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Our ref mm/kad

For the attention of John Conway

21 October 2014

Dear Sirs

UK implementation of the EU Accounting Directive

We welcome the opportunity to comment on the BIS consultation on the UK implementation of the EU Accounting Directive ('the consultation').

Our key observations are as follows:

Early adoption of part of the Audit Directive (Q35)

We agree with the proposal to early-adopt the changes to the Accounting Directive to be introduced by Article 28(2)(e) of the Audit Directive, in order to avoid creating an intervening period of change that then reverses.

IFRS formats (Q25)

Whilst we support the wish to be able to apply IFRS formats, it is not clear that the Accounting Directive offers material additional flexibility (compared with the old Directives) or sufficient flexibility to permit the adoption of IFRS presentation in full.

Small companies (Q7-8)

The overall impression given by the consultation, as specifically stated in the impact assessment, is that the preparation of accounts is unjustifiably burdensome. There is little or no consideration of whether the small company changes continue to "protect essential user needs" (para 5.5 of the consultation) and little analysis of the benefits and disadvantages of the different options presented (e.g. increase in small company thresholds in paragraph 8.9). Increasing the number of companies eligible for the "simplified" approach for small companies is stated as a

benefit in the impact assessment, but this depends on whether the simplifications are appropriate. Related to this, it is not clear how BIS has concluded that the maximum 13 note disclosures permitted by the Directive are necessarily "more proportionate" to the information needs of users of small company accounts. Furthermore, the simplifications might be illusory due to the need to put back bespoke disclosures in order to give a true and fair view, including for those companies newly falling into the "small" category, being the larger and more complex among "small" companies. The impact assessment goes on to refer to a benefit of a "greater level of comparability and consistency of financial reporting across the EU, particularly for small companies." Given the need for additional disclosures to be given on a case-by-case basis in order to give a true and fair view, it is not clear how such a benefit will arise.

Finally in this area, this is the latest, but probably not the last, in a series of incremental, reactive changes in relation to small companies. Instead, perhaps BIS should consult and formulate a position on the wider public policy question: absent EU law, what is the appropriate balance between the entitlement of those dealing with an entity to have confidence in publicly available financial information and the reduction of burden on smaller companies to foster growth? After all, this is the question begged by this consultation's leitmotif of accounts being a burden, with an implicit answer in favour of the latter (e.g. the existence and continued increase in exemption thresholds). Explicitly answering it would provide BIS with a mandate as to where to draw a line against the watering-down of necessary requirements or, alternatively, to welcome the removal of unnecessary law. It would also drive further questions such as: what is small, and should any required accounts give a true and fair view.; It would also enable a resolution of the apparent contradiction of unaudited small company accounts (if there is no need for quality assurance over accounts, why are those accounts needed at all?).

The true and fair view (Q13-14)

There is an inherent tension between a fixed, maximum set of disclosures for small companies and the requirement for accounts to give a true and fair view. So the consideration of which (if any) additional disclosures, beyond the maximum 13 permitted by the Directive, are necessary to present a true and fair view will present practical difficulties for preparers of small company accounts (especially if they are unaudited). How can that task be made lighter for diligent directors? For nearly half a century the answer has been standardisation through accounting standards. Yet it is now said (paragraph 8.16) that this is no longer possible for small companies.

We understand that that prohibition is a view held by the European Commission. We believe that it would be such a fundamental, adverse change for the status and authority of UK accounting standards that it is in the public interest that the Government should obtain and publish independent legal advice on the matter. After all, we have a series of learned opinions from QCs on the status and authority of UK accounting standards. The settled position, confirmed many times, is that their authority does not rest on any legislative requirement to comply (indeed, there is no such requirement). Furthermore, if it were true that their status and authority has changed, it would be important to know whether that extends to all companies.

Abbreviated shareholder accounts (Q15-17)

We do not support the introduction of abbreviated accounts for shareholders (and note that our responses to the Company Law Review consultations supported the abolition of abbreviated accounts altogether). This option is available under the "old" Directives and the UK has an existing settled position of not taking that option.

Taking the shareholder abbreviated accounts option would create practical difficulties since the abbreviated accounts would still be required to give a true and fair view. It is beyond question that abbreviated accounts do *not* present a true and fair view due to the omission of certain key information: turnover, for example. The consultation does not consider how directors would be guided in presenting abbreviated accounts that give a true and fair view. The problem remains, of course, of those who would be attracted to a view that abbreviated accounts need no additions in order to give a true and fair view – resulting in poorer information to shareholders.

We do not foresee any significant cost benefits arising since the omitted information would be required to arrive at the minimum required disclosures. For example, in order to determine the gross profit/loss figure for inclusion in the profit and loss account, it will first be necessary to determine the turnover figure. We perceive there to be no cost saving in not transcribing into the accounts for shareholders known figures (being essential to the underlying accounting).

We consider that the simplest approach would be to retain the current position.

Inclusion of full list of subsidiaries in annual report (Q29)

We disagree with the proposal to include a full list of subsidiaries in the annual report. Whilst we agree that the information should be presented in one place, in our view the most appropriate location would be the annual return. To include this disclosure in the annual report would in many cases introduce copious information unrelated to a true and fair view, i.e. extreme clutter, to the annual report.

We set out our responses to the specific questions raised in the consultation in Appendix 1 to this letter.

If you wish to discuss any of the points raised, please contact.

Yours faithfully

KPMG LLP

cc Financial Reporting Council

Enclosures: Appendix 1

Appendix 1

Responses to specific questions raised in the consultation

Section 6 The Government's Approach to Implementation

Q1: 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?

Yes, and we are a little surprised at some of the existing, settled positions that the consultation seeks to re-open.

Q2: 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?

Yes.

Q3: 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?

Yes.

Q4: Do you have suggestions for other regulations 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.

We have no suggestions, including because consolidation is not substantive deregulation in any case.

Section 7 Timetable for implementation

Q5: Do you agree that the new regulations should apply to financial statements for financial years commencing on or after 1 January 2016?

Yes.

Q6: 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?

Yes. Early adoption would minimise the need for those companies that would fall within the small companies regime for the first time under the revised thresholds to have to apply, say, FRS

102 in full in their 2015 accounts and then to change again to apply FRS 102 for small companies in 2016.

Section 8 The Proposal

Q7: 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?

Given the lack of extensive cost/benefit analysis provided in the consultation, we are unable to express a preference. Please see our covering letter on this point.

We note that the threshold table set out on page 18 of the consultation refers to "greater or equal to" for the large company thresholds. The "equal to" element is not correct here, since a medium-sized company "must not exceed" two of the three thresholds. Only if the threshold is exceeded is the company defined as large.

Q8: 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.)

Please see our covering letter on this point.

Q9: 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?

Other than discussed in Q10 below in relation to net turnover, and Q11 in relation to consolidated thresholds, there is no option in the Accounting Directive to do otherwise.

Q10: 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?

Yes; in some instances investment income (investment companies) or donation income (charities) is the primary income source of an entity rather than traditional turnover. The substitution of other measures need not require extensive drafting of tests etc. It may be possible to provide merely that if turnover is not the largest income figure for the period, then whatever is the largest should be used. Please also see our response to Q44.

Q11: 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?

No.

Q12: Do you consider that there are circumstances where the Government should adopt either or both of the above provisions?

No; please see our response to Q11 (Q12 appears to be a repeat of Q11).

Q13: 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?

Yes.

Q14: Should the requirement for the five additional notes be set out in regulations or should the need for additional notes be set out in accounting standards?

To minimise potential confusion over the status of the five additional notes, and in the event that standards really are estopped from making further provision, it would be preferable for this requirement to be set out in regulations.

Q15: Do you agree that small companies should have the choice of preparing an abbreviated balance sheet and profit and loss account if they wish?

No; this option is available under the current Accounting Directives and has not been adopted in the UK. Abbreviated accounts will not meet the "true and fair view" requirement in law (for example due to the non-presentation of "turnover"). Please see our covering letter on this point.

Q16: 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.

Please see our response to Q15.

Q17: What benefits or costs might a small company see from deciding to prepare an abbreviated balance sheet and P&L?

Any potential cost savings would be negligible, if not nothing, since companies would be nevertheless required to prepare the detail prior to a final step of omitting some of it from the statutory accounts. Please see our covering letter on this point.

Q18: What benefits do you believe the exemption of small groups from consolidation will offer to

small groups of companies?

None; companies within the small companies regime are already exempt from consolidation under s398 and s399 Companies Act 2006 and Article 6 of the Seventh Directive.

Q19: Should the Government only exclude from the small company accounting regime those public companies whose securities are traded on a regulated market?

No, AIM companies are an example of public companies that should continue to be excluded from the small company accounting regime. Rather than excluding various named markets (which change from time to time) it is simpler to maintain the current exclusion. Non-traded public companies have the option to re-register as a private company should they wish to avoid being caught by the exclusion.

Q20: Should the Government allow small companies who are members of a group which includes a public company to access the small companies regime?

No; we do not see a case for re-opening an existing settled position. Such a change might result in groups which include a public company being constructed in a contrived manner in order to bring subsidiaries within the small companies regime. As noted in our response to Q19, non-traded public companies have the option to re-register as a private company should they wish to avoid being caught by the exclusion.

Q21: Should the Government only exclude from the medium-sized company regime those public companies whose securities are traded on a regulated market?

No; please see our response to Q19.

Q22: Should the Government allow companies who are members of a group which includes a public company to access the medium-sized companies regime?

No; please see our response to Q20.

Q23: 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?

It is not clear whether this question is raised only in respect of situations where a subsidiary has a parent company guarantee, or in respect of dormant subsidiaries generally. We have responded on the basis that it applies to both categories of subsidiaries.

a) We do not object to this change as it is unlikely that a dormant public company will be either quoted or traded on a regulated market.
b) No; if a subsidiary is dormant it is not relevant whether it is a member of an ineligible group.

Q24: Do you agree that only permitting Formats 1 and 2 of the P&L should not impact significantly on UK companies?

Yes.

Q25: Should the UK take advantage of this option to provide greater flexibility in the layout(s)?

It is not clear to us that Articles 11 and 13(2) provide any greater flexibility than that currently afforded by Articles 10a and 22 of the Fourth Directive.

In addition, whilst it would be desirable, it is not clear that this would fully permit the use of IFRS formats. For example, it would not appear to permit the presentation of the result of discontinued operations as a single line in the profit and loss account (under IFRS 5) without further disclosure on the face of the profit and loss account to present, for example, total turnover. That particular conflict is the reason why FRS 102, and previous UK GAAP, does not follow the IFRS 5 approach – see FRS 102 Appendix IV paragraph A4.39.

As noted in our response to Q26, it would be important for any alternative formats to be included in accounting standards and/or industry SORPs in order to minimise diversity in practice.

Q26: If the UK took up this option, should flexibilities be dealt with in the regulations or in accounting standards and why?

This would be better dealt with in accounting standards and/or industry SORPs. Please also see our response to Q43.

Q27: Do you agree that the legislation should enable participating interests to be accounted for using the equity method in individual company financial statements?

No; this would confuse individual accounts with consolidated accounts.

Q28: Do you agree that the Government should provide for the 10 year maximum period for write-off offered in the Accounting Directive?

Yes, and we would expect FRS 102 to be amended accordingly.

Q29: Do you agree that the removal of [the option to disclose information on group undertakings in the annual return] should take effect alongside other changes to the UK's financial reporting framework?

We disagree with the proposal to disclose this information in the annual report. Please see our covering letter on this point.

Q30: 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?

We have no preference.

Section 9 Implications for the UK's Approach to Statutory Audit

Q31: Do you agree that the thresholds for the small companies audit exemption should remain unchanged for the time being i.e 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?

Yes.

Q32: 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 this definition as amended for the purpose of implementing changes to the small companies accounting regime?

No; please see our responses to Q19 and Q20.

Q33: 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?

No; please see our response to Q23.

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?

No; please see our responses to Q23.

Q35: 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?

Yes; please see our covering letter.

Q36: 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?

No.

Q37: 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?

Yes, except to the extent that the companies are public companies (whether listed or not).

Q38: 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 public companies unless they have securities traded on a regulated market?

No; all public companies (not only those that are traded on a regulated market) should be required to give the disclosure unless they are included in a consolidation which gives the disclosure on a group basis.

Q39: 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 companies in the same group as a public company?

Yes, except to the extent that those companies are themselves public companies.

Q40: 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 medium sized and small companies that are members of ineligible groups?

No, provided that the companies are included in consolidated accounts that include the non-audit fee disclosure on a group basis.

Q41: 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?

Our preferred approach is (a), as option (b) would involve unnecessary complexity in the preparation of the consolidated accounts.

Section 10 Application to Charitable Companies

Q42: 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?

No, as that would imply that there is a general rule that additional provision cannot be made unless specifically authorised by statute.

Q43: 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?

Yes. Please also see our response to Q26.

Q44: Do you agree that a threshold based on gross income is more appropriate than its turnover for company charities?

Yes. Please also see our response to Q10.