By email to: Accounting_Directive@bis.gsi.gov.uk

John Conway
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24 October 2014

Dear Sir

Consultation on UK implementation of the EU Accounting Directive (chapters 1 to 9)

We welcome the opportunity to respond, on behalf of PricewaterhouseCoopers LLP, to the consultation paper on implementing the EU Accounting Directive (the 'Directive') in the UK. We comment below on the main matters arising from the consultation paper and respond to the specific questions in appendix 1 to this letter. Our comments on other matters relating to the implementation of the Directive are given in appendix 2.

Overall

We agree that the existing approach to financial reporting should generally be maintained and changes should be restricted to those introduced or permitted by the Directive. An exception to maintaining existing rules could be the approach to identifying companies in a group that may be considered 'ineligible'.

We support early adoption of the new rules, if this is possible under the Directive, so that companies can apply them at the same time as mandatory adoption of FRS 101 and FRS 102.

Small companies

We support separate Regulations both for small companies and groups, and for micro-entities.

In line with its focus on deregulatory measures, we believe that the Government should maximise the small company thresholds for the accounting regime. We also believe the Government should continue to explore opportunities where possible to streamline the accounting and audit regimes.

We find the section in the consultation paper on the definition of Public Interest Entities unclear. Also, it is not clear how this interacts with the small companies regime for accounting purposes and the definition of an ineligible company and group. We comment further on this in appendix 2 to this letter.

Some of the existing restrictions applying to members of an ineligible group (but which themselves are not ineligible) appear to be UK government 'gold-plating' of EU requirements. We would support relaxing certain of these prohibitions.

A small company would have to provide additional notes in the financial statements in order for them to give a true and fair view where the mandatory notes are insufficient for this purpose. We have concerns as to how this will be applied in practice, but believe that guidance on this should be given in accounting standards (that is, FRS 102), rather than the law.

If there is a degree of flexibility in the balance sheet and profit and loss account formats, and given the minimal disclosure requirements for small companies, we question whether abbreviated financial statements for small companies continue to be necessary.

Formats

We consider that all the flexibility allowed to Member States for both the balance sheet and profit and loss account formats should be taken into UK law, without any attempt to add detail into law. The detail can then be developed where necessary or desirable in accounting standards.

Other

In our view, an 8 week consultation period is too short for a consultation of this significance and we hope and expect that there will be an opportunity to comment further on draft legislation when this is available.

If you have any questions, please do not hesitate to contact Peter Hogarth on 020 7213 1654.

Yours faithfully

PricewaterhouseCoopers LLP

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Appendix 1 to letter dated 24 October 2014

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:

Yes, we agree that the existing approach to financial reporting should generally be maintained and changes should be restricted to those introduced or permitted by the Directive. The Member State options previously available should be maintained. One exception to maintaining the existing rules could be the approach to identifying companies within a group that might be considered 'ineligible' (see further our response to question 20 and Appendix 2).

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:

Yes, this is important to reflect the 'think small first' principle. Separate regulations are easier for small companies to navigate.

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 note that the current position is that The Small Companies and Group Regulations incorporate the micro-entities exemptions. (For example, a Format C has been added to Schedule 1 of those Regulations to deal with micro-entities.)

But we believe there should be a separate set of Regulations for micro-entities. Micro-entities are the smallest of entities so they have the least resources available for studying the law. So the law should accommodate them by creating a 'one-stop shop' set of Regulations, uncluttered by the requirements for other small companies. (Other small companies would also benefit from not having the Regulations applying to them cluttered with exemptions unavailable to them.) Admittedly, this will mean some duplication of definitions and rules in the Regulations but this duplication will not create any inconvenience for users. An alternative (or, even better, an addition) would be for BIS to liaise with the FRC to have the FRC create a 'one-stop shop' combining the new FRSME and the legal requirements for micro-entities.

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:

It would be helpful if all financial statement disclosure requirements applying to a particular class of company were located in one place. This would require more than just consolidating regulations.

Some disclosures are included in the body of the Companies Act 2006, rather than in the supporting regulations. Unless there is some legal reason not to do so, we suggest that they should be moved to the regulations and, like the requirements on directors' remuneration, put in a separate schedule where necessary so that they are applicable to both IFRS and UK GAAP reporters.

Also, some subjects are dealt with partly in the Act and partly in the Regulations (for example, section 416 of the Act has requirements on the content of directors' reports and so does Schedule 7 of SI 2008/410).

Subjects covered wholly or partly in the Act are:

- Secs 409, 410: Related undertakings.
- Sec 410A: Off balance sheet arrangements.
- Sec 411: Employee costs and numbers.
- Sec 413: Directors' advances credit and guarantees.
- Sec 416: Directors 'report.
- Sec 414C: Strategic Report (we note that the disclosure requirements for the directors' report are mainly in the Regulations, but the disclosures for the strategic report are in the Act).

The auditor remuneration rules (currently in SI 2008/489) could usefully be put into the new Regulations along with the other required disclosures. There does not seem to be any good reason why these disclosures should be in a separate place. The small company regulations would then reflect the exemptions available to small companies.

BIS could consider consolidating in the Companies (Receipt of Accounts and Reports) Regulations 2013, which deal with sending the strategic report and supplementary material to shareholders instead of the full accounts and reports. The new Regulations will deal with the content of financial statements that are prepared and those that are filed. They could also deal with what could be sent to shareholders.

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 agree that the mandatory date for applying the changes resulting from the new regulations should be financial years commencing on or after 1 January 2016.

But it would be helpful if companies had the option of applying the changes early – please see our response to question 6.

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:

Given that the new UK accounting standards (FRS 101 and FRS 102) apply to accounting periods beginning on or after 1 January 2015, it would be helpful if companies were able to apply the company law changes at the same time, if this is possible under the Directive. This would avoid companies having to make changes in consecutive accounting periods.

It would mean that companies that qualify as small under the new company law regime could use the new accounting rules for small companies on implementation of FRS 102.

Also, if BIS concludes that it is possible to take advantage of greater flexibility for the formats of the profit and loss account and the balance sheet (see question 25), early adoption of the company law changes would benefit companies applying FRS 101.

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

In line with the Government's focus on deregulatory measures, we agree with the proposal to maximise the small company thresholds for the accounting regime. But this is subject to our comments below on the provision of additional guidance in accounting standards to help directors of small companies prepare true and fair accounts (see response to question 13) and the proposal to permit small companies to prepare abbreviated financial statements (see response to question 15).

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)

The main benefit of introducing the maximum small company thresholds would be to increase the number of companies that can take advantage of simplified financial statements, particularly in reducing the amount of required disclosures for those companies.

Otherwise, we do not have any further comment to make on the costs and benefits that might arise from raising the company size thresholds, from an accounting perspective.

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:

Yes. We agree that a small company's size should continue to be determined by reference to its balance sheet total, net turnover (but see our response to question 10), and average number of employees. This has worked in practice for some years now and we see no reason to change it.

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:

This is an area that has given rise to issues in practice in interpreting whether a small company meets the size criteria to qualify for the regime. There is diversity in practice as to how some companies classify certain types of income in the profit and loss account formats. Depending on the nature of their business some companies may classify income as turnover, whereas others include it in the strict format line item. It would help if such companies were treated the same for the purpose of the small company regime, regardless of how they classify the income. For instance, this could apply to investment income and to income from associated undertakings for those companies whose main business is to receive such income.

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:

It is unclear what is proposed in (a) that would go beyond the current position in the UK accounting framework. The current position is that a parent undertaking can only qualify as a small company if the group headed by it is a small group (and as a medium company if the group headed by it is a medium group). We do not consider that change is needed in this area, either for parent undertakings or for affiliated undertakings (that is, other members of a group).

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:

It is unclear how this question differs from question 10 and so we refer to our response to that question 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 acknowledge that the Government has limited flexibility with regards to the mandatory notes that can be required to be given in small company financial statements. We agree that most of the additional notes referred to in the Directive should be required to be disclosed, namely the following:

- Name and registered office of the undertaking drawing up the consolidated financial statements of the smallest body of undertakings of which the undertaking forms part.
- Nature and business purpose of arrangements not included in the balance sheet.
- Nature and effect of post balance sheet events.
- (Limited) related party transactions.

We could accept the fixed asset note not being mandatory for all small companies.

We note that a small company is still required to consider if its financial statements provide a true and fair view of its financial position. Paragraph 8.16 of the consultation paper notes that a small company may be obliged to provide additional notes in order to provide a true and fair view if the mandatory notes are insufficient for this purpose. We have concerns as to how this will be applied in practice, given the minimal mandatory disclosure requirements for such companies. We believe that guidance on this should be given in accounting standards (that is, FRS 102), rather than the law. The judgemental nature of this could lead to small companies giving more disclosure than at present. However, we note that it will be difficult to justify a small company being required to disclose information by virtue of this 'catch-all' disclosure requirement that a large company complying with FRS 102 would not.

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* [not a yes/no question]

Please provide any information to support your views:

We would prefer to keep detailed accounting disclosure requirements in company law to a minimum so we support the requirement for the additional notes being included in accounting standards, rather than in regulations.

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:

If there is a degree of flexibility in the balance sheet and profit and loss account formats (see question 25 below) and given the minimal disclosure requirements for small companies, we would question whether abbreviated financial statements continue to be necessary.

In any case, we do not support extending the concept of abbreviated financial statements to the financial statements prepared for members.

For abbreviated financial statements prepared under the current small company regime, our view is that, in light of the extensive range of exemptions allowed in those financial statements, they cannot give a true and fair view. This could also be the case under the proposed new regime, which would be an issue if the abbreviated financial statements were the only ones prepared.

If abbreviated financial statements are permitted to be prepared for members, the position of minority shareholders should be considered. It might be sensible to build in a protection such as that which applies to the intermediate parent exemption from preparing consolidated financial statements – that is, the minority (if meeting certain holding requirements) can serve notice on the company requiring preparation of unabbreviated 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 noted in our response to question 15, we have difficulty in seeing how abbreviated financial statements (that is, containing less information than a set of financial statements that a small company would otherwise be required to prepare under the small companies regime) could give a true and fair view. This might depend on how much abbreviation there is.

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 have any comment to make in this area.

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)

Parent companies of eligible small groups are currently not required to prepare consolidated financial statements and so it is not clear what change is proposed.

Also, it is unclear if BIS is proposing to change the definition of an ineligible group in section 384 of the Companies Act 2006. The current definition is wider than the definition would be if it was restricted to groups containing a Public Interest Entity. We comment further on this in Appendix 2.

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)?

If the Government restricts ineligible companies and groups to those specified in the Directive (that is, no 'gold-plating' of the EU requirements in this area), the wider implications on the current small company regime will also need to be considered. We comment further on this in Appendix 2.

If not, then, in our view, there is no compelling reason to change the current position whereby the small companies accounting regime does not apply to a UK public company, regardless of whether it has listed securities or not. It can be argued that this is a consequence, or a 'price', of being registered as a public company.

If the exclusion only applied to public companies whose shares are traded on regulated markets, BIS would need to consider the implications for companies with securities listed in other markets, for example AIM.

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)?

If the Government restricts ineligible companies and groups to those specified in the Directive (that is, no 'gold-plating' of the EU requirements in this area), the wider implications on the current small company regime would need to be considered. We comment further on this in Appendix 2.

The Government might change the definition of an ineligible group to remove section 384 2(a) (which says that a group is ineligible if any of its members is a public company). If so, we would support this approach for determining if a company is eligible for the small company regime; this would mean that a company meeting the small size-criteria would be so eligible if it is not itself a Public Interest Entity ('PIE').

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)?

The treatment of public companies for the purpose of the medium-sized companies regime should be consistent with that for the small companies regime and so we refer to our response to question 19 above.

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:

The treatment of medium-sized companies that are members of a group containing a public company should be consistent with that of small companies that are such members and so we refer to our response to question 20 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 consider that it makes sense to bring the definition for companies with publicly-traded securities into line with that used in the small companies regime. At present, companies excluded from the dormant subsidiaries exemption include quoted companies as defined in section 385(2) of the Companies Act 2006. Under section 385 of the Companies Act 2006, a 'quoted company' means a company whose equity share capital is included in the official list, is officially listed in an EEA State, or is admitted to dealing on either the New York Stock Exchange or Nasdaq. The proposed change would mean that the exclusion would apply to companies with securities admitted to trading on a regulated market of any Member State. We think that this will simplify the Act in this area so we support the proposed change. But we note that where a company has securities listed on a market other than an EU-regulated market, that market might impose its own requirements that the company would have to consider before using the exemption.

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:

Currently, the dormant subsidiaries accounting exemption is available to companies that are part of an 'ineligible group' as defined for the purpose of the small companies accounting regime. We comment in Appendix 2 to this letter as to whether the Government is 'gold-plating' the EU requirements for small companies. In any case, we see no reason to remove the current exemption for dormant subsidiaries that are members of 'ineligible groups'.

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.

In our experience, most companies choose between the vertical presentations for the profit and loss account (that is, between Formats 1 and 2). The presentations in which the profit and loss account shows charges separately from income (that is, Formats 3 and 4) are not commonly used. So we agree that the removal of these formats should not impact significantly on UK companies.

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.

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.

Yes, we consider that all the flexibility allowed to Member States for both the balance sheet and profit and loss account formats should be taken into UK law, without any attempt to add detail into law.

The detail can, where necessary or desirable, be developed in accounting standards. Standard-setters can also consider whether to add constraints. This would also enable sector-specific guidance on formats to be issued for companies in certain sectors (e.g. oil, mining, real estate); such companies might welcome this flexibility.

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* [not a yes/no question]

Please provide information in support of your answer:

As noted in our response to question 25 above, we consider that the flexibilities for both the balance sheet and profit and loss account formats should be dealt with in accounting standards.

In our previous responses to proposals for company law reform, we have commented that we believe that the law, whether it is created by primary or secondary legislation (or a form thereof), is a cumbersome tool for responding to the needs of users of financial information. The implementation of the IAS Regulation in the UK has, for those companies using EU-adopted IAS, effectively delegated accounting rules to the IASB (to the extent that these rules are endorsed by the EU). But those companies continuing to use UK GAAP, in the absence of a change to the existing position, still have to look to the law when preparing their financial statements, particularly in determining the form and content of their accounts. Given that UK accounting has developed in tandem with international accounting standards, especially with the introduction of FRs 101 and FRS 102, it is important that the UK legal framework facilitates compliance with UK accounting standards.

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 support the principle of extending the policy choices afforded by the Directive, but we have some concerns in relation to its application in practice.

The cost method is a straightforward and well understood basis for accounting for investments in the UK and we believe most entities will continue to apply it.

Without further guidance there may be a risk that the sophistication to apply the equity method is underestimated and that there would be considerable variation in practice. In particular, transactions between parents and subsidiaries, and the interaction with equity accounting and company law could potentially create unnecessary complexity. Additional guidance to address this complexity may be disproportionate to the likely uptake of this option by UK entities.

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:

Yes. 10 years is more likely to provide relevant information. We also acknowledge the alignment with IFRS for SMEs and would welcome the FRC aligning FRS 102 in due course. A 5 year period is so brief that it is essentially a deferred write-off to the profit and loss account. The rapid reduction in impairment risk means that users have little information about the recoverability of the consideration paid for a business/intangible asset.

Whilst impairment testing assumes that detailed forecasts are not generally available over 5 years it does not necessarily follow that no value can be reliably attributed after this period for many companies. In particular, business plans to support acquisitions will frequently make assessments of cash flows later than 5 years which contribute to the funding case.

We note that paragraph 8.35 of the consultation paper is clear that this amendment is limited to the exceptional circumstances when the useful economic life cannot be reliably estimated, and that outside of these circumstances longer useful lives may be supportable.

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 recognise the usefulness of having a single and complete list of subsidiaries that is consistently presented. But there are a relatively small number of companies that hold several hundred or more subsidiaries which would be disproportionately impacted by this change.

As acknowledged by some respondents to the April 2014 consultation, providing this disclosure can conflict with the wider objective of cutting clutter in annual reports. We believe the objectives of the amendment could be met by companies disclosing their principal subsidiaries, and if necessary a clear statement that the list is not complete, and where the complete list may be obtained (such as the company's website). This would seem a small additional step for those users for whom a list of principal subsidiaries was not sufficient and be of benefit to users in general through reducing clutter.

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:

We believe that a micro-entity should not be able to avoid disclosing the names of its directors. If this disclosure cannot be required in the notes to the financial statements, then it would need to continue to be given in a directors' report.

As it is a requirement of the Directive, we agree that the disclosure of acquisition of own shares by a micro-entity can be given as a footnote to the balance sheet.

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 have not expressed a view either in favour of raising the thresholds for audit exemption or of maintaining them at their present level. Rather, we set out below some considerations for and against raising the thresholds, together with observations based on our experience with companies in our client base.

As we have noted in previous responses to BIS when audit exemption thresholds have been consulted on, there are differing relevant and legitimate policy objectives that should be considered. On the one hand, there is a powerful argument in favour of relieving regulatory burdens. As a firm, we support initiatives to alleviate regulatory burdens on business and to remove 'red tape'. The department is proposing to retain the current thresholds for audit exemption, that is, they will not increase in line with the thresholds used for accounting purposes. In itself, this may be perceived as not taking advantage of an opportunity to lift the regulatory burden for small business. Moreover, having differing thresholds for accounting and audit purposes may be perceived to contribute further to complexity and the burden for business of understanding the regulations.

On the other hand, de-regulation involves risk – for example considering whether a range of stakeholders will be disadvantaged or potentially harmed by the removal of the audit requirement. The external audit is a means of enhancing confidence in the financial information that is used by stakeholders for analysis and other purposes. Removal of the audit requirement for some companies also has an impact on the accounting profession (mainly at the smaller end). Some of the expertise and capacity in the sector to audit SMEs may be lost.

Our experience from dealing with companies in our client base is that, regardless of the limits set by statute, many would seek an audit (on a voluntary basis) in any event. This might be because, for example, they are currently private but fast growing and have an eye to raising finance in the markets in the future, because they are connected with venture capital funds that might request an audit, or because they rely on bank finance and an audit may be required through bank covenants and facilities. Hence raising the exemption thresholds by a relatively modest amount may in practice have a limited impact.

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 any 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?

Consistent with our response to Question 31, and based on experience with our own client base, we believe many companies that may fall into the category of being 'public' but not traded on a regulated market may request a (voluntary) audit in any event, for the reasons set out in our previous response above.

Clearly, companies with securities traded on a regulated market should be excluded from the small companies audit exemption. BIS could consider excluding entities traded on AIM and other non-main market exchanges as well, but this may in practice have a limited impact as we believe that in most cases investors or other providers of finance would insist that an audit is performed.

Our understanding from page 17 of the consultation document is that entities that meet the definition of a PIE should continue to receive a mandatory statutory audit. This would include entities such as credit institutions and insurance undertakings (which may be public companies) that might otherwise meet the criteria for 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?

Notwithstanding any amendments to the law that may be made in respect of (a) above, we believe a small company should not be prevented from taking the exemption simply because another entity within the group is public. We also suggest that, regarding UK subsidiaries of foreign-owned groups, BIS considers this aspect of the requirements in the context of the regimes established in other major jurisdictions with which the UK trades and competes

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:

Yes - this seems sensible, however our experience in practice with our client base is that few companies take advantage of the parent company guarantee exemption.

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:

This is less straightforward. If a subsidiary is wholly owned by a public company on a regulated market and therefore falls within the new narrower definition of an ineligible group, we are not convinced of the public interest benefits in excluding this from the subsidiaries audit exemption. It would seem to contradict the reason for setting up the parent company guarantee in the first place.

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:

Yes. While there may be limited value in requiring a dormant entity to have an audit, such an audit should not be too onerous or costly (if the company is indeed dormant) and for companies traded on a regulated market it may be perceived that there is a public interest benefit in the audit confirming the numbers and that the entity is dormant. There have been instances where 'shell companies' whose securities are traded have attracted adverse public comment, however these may still have some transactions and hence may not be considered 'dormant'.

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:

Similar to our response to Question 33, we consider this is less straightforward. There would seem to be some merit in trying to align the considerations relating to ineligible groups, such that they are similar for small companies, subsidiaries and dormant companies (recognising that in many cases a small company, dormant or otherwise, is likely to be a subsidiary).

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:

Yes. It is sensible to implement Article 28 (2)(e) of the Audit Directive at the same time as the Accounting Directive for the reasons set out in the consultation document.

However, we believe that the interpretation of Article 28 (2)(e) requires clarification. It is unclear whether the required opinion on the 'management report' (Strategic and Director's reports in the UK) is intended to mean that the report includes the required content or that the auditor has 'audited' all of the content in that report. There are differing requirements regarding auditors' responsibilities for the management report across European Union Member States today. As a result, there is a risk that there will be different levels of understanding of what is expected and the related audit work effort across Europe. Auditors in the UK already express an opinion, in accordance with section 496 of the Companies Act 2006, on the consistency of the Strategic Report (if any) and Director's Report with the audited financial statements. In doing so, the auditor does not separately 'audit' those reports but applies the requirements of auditing standards - ISA (UK&I) 720B - as part of the overall audit of the financial statements. We believe the current UK auditing regime is logical and that it would be sensible if the requirement of the Audit Directive is interpreted consistent with the UK position today, that is, in stating that the Strategic Report and Director's Report have been prepared 'in accordance with the Companies Act 2006' should mean that those reports include the required content specified in the Act, and not that they have been separately audited. This would also be consistent with the comparable requirement in the EU Audit Regulation that clarifies that this opinion is based on the work undertaken in the course of the audit.

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:

No. We do not support implementing any other element of the Audit Directive at the same time as the Accounting Directive.

Questions 37 to 40

Please note that we have addressed questions 37 to 40 together. Our response follows question 40.

Also, we assume that it is intended to refer to 'small and medium sized public companies' in these questions and have responded on this basis.

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?

Please see 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 [small and medium sized] 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 [small and medium sized] 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?

Please see below.

Question 39: Do you agree that the current requirement for disclosure by large companies of fees they have paid to auditors for non-audit services should no longer be extended to [small and medium sized] companies in the same group as a public company? (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?

Please see below.

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

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:

Questions 37 to 40 all deal with proposals to exempt more classes of company from the requirement to disclose non-audit services fees. Our understanding of these proposals is that non-audit service fees would be disclosed only by large companies with securities traded on a regulated market plus categories of entity excluded from the small company regime (for example credit institutions and insurance undertakings).

Our experience is that this information tends to be of interest in the accounts only where there is a broader shareholder base. We have no objection as auditors to the transparency of disclosing both audit fees and fees for non-audit services paid to the external audit firm. At the same time, we support the general approach followed by BIS that the UK should not seek to 'gold-plate' EU requirements, and should take opportunities to ease regulatory burdens.

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:

Our preference would be (a). The consolidated accounts should deal only with the fees paid to the parent's auditor as these are the only fees that could affect the group auditor's independence - which is what is relevant when considering the consolidated accounts.

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:

Yes. We consider that it would be helpful to charities to signpost in regulations made under company law that the disclosure requirements applicable to charities that are companies are not limited to those required by the Accounting Directive. Significant thought has gone into the disclosure requirements required by the charities SORP and these should continue to be complied with.

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:

Yes. A non-profit making organisation can better present its results using an income and expenditure account rather than a profit and loss account. The flexibility currently given to adapt the narrative in the headings and subheadings also allows charities to describe their activities more clearly to stakeholders.

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:

We agree with BIS's argument set out in the consultation paper.

Appendix 2 to letter dated 24 October 2014

Other comments on the implementation of the EU Accounting Directive

Definition of a Public Interest Entity

We find paragraphs 8.1 to 8.6 of the consultation paper somewhat unclear.

- Paragraph 8.2 says that the revised list of definitions provided in the Accounting Directive will be reflected into UK company law as appropriate. This includes the definition of a 'Public Interest Entity' ('PIE'). It is unclear how this will impact existing company law. For instance, it is not clear if it will replace the current list of companies that are excluded from the small company regime in section 384 of the Companies Act 2006, or if it will form part of it.

- The definition of a PIE in Article 2(1) of the Accounting Directive includes "*(d) designated by Member States as public-interest entities, for instance undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees*". This is referred to in paragraph 8.3 of the consultation paper, but there is no indication in the paper as to whether BIS are considering designating additional entities as PIEs under this part of the Directive. Our views in this area will depend on the purpose of the PIE definition in UK company law. However, BIS should confirm which entities, if any, have been identified as falling within point (d) of the PIE definition.

- Paragraph 8.5, which says that "*PIEs will always report in the same way as large undertakings regardless of their number of employees, balance sheet total or turnover*", does not seem to be consistent with paragraph 8.4, which notes that PIEs must report as large companies unless the Accounting Directive explicitly provides otherwise.

- Paragraph 8.6 notes that there could be two different definitions of PIEs for accounting and audit purposes. This would seem to be confusing and out of line with the Government's aim for simplification, but we reserve judgement on this until we see the relevant proposals.

Interaction of PIE and 'ineligible' companies and groups

It is unclear how the new definition of PIE will fit in with the concept in company law of ineligible companies and groups for the purpose of the small company regime, particularly if it is the Government's intention that there is no 'gold-plating' (as indicated in paragraph 6.6 of the consultation paper).

From paragraph 8.24 of the consultation paper, BIS are considering removing public companies from the 'ineligible' category. BIS will need to ensure that PIEs are classified as ineligible (if the current 'ineligible' definition does not cover all the PIE categories). It seems that no other changes are envisaged so a company that was previously ineligible will continue to be so (apart from public companies – but see our response to question 19). Whether BIS should remove any 'gold-plating' in the definition of an ineligible company is a separate issue, but the implications of any change would need to be considered.

It is unclear whether BIS has concluded that the entities (other than public companies) that are currently excluded from the small companies regime but which are not explicitly identified as PIEs, fall within Article 2(1)(d) of the PIE definition. If so, this should be clarified.

Also, whilst the Directive excludes companies that are PIEs from small company exemptions, it does not extend this to companies that are a member of a group containing a PIE (apart from in the context of preparing consolidated financial statements). Looking back, the concept of a company being ineligible for the small company exemption by virtue of the status of other group companies seems to be gold-plating the EU requirements. Removing this would be a significant change and the implications would need to be considered. However, we believe that, consistent with our response to question 20, BIS should investigate this further.

If the Government retains the concept of being a member of an ineligible group for the purpose of the small company regime (as well as for small groups), the interaction of the PIE definition with the current definition of an ineligible group needs to be made clearer.

Overseas listings

Where a company is a member of a group that includes a public company or a body corporate traded in the EEA, it is currently part of an ineligible group.

The PIE definition in the Directive is based on the securities being admitted to trading on a Member State regulated market, a narrower category than EEA regulated markets. So, in defining ineligibility, BIS might want to change 'EEA State' to 'Member State'.