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Department of Business, Innovation and Skills
3rd Floor, Spur 2
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Our ref: mjs/tp/1810

Dear Sirs

Consultation on the UK implementation of the EU Accounting Directive: Chapters 1-9

We are pleased to comment on the proposals for the implementation in the UK of the revised EU Accounting Directive. We have responded to the questions posed in the consultation paper in the attached Appendix. However we have some general observations. In particular we believe that the small company limit should be set at the minimum, rather than the maximum, level permitted by the EU and should not be de-coupled from the audit exemption criteria. Please see our responses to questions 7 and 31 below.

Whilst we realise that there is a certain amount of time pressure because of the need to reflect the revisions to the Directive in UK law in a reasonably short time frame, we are concerned that a consultation period of only 8 weeks has been allowed rather than the preferred 12. This is a change in UK company law which will have wide ranging consequences, particularly if some of the individual proposals in the consultation paper are implemented unchanged (which is usually the case). Therefore, the consultation needs to reach as wide an audience as possible with that audience having sufficient time to properly consider the proposals and their effects, particularly smaller organisations who necessarily do not have the same level of resources as the largest firms. Wide ranging and timely consultation is, we believe, a key aim of the Government.

We are also concerned that the accounting firms initially consulted were drawn entirely from the top ten firms. The main impact of the changes is unlikely to significantly affect the largest firms – rather it will be felt by those firms whose client base is drawn largely from smaller owner managed businesses. Whilst we recognise that larger firms, particularly larger mid tier firms, do still deal with such businesses they do not form the majority of their client base as is the case for the majority of the profession. It is therefore vital that the views of the profession as a whole, and not just the largest firms, are obtained and taken into account during the consultation process and as mentioned above this is a key aim of Government.

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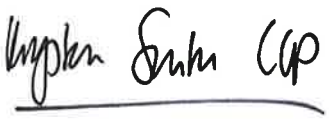
We hope that our comments are useful to you. If you have any questions on the contents of this letter then please contact either Sir Michael Snyder or Tessa Park.

Yours sincerely



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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?**

We agree that the Government should maintain this overall approach.

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?**

Yes, we agree with this position although we also think it would be helpful to provide discrete regulations for micro-entities for the reasons set out below.

3. **Do you agree it would be helpful to have a new set of Small Companies and Groups 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?**

We agree that revised Small Companies and Groups Regulations should be prepared which set out the new regime and small company exemptions. However, we think that separate Micro Regulations should be prepared. The Micro Entity framework will be quite different from, and much reduced compared to, the small company framework and indeed there are different financial reporting requirements. We therefore believe it would be less confusing were the micro regulations to be presented separately. Three sets of regulations would therefore be needed, Micro Companies, Small Companies and Large and Medium Companies.

4. **Do you have suggestions for other regulations that might reasonably be consolidated as part of the implementation of this Directive?**

We do not have any other suggestions and as noted above believe that in the case of micro entities it would be more helpful for the regulations to be disaggregated rather than consolidated.

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

Although this is a relatively short time frame in which to apply changes of this magnitude we recognise that the Government does not have any scope to delay further and therefore agree that the new regulations should apply from this date.

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?**

Because the time frame for application is already quite short we do not believe early adoption should be permitted. The effective date of the new requirements will be a matter of law rather than accounting standards and permitting (rather than mandating) early adoption would be likely to lead to confusion and also to a lack of comparability between those companies that elected to early adopt and those that did not.

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

No, we do not agree that the small company thresholds should be raised to the maximum; rather we believe that they should be set at the mandatory minimum threshold required by the Accounting Directive, i.e. £7m turnover, £3.5m total assets and 50 employees. To raise the small company thresholds to the maximum permitted will mean that companies which in reality are not 'small' – and which would actually have been at the top end of the 'medium' category not so many years ago – will present significantly reduced disclosures in their financial statements and will also potentially be exempt from audit, if not immediately then at least in the short to medium term.

As a company grows, it is more likely to have complex financial transactions, external finance and external investors who will require more information from the financial statements than the small company accounts prepared in accordance with the Directive will contain. The company is likely therefore to need to supplement the statutory information with additional information.

Moreover, stakeholders are more likely to want the protection of knowing that the financial statements have been subject to at least some form of independent scrutiny, which will often not be the case. The desire to cut costs for as many businesses as possible needs to be balanced against the need for useful financial information to be prepared that meets the needs of users of the financial statements. The concept that audit is a regulatory burden may be believed by the Secretary of State and those that do not realise the considerable value of an audit to a business, but it is simply not true. In particular even a business with a £7m turnover will be a very significant size in relation to to a local community or small town and could have wide ranging implications for the local economy should it fail due to inaccurate and unaudited accounts.

8. What benefits or costs do you think will arise from raising the company size thresholds?

We have covered this in our response to the above 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?

Yes, this remains a sensible method for determining a company's size.

However, we believe that the Government should consider replacing the term 'balance sheet total' with 'total assets'. Although 'balance sheet total' is defined in the Companies Act as 'total assets' it is sometimes misinterpreted as referring to 'net assets' i.e. total assets less total liabilities, leading to companies believing they qualify as small when in fact they do not. Amending the terminology would ensure that it was clear that it is total, not net assets which need to be less than or equal to the relevant size limit.

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?

No, we believe that the current criteria are appropriate.

11. Do you consider that there are circumstances beyond those currently 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?

We believe that the current regime where a parent undertaking can calculate their thresholds either net or gross of consolidation adjustments is still appropriate.

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

The current regime remains appropriate and in our view there is therefore no need to change it.

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 additional notes?

Yes, we agree that the Government should continue to require the five additional notes.

We do have significant concerns about how certain small companies will ensure their accounts show a true and fair view when only thirteen notes are mandatory. The consultation paper observes that a company is still required to consider whether its financial statements provide a true and fair view and may therefore be required to present additional notes in order to do so. However the Government will be unable to require the presentation of additional notes either through law or via the medium of accounting standards.

We note that there is no proposal for a 'deeming provision' i.e. for accounts which only include the mandatory 13 notes to be deemed to show a true and fair view, in the same way as 'micro' accounts are deemed to show a true and fair view (when from a common sense perspective they clearly do not). We do not believe that a deeming provision would be appropriate for small companies.

A significant degree of judgement is therefore going to be needed in determining whether a set of accounts prepared under the new requirements show a true and fair view – a much greater degree than is the case at present, where a company will simply follow the requirements of the relevant accounting standards. Moreover, it is easy to envisage a scenario where a company believes that no, or minimal, additional notes are required to show a true and fair view but the company's accountant or auditor believes otherwise. Such notes may well include information that a company might prefer not to disclose but is of importance to the users of the accounts – for instance related party transactions not covered by the mandatory disclosures, or contingent liabilities.

Whilst we believe that many companies will use the relevant accounting standards for guidance about what additional notes may be required, we do believe that confusion and differences of opinion will arise in practice.

14. 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?

We believe either would be acceptable, with the exception of the requirement to disclose the name and registered office of the undertaking drawing up the consolidated financial statements of the smallest group of which the company forms a part. This is in our view a legal requirement which

has nothing to do with whether the accounts show a true and fair view and does not therefore sit well within an accounting standard. This requirement should in our view therefore be set out in regulations.

15. Do you agree that small companies should have the choice of preparing an abbreviated balance sheet and profit and loss account (instead of full financial statements) if they wish?

No, we do not believe that this should be permitted. At present a small company has the option to *file* abbreviated accounts which do not include a profit and loss account and include only limited notes. The information available about the company to users of the accounts, including external stakeholders, is therefore extremely limited; however, because the company is required to prepare full accounts for its members, sufficient additional information exists that members, and other users of the accounts such as providers of finance (if they request copies of the full accounts), can obtain a fuller picture of the state of affairs and profitability of the company.

Whilst possibly reducing costs for companies, we therefore believe this would be a retrograde step which could negatively affect companies. Indeed, given that most small company accounts are produced on accounting software, any cost savings are likely to be minimal as the same information will need to be input regardless. Moreover, we believe that such accounts would be highly unlikely to show a true and fair view (except in the event of a 'deeming provision') and would therefore potentially conflict with the directors' duty in preparing the financial statements.

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 see our response to the above question.

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

Please see our response to question 15.

18. What benefits do you believe the exemption of small groups from consolidation will offer to small groups of companies?

Small groups are currently exempt from consolidation and therefore this exemption to a large extent maintains the status quo. However we are concerned that the proposal to reflect the change in the Directive, i.e. that small groups are exempt unless a member of the small group is a PIE, may lead to some groups now regarded as ineligible being able to take advantage of small company exemptions when it is not appropriate. We have explored this in more detail in our responses below.

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

We do not believe it would be appropriate to only exclude from the small company accounting regime those companies with securities traded on a regulated market. If this were to be applied strictly, it would mean that numerically small AIM and ISDX Growth Market companies (of which

there are many) would in theory be able to prepare vastly reduced accounts and even, at least in law, take advantage of the audit exemption.

This is in our view entirely inappropriate for companies that are publicly traded and whilst the AIM rules require consolidated accounts to be prepared in accordance with IFRS, there are AIM companies which are not parent companies and which therefore are permitted to follow UK GAAP. ISDX Growth Market companies are permitted to adopt either IFRS or UK GAAP and indeed many continue to prepare their accounts under UK GAAP.

Such companies, if small, would under the proposed exemptions be able to prepare small company accounts under 'UK GAAP' with only thirteen notes being mandated. This would simply not provide enough information for a publicly traded company and the issue of what additional notes would or would not be required for the accounts to give a true and fair view would be even more contentious. Whilst the AIM and ISDX rules could (and we expect would) be amended to require additional disclosure, it would be preferable for this to be addressed in the Companies Act by excluding such companies from the small companies regime.

Similarly in respect of audit, whilst both the AIM and the ISDX rules require the preparation of audited accounts, we believe that it would be far better for the restrictions in the audit exemption to be enshrined in law rather than simply required by the regulations of the relevant exchange. In our view, any company which is publicly traded should not be permitted to qualify as small, nor to be exempt from statutory audit.

There may be some scope for debate about whether plcs that are not publicly traded ('vanity plcs') should be able to qualify as small. Many such companies are very small and do not have significant external investment however some do, for instance those backed by venture capital or those anticipating seeking a listing in the near future; as a result there are arguments both for and against such companies being able to qualify as small. It may therefore be simplest to exclude all plcs, whether publicly traded or otherwise, from qualification as small (and also from being able to claim exemption from audit). Companies with limited external investment would then need to decide whether the additional burdens imposed by plc status were justifiable in the context of their business model.

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

We can see some justification for permitting small companies that are subsidiaries of an ineligible group to qualify as small for accounting purposes. Generally in a group headed by a publicly traded company it is the group accounts which are of most interest to users and the potential risk of loss of publicly available information if small companies that were members of such groups were permitted to prepare small company accounts is relatively minor. This differs from small standalone companies where the company accounts may well be the only publicly available information.

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

We believe the exclusion should be drawn in the same way as for small companies, i.e. that any company which is publicly traded should not be able to qualify as medium-sized.

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

Again, we can see some justification for allowing access to the medium-sized regime for such companies.

23. Do you consider that the exclusions from the dormant subsidiaries accounting exemptions should be amended so that companies are excluded because they have securities traded on a regulated market rather than because they are quoted companies; and excluded if they are part of an ineligible group as amended for the purposes of the small companies accounting regime?

No, the exclusions should be drawn to exclude companies that are publicly traded. Please see our comments above on ineligible groups.

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

Yes, as these are the two formats used in the UK in practice.

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

Yes, although it should be clear that increased flexibility does not constitute a 'free for all'. Rather, the Regulations should permit additional flexibility in the context of relevant guidance, for instance as required by a SORP. In addition, IFRS formats should be permitted to be used for primary statements. This would potentially improve consistency and also remove some of the anomalies in the new UK GAAP financial reporting framework, for instance debate over whether IFRS terminology can legally be used in the primary statements, and how a set of financial statements prepared in accordance with FRS 101 'Reduced Disclosure Framework' should be presented.

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

We believe this should be dealt with in the regulations with guidance then being provided in accounting standards/ SORPs.

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

We do not see any reason why this should not be permitted although we doubt it will be used much in practice.

28. Do you agree that the Government should provide for the 10 year maximum period for write off (e.g. of goodwill) offered in the Accounting Directive?

In theory we agree with this on grounds of offering the maximum flexibility available under the Directive. However the timing is unfortunate given that FRS 102 applies a default write off period of five years where the useful economic life cannot be reliably measured. If the maximum ten year option is to be used then we think it is important for FRS 102 to be amended to permit the ten year period in sufficient time for companies to apply this period in their first set of FRS 102 financial statements (the first of which will be for accounting periods beginning on or after 1 January 2015, except for early adopters).

29. Do you agree that the removal of the option (to include subsidiary information in the annual return) should take effect alongside other changes to the UK's financial reporting framework?

Yes, the changes should be implemented simultaneously as far as possible. However, in the interests of cutting clutter in the financial statements we believe a better option would be to permit the accounts to cross reference to a full list of subsidiaries publicly available elsewhere, for instance on the company's website.

30. Do you agree that companies eligible to take advantage of the micro-entity regime should be relieved of the obligation to prepare a directors' report?

Yes, given that the accounts prepared by a micro entity contain so little information already, and the requirements for a small company directors' report are now minimal, we see little benefit in requiring micro entities to prepare a directors' report.

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

We are somewhat surprised that the Government is proposing to decouple the small company thresholds for accounting purposes from the audit exemption limits given that it is only recently that the thresholds were aligned. Given that our understanding is that the Government wants to increase the audit exemption thresholds in line with the accounting limits at some stage in the short to medium term we do not entirely understand why this has been delayed.

We presume the reason for the delay is to allow time for a wider debate about what size and nature of companies should be subject to statutory audit. As should be clear from our earlier responses, we are concerned that the audit exemption threshold, if set at the maximum small company thresholds, would be too high and could have unintended consequences particularly at a local level.

We strongly believe that the Government should set the small company thresholds at the minimum level required by the Directive and in our view there would then be no need to decouple the small company accounting and auditing provisions. This would enable some additional companies to take advantage of the audit exemption whilst maintaining the exemption threshold at a sensible level.

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 are 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' as amended for the purpose of implementing changes to the small companies accounting regime?

No, we believe that as a minimum any company that is publicly traded should be excluded from any statutory audit exemption. As we noted in our response to question 19, whilst there may be some mileage in debating whether 'vanity Plcs' should be able to take advantage of the small company exemption it may well be simplest to exclude all plcs. The same logic can be applied to the audit exemption for small companies (we would note that the subsidiary audit exemption does *not* exclude vanity plcs).

33. Do you consider that the exclusions from the subsidiaries audit exemption (where there is a parent company guarantee) should be amended so that (a) companies are excluded because they are traded on a regulated market rather than because they are quoted companies; (b) companies are excluded if they are part of an 'ineligible group' as amended?

We do not believe there is any particular need to amend the exclusions from the subsidiary audit exemption.

34. Do you consider that the exclusions from the dormant companies audit exemption should be amended in the same way?

Again, we do not believe there is any particular need to amend the exclusions.

35 & 36

We have no comments to make in respect of questions 35 and 36.

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?

We do not see any reason whatsoever to revoke this disclosure requirement and do not understand the reason for this proposal.

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?

No, we believe any company which is publicly traded should be required to disclose fees paid to auditors for non-audit services. This provides useful information to users of the accounts, particularly in the context of recent debate about the provision of non-audit services by the auditor. Again we do not understand the reason for proposing this.

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

We can see some logic for this, as the main focus of the users of the financial statements will be on the non-audit fees across the group as a whole. However any company that is itself publicly traded should be required to give these disclosures (for itself and any sub-group that it heads).

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?

Again, we can see some logic for this.

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?**

We do not agree that the exemption proposed in (a) should not apply where the subsidiary is not audited by the group auditor as this could act as a disincentive to groups from using different auditors and therefore be inimical to competition and choice. We do wonder if this is why this proposal has been made. It should be available where the disclosures in (b) above are made in the consolidated accounts.

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?

We have no particular objection to such a statement which will make it clear that there is a framework for additional requirements for charitable companies, for instance through charity law or the SORP. Indeed for incorporated charities it is vital that additional requirements could be imposed as the 13 notes required under the Directive are perhaps even less likely to give a true and fair view for charitable companies than other companies.

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-headings of financial statements to reflect the special nature of the company's activities, should be retained?

Yes, we agree that the current flexibility should be retained.

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

Yes, we agree that a threshold based on gross income would be more appropriate.