Department for Business Innovation & Skills

UK IMPLEMENTATION OF EU ACCOUNTING DIRECTIVE

Chapters 1-9: Annual financial statements, consolidated financial statements, related reports of certain types of undertakings and general requirements for audit

RESPONSE FORM

AUGUST 2014

UK Implementation of the EU Accounting Directive – Chapters 1-9: Annual financial statements, consolidated financial statements, related reports of certain types of undertakings and general requirements for audit

Consultation response form

The Department may, in accordance with the Code of Practice on Access to Government Information, make available, on public request, individual responses.

The closing date for this consultation is 24 October 2014

Name: Grant Thornton UK LLP
Organisation (if applicable): Grant Thornton UK LLP
Address: Grant Thornton House, 22 Melton Street, London NW1 2EP

Please return completed forms to:
John Conway
Corporate Frameworks, Accountability and Governance
Department of Business, Innovation and Skills
3rd Floor, Spur 2
1 Victoria Street
London SW1H 0ET

Telephone: 020 7215 6402
Email: Accounting_Directive@bis.gsi.gov.uk

Please tick a box from the list below that best describes you as a respondent.

	Business representative organisation/trade body
	Non-government standard setting/regulatory body
	Charity or social enterprise
	Individual
	Large business (over 250 staff)
	Legal representative
	Local Government
	Medium business (50 to 250 staff)
	Micro business (up to 9 staff)
	Small business (10 to 49 staff)

	Trade union or staff association
√	Other – Accountancy firm

SECTION 6. 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? *(Paras 6.3-6.4)*

☒ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

We support the view 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.

However, where options are permitted and taken up, we would encourage the Government to consider fully the impact of those options on users of financial statements.

For example, we note that the Government is proposing to take up the option which allows companies to prepare abbreviated accounts for shareholders. In our view, this is inconsistent with the Government's growth agenda as we believe that the reduced transparency resulting from preparing only abbreviated accounts will reduce small businesses' access to credit and other external sources of finance, without which their growth potential will be stifled.

This proposal appears to conflict with the question being considered above which refers to introducing changes only where imposed by the Directive or where new options have been introduced. The option to prepare abbreviated accounts has been available for some time in EU law, but has not been taken up in the UK thus far. We are therefore unclear as to why the Government is proposing to take up this option now.

Taking up this option would represent a significant reduction in the financial information that shareholders receive, and we do not believe that this is compatible with the Government's stated priority of ensuring that the UK's framework continues to provide high quality information for users/third parties such as creditors, shareholders and regulators.

We discuss this option further in our response to Question 15.

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? *(Para 6.7)*

☒ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

The current position of providing discrete regulations for small companies and for large and medium-sized companies is helpful as it reduces the possibility of confusion over which requirements apply to which companies. The regulations which exist for both small companies and groups and medium-sized and large companies and groups are well established and users are now familiar with the form and content of those regulations.

We therefore agree that there would be little benefit in consolidating the two sets of regulations.

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? *(Para 6.8)*

☐ Yes ☒ No ☐ Not sure

Please provide information in support of your answer:

We believe that it would be helpful to have separate stand-alone regulations on the form and content of accounts for small companies and for micro-entities. Many micro-entities will remain as such but others that are growing may choose not to adopt the micro-entity regime even whilst they remain eligible.

Question 4: 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. *(Para 6.8)*

☐ Yes ☒ No ☐ Not sure

Please provide information in support of your answer:

We do not believe that there are any clear opportunities to consolidate regulations as the main regulations each serve distinct purposes and combining regulations would be likely to make the legislation more cumbersome and less clear.

SECTION 7. 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? *(Para 7.1)*

☒ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

We believe that companies should not be forced to adopt new requirements in advance of the mandatory EU effective date of 1 January 2016.

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? *(Para 7.2)*

☒ Yes ☐ No ☐ Not sure

Please provide an explanation for your position. In particular, we would welcome information about the costs/benefits associated with your preferred option:

We support the possibility of voluntary early adoption, in addition to the mandatory implementation date of 2016. We propose that voluntary adoption should be permitted for financial years commencing on or after 1 January 2015.

FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* replaces almost all existing UK accounting standards and is effective for accounting periods commencing on or after 1 January 2015. A large number of companies in the UK will therefore apply the standard for the first time in their 31 December 2015 accounts.

A company applying FRS 102 for the first time in 2015, which then qualifies as small in 2016 under the new proposed limits, will be able to follow the small company accounting regime in their 2016 accounts. Without early adoption being permitted, such a company would have to apply two new accounting regimes in consecutive years. We do not believe that this is helpful to small companies and is potentially burdensome.

If voluntary early adoption is permitted, costs associated with applying two new GAAPs in quick succession would be reduced, for example, costs of training, systems changes and explaining the reporting regimes to shareholders and other users of accounts.

Whilst maximising the time allowed for the transition to the new regulations might in other circumstances be helpful, the fact that companies will be thinking about, if they have not done so already, the transition to FRS 102 and the impact of the new standard on their first financial statements prepared under FRS 102, it would be more effective if the impact of the proposed revisions to company law could be considered at the same time if companies wish to do so.

However, early adoption would only be possible where the appropriate accounting standard is available – ie that the proposed amendments to FRS 102 (subject to a separate Financial Reporting Council consultation) have been made in time so as to facilitate early adoption.

SECTION 8. The Proposal

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? *(Para 8.10)*

☒ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

We agree that the small company accounting thresholds should be maximised. In our view to set a lower threshold would reduce the competitiveness of smaller UK companies not only domestically but also internationally, in particular with other EU Member States that are intending to take advantage of the maximum thresholds permitted. As stated in the preamble to this question in the consultation, small companies are permitted to prepare accounts following the requirements applicable to larger companies or provide more information if they choose to do so and that choice remains irrespective of the statutory threshold.

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.) *(Para 8.10)*

Benefits would include:

- a potentially significant number of companies and groups currently falling within the medium-sized companies and groups limits would qualify as small. This would mean that parent companies would no longer be required to prepare group accounts
- competitive advantage both at home and abroad
- financial cost savings through the adoption of a simpler financial reporting regime.

Costs would include:

- reduced disclosure in accounts may lead to increased cost indirectly through third parties not having access to detail that previously they were used to, which could lead, for example, to reduced availability of supplier credit, particularly for the largest small companies.

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? *(Para 8.12)*

☒ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

These measures are well established and represent the most likely indicators of a company's size. Other measures such as a measure of profit are likely to be more volatile and affected by non-recurring profits and losses, which could distort the results of a company's ordinary activities.

However, in respect of the term 'balance sheet total,' we note that there is often confusion as to what the figure represents. It might therefore be more helpfully described in legislation as 'total assets.' We also note that the word "net" is not currently used in relation to turnover in the Companies Act 2006 and we recommend that this approach should continue.

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? *(Para 8.12)*

☒ Yes ☐ No ☐ Not sure

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:

Circumstances where the option should be applied are where companies have significant income streams other than from turnover, for example, dividend income, interest income or in some cases, rental income. However, we are not aware of how significant an issue this is likely to be and would therefore recommend that BIS undertake further research into this area to assess the impact of the change. For example, are there a large number of companies taking advantage of the small company accounting regime as a result of excluding significant other income in determining whether they meet the relevant size criteria?

We are unclear as to whether BIS is proposing to expand the definition of 'net turnover' compared to what is set out in Article 2(5) of the Directive, ie the amounts derived from the sale of products and the provision of services after deducting sale rebates and value added tax and other taxes directly linked to turnover. It is not clear to us that the Directive permits this definition to be expanded upon. Rather, we see the question as being whether the Member State option in paragraph 12 of Article 3 should be adopted. This states that, when calculating the thresholds, Member States may require the inclusion of income from other sources for undertakings for which "net turnover" is not relevant, ie such other income is treated as being part of "net turnover" for the purposes of the size limits only. The practical difficulty that we see is how legal clarity could be achieved in identifying undertakings for which "net turnover" is not relevant. Would this be, for example, undertakings which have no turnover or undertaking for which clearly defined other sources of income exceed their turnover? Other sources of income could be identified by reference to profit and loss account statutory format headings.

Question 11: 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?

☐ Yes ☒ No ☐ Not sure

Please provide details of the circumstances to which the option should be applied, indicating the problem to be addressed and the costs/benefits that would arise:

We believe that the position under existing UK law is satisfactory and see no reason to change it.

Question 12: Do you consider that there are circumstances where the Government should adopt either or both of the above provisions? *(Para 8.13)*

☐ Yes ☒ No ☐ Not sure

Please provide details of the circumstances to which the option should be applied, indicating the problem to be addressed and the costs/benefits that would arise:

See our response to Question 11 above.

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? *(Para 8.19)*

☒ Yes ☐ No ☐ Not sure

If no, please provide an explanation, indicating which, if any, of the five notes you believe should be mandatory for small companies:

We agree the Government position should be to require the additional five notes listed at paragraph 8.18 in the Accounting Directive. The additional notes are not going to be relevant in every set of accounts, and are therefore unlikely to be onerous or burdensome for small companies. For example not all companies will have post balance sheet events to report, but where post balance sheet events have occurred and are material, disclosure would in any case be necessary in order for the accounts to show a true and fair view.

Question 14: Should the requirement for these additional notes be set out in regulations or should the need for additional notes be set out in accounting standards? *(Para 8.19)*

☐ Yes ☐ No ☒ Not sure

Please provide any information to support your views:

We note that the way in which the question is phrased means that a simple yes or no answer would be ambiguous, which is why we have given a ‘not sure’ answer.

The primary role of accounting standards for small companies under the new framework will be to determine the measurement and recognition requirements of the transactions and balances included in the financial statements. It may therefore be helpful to have disclosure, recognition and measurement requirements located in one document. Therefore, our preference is for the disclosures to be set out in accounting standards.

However, where disclosure requirements are contained in accounting standards, care needs to be taken to ensure that it is clear to users that the more extensive disclosure requirements of accounting standards for larger companies are not required by small companies. As EU law does not permit Member States to require greater disclosure than is set out in the Accounting Directive (including accounting standards), it may be confusing to include statutory disclosures within accounting standards, the content of which is not statute driven, unless those standards make clear which disclosures are required for each size of company.

Question 15: Do you agree that small companies should have the choice of preparing an abbreviated balance sheet and profit and loss account if they wish? *(Para 8.21)*

☐ Yes ☒ No ☐ Not sure

Please provide information in support of your answer:

We strongly disagree with the proposal to permit companies to prepare abbreviated accounts for their shareholders principally because the level of detail required to be given in the abbreviated accounts for shareholders is unlikely to achieve a true and fair view. This is illustrated as follows. Article 14 of the Accounting Directive permits the abbreviated balance sheet for shareholders to show only those items in Annexes III and IV preceded by letters and roman numerals. Therefore in respect of debtors and creditors, there would be no requirement to give an analysis of individual amounts making up the totals for these headings. Similarly, the profit and loss account need only start with gross profit in which case a figure for turnover would not be required. Given that turnover is often used as a key measure of the size and performance of a company (as discussed in our response to Question 9 above) it is difficult to see how the accounts could be true and fair without this figure being disclosed.

We also note that the option to prepare abbreviated accounts for shareholders has been available for some time but in the UK this option has not been taken up. Instead small companies have been required to prepare full accounts for shareholders but have been able to file abbreviated accounts at Companies House. We therefore question why the Government wishes to take up this option now, and change the long established position in the UK. This change also appears to conflict with the Government's objectives of transparency and promoting economic growth, as we noted in our response to question 1 above.

We understand that it will no longer be possible to file abbreviated accounts unless the option to prepare abbreviated accounts for shareholders is taken up, which means that the balance sheet and related notes filed at Companies House will be copies of those provided to shareholders. However, we do not believe that this will disadvantage companies significantly. The principal benefit to companies of filing abbreviated accounts has generally been the omission of the profit and loss account, and this will still be permitted even where the option to prepare abbreviated accounts is not taken up as, even when full accounts are provided for shareholders, only the balance sheet and related notes will need to be filed.

However, as noted in our covering letter, were the UK to take up the option to permit companies to prepare abbreviated accounts for shareholders, we would recommend that a company's ability to take up this option should be subject to minority objection rights similar to those currently set out in section 476 of the Companies Act 2006 in relation to the small

companies audit exemption so that shareholders effectively have a choice as to whether or not abbreviated accounts are prepared in place of full small company accounts.

Question 16: 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. *(Para 8.21)*

As stated above we do not support introducing the option to permit abbreviated accounts for shareholders. Given the restrictions that are being introduced in respect of the notes that can be required by UK law in small company accounts, the level of detail provided by the balance sheet and profit and loss account in small company accounts takes on greater significance.

To introduce more line items into abbreviated accounts prepared for shareholders would then represent a move towards 'full small company' accounts, which seems to defeat the purpose of having the abbreviated accounts option available for shareholders.

Question 17: 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 *(Para 8.21)*

We do not see that there would be any benefit to small companies from preparing abbreviated accounts for their shareholders rather than full small company accounts as all the underlying information will still need to be assembled in order to arrive at the amounts and disclosures that are presented. However, there is a potential cost in terms of lack of transparency that the reduced disclosure requirements may bring.

Question 18: What benefits do you believe exempting small groups from consolidation will offer to small groups of companies? Evidence in support of your views would be helpful *(Para 8.22)*

Small groups are currently exempt from consolidation unless the group meets the definition of an ineligible group. We see the major benefit of maintaining this exemption as being the cost saving from not having to prepare consolidated accounts.

Our reading of the Accounting Directive and our understanding of the 'maximum harmonisation' rule for small company accounting requirements is that the only way, other than on grounds of size, to exclude undertakings from the small company accounting regime is to designate them as Public Interest Entities (PIEs) under the Member State option in Article 2(1)(d). In implementing the Accounting Directive, we would support the definition of a PIE being consistent with those companies which are described within the current definition of an ineligible group.

In summary, our view is that those small groups that are currently excluded from the exemption to prepare group accounts should continue to be excluded under the new definition of an

ineligible group and that the definition of a PIE for purposes of the Accounting Directive should therefore be drafted to achieve this.

Question 19: Should the Government only exclude from the small company accounting regime those public companies whose securities are traded on a regulated market? *(Para 8.24)*

☐ Yes ☒ No ☐ Not sure

Please explain. If no, are there <u>any</u> types of public companies (other than those whose trading securities are traded on a regulated market) which should be allowed to access the small company regime (and why)?

Please see our response to Question 18 regarding our reading of the Accounting Directive and the apparent need to designate undertakings as PIEs if they are to be excluded from the small companies regime other than on grounds of size.

We note that there is a wider issue regarding the definition of a PIE for the purpose of applying the Accounting Directive and that for applying the Audit Directive and Audit Regulation. We discuss our concerns regarding this issue in more detail in our covering letter. However we wish to clarify here our view that the definition of a PIE for the purpose of applying the Accounting Directive and that for the purpose of applying the Audit Directive should not be the same.

We believe that the existing exclusions from the small accounting regime should be maintained and therefore that all public companies should be excluded from the small company regime. This will include all privately held plcs as well as those public companies which trade securities on markets other than those specified in Article 2 of the Accounting Directive – Aim listed companies, for example.

Whilst one might argue that the requirements for privately held plcs may be onerous as a result of these exclusions, it is a relatively straightforward legal process for a company to reregister as private and, if entitled, thereby take advantage of the small company regime should it wish to do so. Further, the perception of companies which are registered as public, even where privately held, is such that a higher level of application of the law would be expected. To allow public companies to access the small companies accounting regime could impact on the integrity of and confidence in the accounts prepared by such companies, and this is something that we understand the Government wishes to avoid.

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? *(Para 8.25)*

☐ Yes ☒ No ☐ Not sure

Please explain. If no, are there any circumstances in which other small companies within a group which includes a public company should be allowed to access the small company regime (and why)?

As noted above in our response to Question 19, we believe that the current exclusions (where companies are members of an ineligible group) should continue to apply, ie that companies that are members of a group which includes a public company should not have access to the small companies 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? *(Para 8.26)*

☐ Yes ☒ No ☐ Not sure

Please explain. If no, are there any types of public companies (other than those whose securities are traded on a regulated market) who should be allowed to access the medium-sized companies regime (and why)?

As noted in response to Question 19 above in respect of small companies, we believe that the existing exclusions from the medium-sized accounting regime should be maintained and therefore that all public companies should be excluded. This will include all privately held plcs as well as those public companies which trade securities on markets other than those specified in Article 2 of the Accounting Directive – Aim listed companies, for example.

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? *(Para 8.26)*

☐ Yes ☒ No ☐ Not sure

Please provide information in support of your answer:

See our responses to Questions 20 and 21 above.

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? *(Para 8.27)*

☐ Yes ☐ No ☒ Not sure

Please provide information in support of your answer:

We are not sure that such an amendment would have a significant impact. This is because companies that are either quoted or have securities traded on a regulated market generally do not meet the definition of dormant.

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? *(Para 8.27)*

☐ Yes ☒ No ☐ Not sure

Please provide any information in support of your answer:

We do not see the need for any change in this area.

Question 24: Do you agree that only permitting Formats 1 and 2 of the P&L should not impact significantly on UK companies? *(Para 8.29)*

☒ Yes ☐ No ☐ Not sure

If no, please provide an explanation for the impact (for example, which companies and in what circumstances) and what its effects might be. Any evidence of the cost of the impact would be welcome.

Given that Formats 3 and 4 contained in current legislation for small companies are rarely seen in practice, we cannot see that permitting Formats 1 and 2 only would cause a widespread issue.

Question 25: Should the UK take advantage of this option to provide greater flexibility in the layout(s)? *(Para 8.30)*

☒ Yes ☐ No ☐ Not sure

Please provide any information in support of your views here including any cost and benefits of providing greater flexibility in the use layouts.

We agree that the UK should take advantage of this option to provide greater flexibility in the layouts. However, whilst the law should permit the flexibility, we would leave the detail to accounting standards. For example, the application of FRS 101 Reduced Disclosure Framework may be made easier and more cost-effective for subsidiaries within a group where the parent reports under IFRS in its consolidated accounts if the subsidiaries are able to use an accounts presentation closer to that adopted by the parent rather than the current statutory formats. In our experience, the need for companies adopting FRS 101 to apply UK statutory formats is a significant deterrent to that standard's adoption at present. We are aware that the Directive requirement that where alternative presentation is permitted, the information given must be at least equivalent to that required under the formats may mean that alternative presentations cannot achieve full alignment with IFRS in all cases. However, in our view this

will affect only a minority of companies adopting FRS 101 and should not be allowed to stand in the way of the law permitting greater flexibility.

In addition, permitting early adoption of more flexible layouts would achieve cost savings for companies planning to adopt FRS 101 in 2015.

If sector-specific layouts are suggested, please can you provide information on the need for such a layout within the sector, the issues the standard layouts currently present to that sector and the nature and value of any benefits greater flexibility might bring.

We do not support sector specific layouts being set out in legislation, other than the current provisions for banks and insurance companies, which we believe should be maintained if possible. Other than in relation to these two sectors, sector specific formats have historically been developed through the use of SORPs and we would encourage this process to continue. This is because experts within a sector and users of sector specific financial statements are better placed in being able to apply and adapt the general legal requirements to their sector and users' needs.

Question 26: If the UK took up this option, should flexibilities be dealt with in the regulations or in accounting standards and why? *(Para 8.30)*

☐ Yes ☐ No ☒ Not sure

Please provide information in support of your answer:

We observe that a yes/no answer is not compatible with the wording of this question.

We believe that the detail of any flexibility should be dealt with in accounting standards, which are more straightforward to update than legislation in the event that IFRS requirements change.

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? *(Para 8.33)*

☒ Yes ☐ No ☐ Not sure

Please provide any information in support of your views, including any costs and benefits of allowing this option:

We note that recent changes to IFRS now permit entities to use the equity method to account for investments in subsidiaries, joint ventures, and associates in their separate financial statements. This proposed change in the law appears to allow a similar treatment in Companies Act accounts.

Whilst we would support a change to the law to permit participating interests to be accounted for using the equity method, in our view accounting standards should address whether this

statutory permission should be taken up and, if so, set out the detail of how this is to be achieved. We note that one of the Financial Reporting Council's objectives in developing UK accounting standards is to have consistency with global accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective of enabling users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs. We therefore believe it should be a matter for the FRC to decide whether to permit the equity method in individual financial statements and that the law should facilitate this option should the FRC decide to take it.

We note that under Article 9 paragraph 7(b) of the Accounting Directive, that "Member States may permit or require that the proportion of the profit or loss attributable to the participating interest be recognised in the investor's profit and loss account only to the extent of the amount corresponding to dividends already received or the payment which can be claimed."

At present, paragraph 13 of Schedule 1 to SI 2008/410 permits only realised profits to be included in the profit and loss account, subject to exceptions where the fair value accounting rules are applied. We observe that Article 6 paragraph 1(c)(i) of the Accounting Directive is less restrictive in that it states that "only profits made at the balance sheet date may be recognised." In our view, the restriction in the current UK law is outmoded and "realised" should be changed to "made" so as not to gold-plate the EU law in this respect.

However, if the current restriction in paragraph 13 of Schedule 1 to SI 2008/410 is retained, then we observe that the UK's implementation of Article 9 paragraph 7(b) would need to restrict the amounts included in the profit and loss account to those that are realised. This is not incompatible with permitting equity accounting in law as any unrealised amounts could be recognised in other comprehensive income under FRS 102 and credited to a non-distributable reserve in accordance with Article 9 paragraph 7(c).

As outlined in Appendix 1 of our covering letter, we believe that, in implementing the new Directive, the phrase "profits realised" should be changed to the Directive words "profits made", which in the context of equity accounting would avoid amounts in respect of profits and losses potentially being recognised in two performance statements, ie the profit and loss account and other comprehensive income.

Question 28: Do you agree that the Government should provide for the 10 year maximum period for write-off offered in the Accounting Directive? *(Para 8.36)*

☒ Yes ☐ No ☐ Not sure

Please provide any information in support of your views, including any reasons that the period should be kept to 5 years, or to any alternative period:

We agree that the maximum period of write off should be provided for, ie 10 years. However the wording of the legislation should broadly follow that of the Accounting Directive, Article 12.11 so as to make it clear that it is only in **exceptional circumstances** that the useful life of goodwill and development costs cannot be reliably estimated. If this point is not made clear, then a useful life of 10 years may be taken as a default position, which is not the intention of the legislation.

Question 29: Do you agree that the removal of this option should take effect alongside other changes to the UK's financial reporting framework? *(Para 8.38)*

☐ Yes ☐ No ☒ Not sure

If no, please provide an explanation and indicate when the change should be effective and what the reasons are for this:

We see no reason why the removal of the option to submit a full list of subsidiaries with the Annual Return, if it is to be implemented, should not be implemented alongside the implementation of the revised reporting framework.

However, we would prefer that the option to provide information on subsidiaries included in a consolidation as part of a company's Annual Return were retained. In cases where companies have a large number of subsidiaries, the information included in the financial statements could become unwieldy, which would be contrary to current initiatives to reduce the volume of disclosures in annual reports and accounts. However, we appreciate that there may be ways in which companies could mitigate the impact of this. For example they could position a full list of subsidiaries towards the end of the notes to the financial statements, or list those principal subsidiaries that are most significant to the group early on in the financial statements with a cross reference to a note detailing less significant subsidiaries located towards the back of the financial statements.

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? *(Para 8.42)*

☒ Yes ☐ No ☐ Not sure

If no, please provide information in support of your view and the value that the Directors' Report offers to a micro-entity company:

Given the already limited requirements for the content of the Directors' Report for a company taking advantage of the micro-entity regime, we agree that micro-entities should be relieved of the obligation to prepare a Directors' Report. Directors and shareholders of such companies are likely to be the same individuals making the need for a directors' report unnecessary.

We cannot see that there are likely to be any significant costs as a result from this change. There will be a marginal benefit in terms of reduced preparation time for the annual accounts.

SECTION 9: Implications for the UK's Approach to Statutory Audit

Question 31: 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? *(Para 9.5)*

☒ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

We agree that the thresholds for the small companies audit exemption should remain unchanged for the time being. There are a number of matters to be considered in relation to any future increase in the small companies audit exemption thresholds and these matters should be considered separately from the increase in the thresholds for the small company regime for accounting purposes. This should be the subject of a separate consultation taking into account the interests of a wide range of users and interested parties such that related matters, including the potential advantages and disadvantages (quantitative and qualitative) of raising the threshold, may be considered fully.

One of the matters that should be considered is the inclusion of other sources of income in determining whether the size limits are met for companies for which turnover is not a relevant measure, which the Directive permits Member States to require. There may be support for this as companies can have major other sources of income, such as interest, dividends or rent that is not counted in turnover. This matter should be given due consideration in relation to any future increase in the small companies audit exemption threshold.

We note that leaving the small companies audit exemption unchanged for the time being gives rise to a period when there will be a number of companies that will be eligible for, and take advantage of, the small companies regime for accounting purposes but will not be eligible for, or choose not to take, the small companies audit exemption. Those companies will prepare accounts under the new small companies regime for accounting purposes, which will have significantly reduced disclosures. These accounts will be required to give a true and fair view and the general requirement to provide additional disclosures if necessary to achieve a true and fair view in the particular circumstances will continue to apply. The directors will continue to have a legal duty not to approve the accounts unless they are satisfied that they give a true and fair view. However, when the auditor comes to audit those accounts, the disclosures that the auditor views as necessary for the accounts to show a true and fair view may be missing, but there will be nothing in the legislation that the auditor can point to to say that such disclosure is required. This situation will exist for auditors until the thresholds for the small companies audit exemption and the small company regime for accounting purposes are aligned again. Even if audit exemption is taken, the directors' duty noted above will continue to apply. As noted in our covering letter, whilst we do not recommend that extensive new guidance is produced on applying the concept of true and fair in this context, it may be helpful for attention to be drawn to guidance that already exists.

We also observe that whilst raising the threshold may result in the cost of an audit being saved for a larger number of companies, this may be outweighed by the potential costs associated with an audit not being undertaken. For example, access to external finance may be limited or become more costly where accounts used in support of raising finance have not been audited.

The proposed small company turnover limit is £10.2m. Companies with business operations which are close to this limit are therefore likely to be sizable companies and are potentially likely to have more complex accounting transactions. Whilst simplification of the accounting regime is likely to reduce the burden on such companies and we would support that, we are not

sure that companies of this size would benefit from an exemption from audit and the assurance that it gives company directors, shareholders and external users of the financial statements.

Further, the audit process is often not simply about signing an audit report. The audit often facilitates a company's access to wider business advice from external auditors alongside the audit to the extent that this is compatible with maintaining auditor independence.

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? *(Para 9.10)*

☐ Yes ☒ No ☐ Not sure

If no, are there <u>any</u> types of public company (other than those with securities admitted to trading on a regulated market) which should be allowed to access the small companies audit exemption?

In summary we believe that all public companies should be excluded from audit exemption.

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? *(Para 9.10)*

☐ Yes ☒ No ☐ Not sure

If no, are there any circumstances in which small companies that are part of an "ineligible group" (as amended) should be allowed to access the small companies audit exemption?

We do not believe that the case for making either of these amendments has yet been made.

There are good reasons for the current position and all public companies should continue to be excluded from the small companies audit exemption. As we have stated in our response to Question 19, Public companies enjoy a higher profile than private companies and for the public at large, this perception may include those public companies which do not have securities admitted to trading on a regulated market. Accordingly it is appropriate that such companies, including AIM quoted and privately held public companies, are subject to the additional scrutiny of an audit. As we have stated, privately held public companies are able to reregister as private companies where they consider the regulatory consequences to be too onerous.

The situation for small companies which are excluded from the small companies audit exemption if they are part of an ineligible group is similar. A group containing any of the companies or entities that make a group ineligible similarly enjoys a higher profile and market privileges and again should not be exempted from the audit requirement merely because it is small in size.

In our view the exclusions from the small companies audit exemption should remain as they currently are, ie that a small company which is a member of an ineligible group is excluded from taking 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? *(Para 9.10)*

☒ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

Our view is that companies that are quoted companies, together with other companies that have securities admitted to trading on a regulated market, should be excluded from the subsidiaries audit exemption with parental guarantee. We note that market regulation will generally require such companies to be audited in any event so the proposed change may not have a significant effect in practice.

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? *(Para 9.10)*

☐ Yes ☒ No ☐ Not sure

Please provide information in support of your answer:

We see no reason not to maintain the current position. We note that the proposed change would prevent any subsidiary of a Public Interest Entity parent or of any other company that is ineligible for the small companies regime from taking advantage of audit exemption in return for a parental guarantee. This would represent a significant narrowing of the exemption that was introduced only in 2012. In our view, there is a fundamental difference between the audit exemption for subsidiaries in return for a parental guarantee and small companies audit exemption, from which members of ineligible groups are excluded, in that creditors of the subsidiary benefit from the guarantee. Therefore, we believe that the difference in scope of the exemptions is well justified and should be maintained.

Question 34: 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? *(Para 9.11)*

☐ Yes ☒ No ☐ Not sure

Please provide information in support of your answer:

It is extremely unlikely that a company with securities admitted to trading on a regulated market would ever meet the definition of a dormant company. We see no reason to change the current position.

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? *(Para 9.11)*

☐ Yes ☒ No ☐ Not sure

Please provide information in support of your answer:

We believe that the current position should be maintained. It is not uncommon for subsidiaries within a group to become dormant but continue to exist, for example as a way of protecting the company name. We see no reason why audit exemption should not continue to be available to such companies.

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? *(Para 9.15)*

☒ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

The additional requirements for the auditor's opinion and statement set out in the Accounting Directive as issued in 2013 have the potential to require auditors to undertake significant additional work, thus increasing audit costs. The text as amended by the 2014 Audit Directive provides a helpful clarification that the opinion and statement should be based only on the work undertaken in the course of the audit, and should be implemented at the same time as the implementation of the requirement in the Accounting Directive, to avoid the otherwise temporary increase in the regulatory burden.

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? *(Para 9.15)*

☐ Yes ☒ No ☐ Not sure

Please provide information in support of your answer:

We do not believe that any other such changes should be implemented at the same time as the specific change referred to in the question.

Question 37: Do you agree that the regulations[1] should be amended to revoke the current requirement for disclosure of fees paid to auditors of medium sized companies for non-audit services? *(Para 9.16)*

☒ Yes ☐ No ☐ Not sure

If no, are there any types of medium sized company (other than banks or insurers or those with securities traded on a regulated market) who should be required to disclose the fees paid to their auditor for non-audit services?

We agree with the BIS proposal that disclosure of non-audit service fees should no longer be required for medium-sized companies as such disclosure is not required by the Accounting Directive. We believe that the disclosure is not key or sufficiently important to a user of the financial statements of such companies to warrant it other than when the company is part of an ineligible group, as discussed in our response to Question 40 below.

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 public companies unless they have securities traded on a regulated market? *(Para 9.16)*

☐ Yes ☒ No ☐ Not sure

If no, are there any types of public companies (other than banks or insurers or those with securities traded on a regulated market) who should be required to disclose the fees paid to their auditor for non-audit services?

We do not agree that the requirement for disclosure of fees for non-audit services should no longer be extended to public companies unless they have securities traded on a regulated market. We believe that all public companies enjoy a higher public profile and as such should be required to give this additional disclosure.

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 companies in the same group as a public company? *(Para 9.16)*

☐ Yes ☒ No ☐ Not sure

If no, are there any circumstances in which other small or medium sized companies within a group which includes a public company should be required to disclose the fees paid to their auditor for non-audit services?

We do not agree that the requirement for disclosure of fees for non-audit services should no longer be extended to small or medium sized companies within a group that includes a public

[1] The Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008 (SI 2008/489)

company. We believe that all public companies and groups that include a public company enjoy a higher public profile and as such should be required to give this additional disclosure.

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 medium sized and small companies that are members of ineligible groups? *(Para 9.17)*

☒ Yes ☐ No ☐ Not sure

Please provide information in support of your response:

We agree that the requirement for disclosure of fees for non-audit services should continue to be extended to medium-sized and small companies that are members of ineligible groups. We believe that a group containing any of the companies or entities that make the group ineligible enjoys a higher public profile and as such should be required to give this additional disclosure.

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? *(Para 9.20)*

☐ a ☒ b ☐ Not sure

Please provide information in support of your response:

Option (b) is preferable, despite the overall increase in the work required, as otherwise there is a possible loss of information for stakeholders. A user of the financial statements can only obtain information on the amount that the group has paid for the audit of the group financial statements under option (b). Under option (a), in order to obtain the same information, a user would have to know which subsidiary was not audited by the group auditor, obtain the financial statements for that subsidiary and add the two numbers together.

SECTION 10: Application to 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? *(Para 10.6)*

☒ Yes ☐ No ☐ Not sure

Please provide information in support of your view:

We believe it would be useful, and would reduce ambiguity, if the fact 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 were to be clarified in regulations.

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? *(Para 10.7)*

☒ Yes ☐ No ☐ Not sure

Please provide information in support of your view:

The nature of the items which make up the performance and position of a charity company which is not trading for profit do not fit into the profit and loss account and balance sheet formats intended for trading companies. It is therefore sensible that the accounts of charity companies can be adapted to reflect the nature of the activities undertaken.

Question 44: Do you agree that a threshold based on gross income is more appropriate than its turnover for company charities? *(Para 10.8)*

☒ Yes ☐ No ☐ Not sure

Please provide information in support of your view:

Charity companies do not always generate turnover, although some may do so, but may have many other sources of incoming resources. The level of gross income is therefore more likely to reflect the true size of the charity.

Thank you for taking the time to let us have your views. We do not intend to acknowledge receipt of individual responses unless you tick the box below.

Please acknowledge this reply ☒

At BIS we carry out our research on many different topics and consultations. As your views are valuable to us, would it be okay if we were to contact you again from time to time either for research or to send through consultation documents?

☒ Yes ☐ No

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Any enquiries regarding this publication should be sent to:

Department for Business, Innovation and Skills
1 Victoria Street
London SW1H 0ET
Tel: 020 7215 5000

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