence in the counterparty. If lenders and trade creditors have any concerns at all that they will not be able to obtain reliable information during the course of the credit period, they may be less willing – and not just at the margin - to lend or trade on credit. Although additional information will sometimes be requested by finance providers in these circumstances, albeit at additional cost to the company, trade counterparties may not be in a position to do so and may be disadvantaged as a result. In any case, such a mechanism is not a complete substitute for readily-available and well-understood financial information.

63. Other stakeholders may also be affected by radical simplifications of small company accounts. For example, it may be more difficult in the case of an insolvency to assess the state of affairs of a company if less information is provided in the accounts. This may make it more difficult to recover assets and increase the costs involved.

64. We believe moreover that there are no significant cost savings to be gained through permitting small companies to prepare only abbreviated accounts. Much (although by no means all) of the accounts preparation process is now automated using specialist software, with few disclosures requiring manual population. Furthermore, abbreviated accounts would still - we assume - need to provide a true and fair view, which would be problematic. In our view this option is not deregulatory - companies would still be required to maintain appropriate books and records and prepare the financial information required for management and tax purposes. Moreover, this is not a new option under the directives and we see no reason whatsoever to change the UK's settled position in this respect. We therefore strongly oppose the proposal that small companies be permitted to prepare only abbreviated accounts.

65. Furthermore, concerns regarding the current option for small companies to *file* abbreviated accounts have resurfaced during this consultation. That is, the very limited value of abbreviated accounts for, for example, trade creditors who access accounts filed at Companies House to gain information about the solvency and creditworthiness of customers and potential customers. Indeed, anecdotal evidence suggests that the filing of abbreviated accounts can in fact have an adverse effect on a small company's credit rating. It therefore seems questionable whether this concession – in particular the non-disclosure of turnover, a key metric for anyone wishing to understand the performance and prospects of a business – is appropriate for entities enjoying limited liability, especially in a business environment where trust and transparency are seen as critical to renewed economic confidence and growth.

66. It would therefore be our preference to revisit the lively debate that took place during the company law review some 10 years ago about the merits of allowing small companies to *file* abbreviated accounts, perhaps as part of the forthcoming consultation on the implementation of the Audit Directive. This perhaps ought to be considered as well in connection with the Government's initiative around 'trust and transparency'; it is unhelpful to have financial statements on the public record that, for example, give no details of transactions between the company and its shareholders and the deficiency in this regard ought to be debated. In the meantime, as noted under question 7 above, we suggest that BIS considers whether the current option to *file* abbreviated accounts should not be extended to those companies which do not currently qualify as small but will do so should the accounting thresholds be increased.

Exemptions from the requirement to produce consolidated accounts

Question 18

What benefits do you believe this change will offer to small groups of companies? Evidence in support of your views would be helpful.

67. We would welcome clarification on this proposal. We believe that the current exclusions are drawn in the correct place and do not see any compelling reason why the existing position should be changed.

Eligibility for small companies regime

68. In our view, BIS has not made a convincing case for change in relation to the eligibility criteria for the small companies regime. Indeed, it seems that changes have been proposed in isolation rather than within the wider context of the law. We would prefer that BIS carries out a separate, holistic review of UK company law which, among other things, reconsiders how different elements of the law apply to what is now a confusing array of types of company (micro/small/medium/large, private/public, quoted/with securities traded on a regulated market/PIEs, etc). If there are options to make the approach more internally consistent or

simpler, they should be considered in more depth with a coherent evidence base presented as there are other areas of the Act where the categorisation is relevant, not just in relation to financial reporting.

Question 19

Should the Government only exclude from the small company accounting regime those public companies whose securities are traded on a regulated market?

69. No, in our view all public companies should be excluded from the small company accounting regime and be treated as 'large' companies. Public companies are distinct in law and we believe that the current exclusions are drawn in the correct place. We see no compelling reason why the existing position should change.

Question 20

Should the Government allow small companies who are members of a group which includes a public company to access the small companies regime?

70. No, we do not believe that the Government should permit members of a group which includes a public company to access the small company regime.

Question 21

Should the Government only exclude from the medium-sized company regime those public companies whose securities are traded on a regulated market?

71. No, in line with our response to question 19 above we believe that all public companies should be excluded from the medium-sized company regime and be treated as 'large' companies. However, as outlined above in our response to question 2, we question whether it is worthwhile maintaining the medium-sized company regime in the UK.

Question 22

Should the Government allow companies who are members of a group which includes a public company to access the medium-sized companies' regime?

72. No, notwithstanding our discussion in question 2 above, we do not believe that the Government should permit medium-sized companies which are members of a group which includes a public company to access the medium-sized company regime.

Question 23

Do you consider that the exclusions from the dormant subsidiaries accounting exemptions (where the subsidiary has a parent company guarantee) should be amended so that:

a) Companies are excluded because they have securities traded on a regulated market rather than because they are quoted companies?

b) Companies are excluded if they are part of an "ineligible group" under that definition as amended for the purposes of the small companies accounting regime?

73. No, we do not believe that the exclusions from the dormant subsidiaries accounting exemptions should be amended such that companies are excluded because they have securities traded on a regulated market, rather than because they are quoted.

74. As explained above, we do not believe that the definition of an 'ineligible group' for the purpose of the small companies accounting regime should be amended.

Formats and layouts

Question 24

Do you agree that only permitting Formats 1 and 2 of the P&L should not impact significantly on UK companies?

75. We agree that limiting the permitted profit and loss account formats to Formats 1 and 2 is unlikely to have a significant impact on UK companies given that these are the formats most commonly used in the UK.

Question 25

Should the UK take advantage of this option to provide greater flexibility in the layout(s)?

76. Yes, in principle we strongly support the inclusion in the regulations of as much flexibility as possible in relation to the layout of the profit and loss account and the balance sheet. This might, in particular, allow companies applying FRS 101 *The Reduced Disclosure Framework* to also apply the limited presentation requirements outlined in IFRS.

Question 26

If the UK took up this option, should flexibilities be dealt with in the regulations or in accounting standards and why?

77. We believe this to be a matter for accounting standards. Therefore we recommend that the regulations permit an appropriate level of flexibility, with the FRC responsible for developing the guidance and detail on how this would work in practice.

Other

Question 27

Do you agree that the legislation should enable participating interests to be accounted for using the equity method in individual company financial statements?

78. In general, we do not support accounting for participating interests using the equity method in individual company financial statements. In our view, the distinguishing feature of individual company financial statements is that interests in other entities are treated as investments. We believe that valuing such investments using the equity method is inappropriate, as doing so will not only result in confusion as to the nature of the individual company financial statements but will also create additional diversity and reduce comparability.

79. However, we prefer the law to be permissive and believe that it is a matter for accounting standards to determine. In other words, we think that the accounting treatment should be permitted by the regulations.

Question 28

Do you agree that the Government should provide for the 10 year maximum period for write-off offered in the Accounting Directive?

80. Our preference would be that company law does not specify any maximum period for the write- off of goodwill and development costs when no reliable estimate of useful economic life can be made. This is, in our view, a matter for accounting standards. However, we accept that the Directive requires member states to set a maximum period over which goodwill and development costs can be written off.

81. We believe that increasing the maximum period of write-off for goodwill and development costs to 10 years will result in unnecessary confusion. The period over which goodwill should be written-off has already been subject to much debate in recent months in the UK as a result of the new requirements set out in FRS 102. Therefore, not only do we recommend that no

further change is made to the maximum period of write-off, we also suggest that the FRC makes it abundantly clear that reverting to the maximum period for the write-off of goodwill and development costs is expected to be the exception and not the rule. That is to say, most entities are expected to be able to make a reliable estimate of the useful economic life of these assets. Continuing to limit the maximum period to 5 years will not therefore have a significant impact for most entities.

Question 29

Do you agree that the removal of this option should take effect alongside other changes to the UK's financial reporting framework?

82. In our view, the decision that information on subsidiaries included within the consolidated financial statements can only be included as a note to those consolidated statements (ie, removal of the option to instead include this information as part of the annual return, or its successor document) goes against recent efforts in the UK to cut clutter in financial statements. Significant improvements have been made in the drive towards achieving clear and concise reporting in recent years and we are concerned that this proposal will be a significant step in the wrong direction.

83. With this in mind, if there is to be no option as to where this information can be included, we believe that the correct place is within the company's annual return (or equivalent document company record update). Ultimately , this type of standing data may be better maintained by quoted/listed companies on their own website to make it more accessible and readily updated.

Question 30

Do you agree that the companies eligible to take advantage of the micro-entity regime should be relieved of the obligation to prepare a Directors' Report? What costs or benefits would result from this change?

84. Yes, we agree that the obligation to prepare a directors' report should be removed for companies which take advantage of the micro-entity regime.

Implications for the UK's approach to statutory audit

85. Contrary to our earlier comments regarding the general quality of the consultation document, we have found the drafting of the questions in this section extremely poor. We are concerned that this will have obscured the underlying changes being proposed by BIS to the detriment of the consultation process in this area.

Audit exemption thresholds

Question 31

Do you agree that the thresholds for the small companies audit exemption should remain unchanged for the time being ie that the thresholds for the audit exemption should not be increased in line with thresholds for the small company regime for accounting purposes at this time?

86. Yes, we agree that the thresholds for the small companies audit exemption should remain unchanged for the time being.

87. Ordinarily, we prefer that decisions on small company accounting thresholds and audit exemption thresholds are made together. At the very least this would avoid multiple changes to regulations within a short space of time. However, we acknowledge that the tight deadline for implementation of the Accounting Directive and the complexity of the issues surrounding any increase in audit exemption thresholds makes this impractical on this occasion. We also acknowledge that in a period of transition, allowing audit requirements to remain applicable to larger 'small companies' might help improve familiarity with the new accounting regime.

88. In reaching a view on whether it is appropriate to increase the audit exemption thresholds, it is necessary to take account of a number of factors. On the one hand, increasing the audit exemption thresholds to be consistent with the proposed higher small company accounting thresholds might have certain advantages. For example, it would be consistent with the current approach whereby the thresholds are aligned and would be easy to understand. On the other hand, the size and nature of companies classified as small already varies greatly, a feature that would become even more apparent were small company accounting thresholds to be increased.

89. It therefore seems a sensible time in the evolution of audit exemption to understand and assess the nature of those companies likely to become audit exempt before deciding whether to again increase the audit exemption thresholds. It may be that there are alternatives to statutory audit, such as assurance review engagements, which can offer a more appropriate and cost effective solution for certain small companies. This may be an important factor to consider when deciding whether or not to increase the thresholds. However, the extent to which these would be taken up voluntarily by firms and therefore provide a viable alternative to mandatory statutory audit is uncertain.

90. Notwithstanding our support for the proposed course of action, we strongly urge BIS to consult widely and without undue delay on whether it is appropriate to increase the audit exemption thresholds. Then, if a view is taken that the thresholds should be increased, any increase could be made effective to coincide with the increase to the accounting thresholds. We suggest a 12 week consultation period would be the minimum necessary to allow proper consideration by stakeholders.

Audit exemption

Question 32

Do you consider that the exclusions from the small companies audit exemption should be amended so that:

a) Small companies are no longer excluded simply because they are public companies, though they are excluded if they have securities admitted to trading on a regulated market?

b) Small companies are only excluded if they are part of an “ineligible group” under that definition as amended for the purpose of implementing changes to the small companies accounting regime?

91. No, we do not support the proposal to extend the exclusions to the small companies audit exemption regime. We do not think there should be any type of public company which should be allowed to access the small companies audit exemption.

92. Similarly, we do not agree that the definition of an ‘ineligible group’ should be amended for the purpose of applying the small companies regime. It should therefore also remain unchanged for the purpose of determining audit exemption. We do not think there are any circumstances in which small companies that are part of an ‘ineligible group’ should be allowed to access the small companies audit exemption.

Question 33

Do you consider that the exclusions from the subsidiaries audit exemption (where the subsidiary has a parent company guarantee) should be amended so that:

a) Companies are excluded because they have securities admitted to trading on a regulated market rather than because they are quoted companies?

b) Companies are excluded if they are part of an “ineligible group” under that definition as amended for the purpose of implementing changes to the small companies accounting regime?

93. No, we do not agree that the exclusions from the subsidiaries' audit exemption should be amended to refer to companies that have securities admitted to trading on a regulated market rather than to quoted companies. The consultation document does not make the case either for why it is desirable to allow certain quoted companies to claim the exemption or for why certain unquoted companies with debt traded on a regulated market would become unable to claim it. Therefore we believe the current exclusion should be left in place.

94. We do not agree either that the exclusions from the subsidiaries' audit exemption should be amended to exclude companies that are part of an 'ineligible group'. The consultation document does not make the case for why it is desirable to further exclude access to the subsidiaries' audit exemption. Therefore again we believe the current exemptions should be left in place.

Q34: Do you consider that the exclusions from the dormant companies audit exemption should be amended so that:

a) Companies are excluded if their securities are traded on a regulated market?

b) Companies are excluded if they are part of an "ineligible group" under that definition as amended for the purpose of implementing the small companies accounting regime?

95. We agree that the exclusions from the dormant companies audit exemption in s481 should be amended to exclude companies with securities admitted to trading on a regulated market. Although the consultation document does not make a clear case, we are unable to envisage a situation in which a company with securities traded on a regulated market could be dormant. However, in such cases the exemption would appear to be inappropriate.

96. We do not agree that the exclusions from the dormant companies audit exemption should be amended to exclude companies that are part of an 'ineligible group'. The consultation document does not make the case for why the exclusion should be extended to dormant subsidiaries within listed groups that could otherwise claim the exemption. To extend the exclusion in the manner proposed would require many small dormant subsidiaries within listed groups to be audited.

Audit report

Question 35

Do you agree that Article 28 (2)(e) of the Audit Directive, as inserted by Article 1 paragraph 23 of the Audit Directive 2014/56/EU, should be implemented with the changes included in the new Audit Directive?

97. Yes, we agree that this section of the Audit Directive should be implemented now.

Question 36

Are there any other changes made to Article 28 of the Audit Directive under Directive 2014/56/EU that you consider should be implemented at the same time as the changes introduced with the insertion of Article 28 of the Audit Directive by Article 35 of the Accounting Directive?

98. No, there are no other changes made to Article 28 of the Audit Directive that we think should be implemented now.

Question 37

Do you agree that the regulations should be amended to revoke the current requirement for disclosure of fees paid to auditors of medium sized companies for non-audit services?

99. We agree that medium-sized companies should not be required to disclose fees paid to their auditors for non-audit services. However, we note that the regulations currently do not require them to do so.

Question 38

Do you agree that the current requirement for disclosure by large companies of fees they have paid to auditors for non-audit services should no longer be extended to small and medium sized public companies unless they have securities traded on a regulated market?

100. No, we do not agree. We believe the current exclusions in s384 and s467(1) should remain in place and that small and medium-sized public companies should continue to be required to disclose fees paid to auditors for non-audit services.

Question 39

Do you agree that the current requirement for disclosure by large companies of fees they have paid to auditors for non-audit services should no longer be extended to small and medium sized companies in the same group as a public company?

101. No, we do not agree. We believe the current exclusions in s384 and s467(1) should remain in place and that small and medium-sized companies in the same group as a public company should continue to be required to disclose fees paid to auditors for non-audit services.

Question 40

Do you consider that the current requirement for disclosure by large companies of fees they have paid to auditors for non-audit services should continue to be extended to small and medium sized companies that are members of ineligible groups?

102. We believe the current exclusions in s384 and s467(1) should remain in place and that small and medium-sized companies that are members of ineligible groups should continue to be required to disclose fees paid to auditors for non-audit services.

Question 41

Do you:

a) agree that the regulation should be amended so that the current exemption from the disclosure of non-audit fees paid by subsidiaries is no longer available to a subsidiary whose auditor is not the group auditor; or

b) think the exemption should be available to these subsidiaries where the total non-audit service fees paid to their auditor by all the companies in the group is disclosed in the notes to the consolidated accounts?

103. We agree with both proposals. We prefer the approach under option (a).

Application for charitable companies

Question 42

Do you agree that there would be merit in specifically stating in regulations made under company law that the information provided in the notes to the financial statements of a company charity is not limited to the information required by the Accounting Directive

104. As explained in the introduction to this response, ICAEW believes that the time is right to consider lifting from charitable companies the dual accounting and auditing requirements which arise through the interaction of company law and charity law, and enable them to report purely in accordance with charity law. Our rationale for this – including the complex interactions which currently arise between charity law and company law – is set out in our Appendix to this response. We would encourage BIS to consult further on this.

105. However, as long as charitable companies remain subject to the regulations made under company law we agree, for the avoidance of doubt, that it would be helpful for the regulations to make clear that *because* charitable companies are not subject to the Accounting Directive,

the notes to the financial statements of a company charity are not restricted in the same way as that of a small company.

106. But, if BIS feels it is appropriate for regulations under company law to include specific accounting requirements for charitable companies, it would be helpful to make explicit reference to the Charities SORP (as in the regulations under charity law for non-company charities), rather than simply stating that the notes are not limited by the Accounting Directive.

Question 43

Do you agree that the current flexibility in presentation of financial statements of charities, in particular the requirement for an income and expenditure account and to adapt the arrangement, headings and sub-heading of financial statements to reflect the special nature of the company's activities, should be retained?

107. Yes, insofar as the accounts of charitable companies are to remain subject to the Companies Act, this flexibility should be retained.

Question 44

Do you agree that a threshold based on gross income is more appropriate than its turnover for company charities?

108. Yes, we agree that if specific provisions for accounting by charitable companies are to remain in the Companies Act, then the threshold should be based on gross income rather than turnover. For a charity whose main income is donations, the trading turnover may be zero, but the donated income may be substantial and should trigger appropriate accounting and reporting thresholds. So gross income is the appropriate measure.

IMPACT ASSESSMENT

109. We have included below our general thoughts on the costs and benefits in section 1 of the consultation paper.

110. We agree that it is very important to try to assess the costs and benefits of proposals for changes to accounting requirements. Formal assessments by governments tend, however, to be unenlightening. Any assessment needs carefully-defined parameters, focusing on the transparency and usefulness of the resultant financial information – factors we acknowledge are not readily quantifiable – and the potential practical implications for business, investors, the public, regulators and governments.

111. We recognise that this is not a straightforward exercise. Indeed, much of the evidence collected for this impact assessment appears to be largely anecdotal. We are therefore concerned that BIS appears to be working under the assumption that the evidence provides a robust evidential basis upon which the proposals can be assessed. We do not believe that this is the case and believe there is a risk of decisions being based on poorly-assessed benefits, coupled with unrealistic and incomplete estimates of costs.

112. For example, we have identified the following concerns with the impact assessment:

- Policy option 3, where only 8 notes would be mandated, includes a discussion of the costs of directors needing to consider whether additional information is required for the purpose of the accounts showing a true and fair view. There is however, no similar assessment of costs for policy option 1 and 2 where 13 notes would be mandated. It appears that there is an implicit assumption within the impact assessment that compliance with the 13 notes would ensure that small company accounts show a true and fair view. As discussed in question 13 above, we strongly dispute this assumption and do not believe that the impact assessment properly reflects the true costs on this matter.

- The focus on costs appears to be based on cost savings with regards to accounts preparation. However, no consideration appears to have been given to other costs or benefits. For example, the impact on the cost of capital or the cost of insurance resulting from a lack of transparency of financial information.

- We are not convinced that 'a greater level of comparability and consistency of financial reporting across the EU' is a meaningful benefit with respect to small companies. We believe that the benefits in this respect have been overstated within the impact assessment.

APPENDIX: CHARITABLE COMPANIES

1. The special issues raised in this consultation regarding charitable companies – in particular, the fact that they fall outside the requirements of the Accounting Directive – causes a number of difficulties in continuing to regulate the accounts of charitable companies through regulations made under the Companies Act 2006. ICAEW thus considers that the time is right to consider lifting from charitable companies the dual accounting and auditing requirements which arise through the interaction of company law and charity law, and enable them to report purely in accordance with charity law.

2. We note that a significant step was taken in this direction through amendments to the bills which became the Charities Act 2006 and Companies Act 2006. The end result was that the Companies Act 2006 removed the 'reporting accountant' regime and the lower audit threshold previously applicable to charitable companies. Section 1175 of the Companies Act 2006 enabled the necessary changes to take effect prior to full implementation of the 2006 Act. However, there remains a confusing regime where charitable companies are subject to a complex interaction between the requirements under charity law and those under company law. As charity law is a devolved matter, whilst company law is reserved to Westminster, this interaction operates in different ways between the three jurisdictions of the UK, as shown in the table below.

3. We note that fewer than 2,000 UK charities are large enough to fall into the medium or large definitions in company law, so the impact on small charitable companies (up to £6.5 million of income) is the main focus of our comments. Around 40,000 small charitable companies would benefit from the simplifications we are suggesting.

4. The table below summarises the current requirements. However, this only considers charities registered in one jurisdiction, but a cross border charity may be subject to more than one set of charity law requirements. Many charities operating UK-wide are formed as charitable companies in England and Wales, but are also required to register with the Office of the Scottish Charities Regulation (OSCR) in respect of their activities in Scotland and in due course they will also have to register with the Charity Commission for Northern Ireland under the 'section 167 register' in respect of their work in that jurisdiction. So a UK-wide charitable company may be preparing reports and accounts subject to a combination of four regimes:

    - Companies Act 2006 – core accounting requirements and audit if medium/large.
    - Charities Act 2011 – trustees report for England & Wales and examination/audit if small
    - Charities and Trustee Investment (Scotland) Act 2005 – core accounting requirements (in addition to company law) and examination/audit if small.
    - Charities Act (Northern Ireland) 2008 – reporting (yet to be determined) as required by section 167 registration.

    We suspect that the removal of the Companies Act from this multi-dimensional framework would be welcomed by charities and their funders.

5. We suggest charitable companies should still be required to file accounts with Companies House by the normal 9 month deadline in order to maintain accountability, but that the content of the accounts, the report and the examination/audit should be determined by charity law alone.

6. Consideration would be needed to deal with charitable companies not subject to any other accounting framework, to ensure they still reported under the Companies Act. But with the advent of compulsory charity registration in Scotland (from 2006) and Northern Ireland (from 2013), and with exempt charities in England and Wales being brought under Principal Regulators who set accounting requirements (e.g. charitable companies operating as Academy Schools are regulated by the Secretary of State for Education), the number of

charitable companies which would not be subject to other accounting requirements would be small.

7. However, we suggest that to avoid uncertainty, it may be safer to limit the exemption from company law accounting requirements only to apply to registered charities. This could be achieved by the following additions to the relevant Parts of the Companies Act 2006:

   "Nothing in this part applies to a company which is registered as a charity pursuant to any one or more of the following enactments:

   (a) section 29 of the Charities Act 2011;

   (b) section 3 of the Charities and Trustee Investment (Scotland) Act 2005; or

   (b) section 16 of the Charities Act (Northern Ireland) 2008."

   Amendments would also be needed to the Charities Act 2011 and the Charities Act (Northern Ireland) 2008 to remove the current exclusion of charitable companies from the accounting provisions of those Acts – though no amendment would be needed to the Scottish charity legislation as charitable companies are already included.

8. If this was felt to be too broad, an exemption on these lines for small charitable companies might be helpful – so that only medium and large charitable companies would remain subject to the company law accounting requirements. This would align with the position on audit.

9. We note that such an exemption would have the effect of allowing charitable companies with under £250,000 income simply to prepare receipts and payments accounts together with a statement of assets and liabilities (statement of balances in Scotland), which would not necessarily be accounts giving a true and fair view. However, this is already permitted for charitable incorporated organisations (CIOs and SCIOs) which are limited liability bodies. Moreover, even where a charity prepares accounts on this basis, a properly prepared statement of assets and liabilities following the guidance issued by charity regulators will generally contain at least as much detail as the abbreviated balance sheets filed by many smaller companies under the present regime. However, if this is felt to be problematic, the consequent amendments to charity law could require the preparation of accruals accounts in accordance with the Charities SORP in all cases where the charity is a company.

10. The following table shows the complexities of the current regime, by summarising the legal frameworks applicable to accounting and reporting for charitable companies established in each jurisdiction of the UK. ICAEW therefore urges BIS to undertake a further review and consultation to consider whether charitable companies should continue to be subject to such a complex regime of dual regulation.

Charitable Companies	*Accounting*	*Reporting*	*Examination/Audit*[1]
England & Wales	Accounts prepared under the Companies Act 2006. It is generally considered that the true and fair requirement entails compliance with the Charities SORP, but there are no explicit accounting regulations to that effect.[2] • *So - company law takes priority*	Both a directors' report under company law and a trustees' report under the Charities Act 2011 will be required – although most charitable companies are "small" for company law and do not therefore have to deliver a directors report. Where both reports are needed they are usually combined, but the trustees report requires much more. • *So – charity law takes priority but company law must also be considered*	For the majority of charitable companies which are "small" under company law, the requirements are determined entirely by the Charities Act 2011 (independent examination for income bands £25K to £500K, audit under charity law above this). Companies Act audit only needed if medium or large. • *So – charity law takes priority if small, but company law if medium or large*
Scotland	Accounts prepared under the Companies Act 2006 and under the Charities and Trustee Investment Scotland Act 2005. Explicit requirement in the Charities Accounts (Scotland) Regulations 2006 to comply with the Charities SORP where the accounts are on an accruals basis. • *So – both company law and charity law have to be considered together.*	Both a directors' report under company law and a trustees' report under the Charities & TI (Scotland) Act 2005 are required – although most charitable companies are "small" for company law and do not therefore have to deliver a directors report. Where both reports are needed they are usually combined, but the trustees report requires much more. • *So – charity law takes priority but company law must also be considered*	For the majority of charitable companies which are "small" under company law, the requirements are determined entirely by the Charities & TI (Scotland) Act 2005 (independent examination for income bands £0K to £500K, audit under charity law above this). Companies Act audit only needed if medium or large. • *So – charity law takes priority if small, but company law if medium or large*
Northern Ireland[3]	Accounts prepared under the Companies Act 2006. It is generally considered that the true and fair requirement entails compliance with the Charities SORP, but no explicit accounting regulations to that effect. • *So - company law takes priority*	Both a directors' report under company law and a trustees' report under the Charities Act (Northern Ireland) 2008 are required – although most charitable companies are "small" for company law and do not therefore have to deliver a directors report. • *So – charity law takes priority but company law must also be considered*	For the majority of charitable companies which are "small" under company law, the requirements are determined entirely by the Charities Act (Northern Ireland) 2008 (independent examination for income bands £0K to £500K, audit under charity law above this). Companies Act audit needed if medium or large. • *So – charity law takes priority if small, but company law if medium or large*

Notes:

[1] For simplicity, where financial thresholds are mentioned in this table, only the income thresholds are mentioned, though in England, Wales and Scotland (but not Northern Ireland) an assets threshold may also trigger an audit requirement.

[2] Where the accounts are subject to audit or independent examination, the auditor or IE is required to draw attention to any material non-compliance with the Charities SORP.

[3] The table shows the position in Northern Ireland once the full accounting framework is implemented under the Charities Act (Northern Ireland) 2008 (expected for accounting periods starting from 1 April 2015 onwards).