

requirements for audit

RESPONSE FORM

AUGUST 2014

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

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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:

Organisation (if applicable): *Reeves & Co LLP*

Address:

Please return completed forms to:

John Conway

Corporate Frameworks, Accountability and Governance

Department of Business, Innovation and Skills

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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 |
| X | 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 (please describe) |

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:

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:

Combined regulations would be unnecessarily complex and difficult to follow, with the likelihood of small companies following regulations that do not apply to them. We support the principle of think small first.

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:

Clarity is an imperative and we would like to see the regulations clearly distinguish between the exemption for small companies and 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:

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:

Although it would have been advantageous to have the new regulations apply with the same effective date as new framework for UK accounting (ie financial years commencing on or after 1 January 2015), it is conceded that time necessary to bring the new regulations into force, along with other changes necessary to UK accounting standards, is such that a later implementation date is necessary.

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:

Although it may sound initially desirable, early access to revised reporting thresholds is only likely to increase confusion as to the appropriate accounting treatment to be followed, particularly for entities falling between the old and proposed new thresholds.

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 are of the opinion that advantage should be taken to maximise the thresholds, accepting that it is a significant increase on the existing thresholds. For simplicity though we would propose a minor amendment to the thresholds, to round the figures, as follows:

| | <i>Small Individual</i> | <i>Small Group</i> | <i>Medium Individual</i> | <i>Medium Group</i> |
|----------------------------|------------------------------------|-------------------------------|-------------------------------------|--------------------------------|
| <i>Turnover</i> | <i>£10.0m</i> | <i>£12.0m</i> | <i>£36.0m</i> | <i>£42.0m</i> |
| <i>Balance sheet total</i> | <i>£5.0m</i> | <i>£6.0m</i> | <i>£18.0m</i> | <i>£21.0m</i> |
| <i>Average employees</i> | <i>50</i> | <i>50</i> | <i>250</i> | <i>250</i> |

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*)

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:

We see no reason to change the criteria for the current proposals. See also our comments to question 13.

However, the term "balance sheet total" causes confusion and is often thought to refer to a company's net assets or shareholders' funds. Altering the description to "total assets" would aid greater understanding.

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:

In a majority of cases turnover continues to provide the best indication of a company's size, although it is noted that for a number of companies, notably those in a start-up phase before trading has commenced or those whose income is primarily derived from the holding of investments, this will not be the case. Legislating for such companies though would make the regulations unnecessarily complex, and it is best left to accounting standards to determine what items should be included within turnover.

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 consider that the current approach, whereby a parent undertaking cannot be considered to be smaller in size than the group of which it is the parent, works well and is easily understood.

We see no benefit to amend the approach for affiliated undertakings, whose size should be determined by their own circumstances and not those of the wider 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:

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 with the Government position. These 5 notes provide information that is beneficial to the users of financial statements to gain a fuller indication of a company's financial affairs.

Financial statements need to have information sufficient for the legitimate needs of the users of the accounts. For markets to be effective and efficient financial statements need a base level of information that is relevant, reliable and consistent. As small company thresholds increase the right balance has to be maintained between cost of production of financial statements and the information needs of users of accounts of what can be significant entities in local communities or sectors.

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 are of the opinion that accounting standard is the best way to ensure compliance as this can include additional guidance as necessary.

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 would agree that for companies with no external shareholders the option of preparing abbreviated accounts if they wish would be of benefit. It is vital however for shareholders who are not directors to have sufficient financial information upon which to judge the performance of the company, and thus to be able to require the company to prepare full accounts for distribution to shareholders.

See also our comments to question 13.

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)

The present information contained within abbreviated financial statements is well understood and appropriate.

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)

Cost savings are likely to be minimal.

Certain users of financial statements will require additional information and there will be costs of responding to legitimate requests.

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 already exempt from preparing consolidated accounts, which represents a significant cost saving for those companies involved. The proposed increase in the size limits will extend the number of groups that will be able to take advantage of this, as will the new definition of Public Interest Entities, which should see a greater number of groups qualifying as small in size..

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 any 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)?

We are of the opinion that any public company that has any of its securities publicly traded should be treated as being large in size. This would, for example, include public companies with securities traded on the Alternative Investment Market in addition to those with securities traded on the Main Market of the London Stock Exchange.

Public companies with no securities that are publicly traded should have access to the small company accounting regime..

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)?

The presumption that a company should be subject to a greater reporting burden simply because a fellow group member is a public company is erroneous, and we are of the opinion that removing this presumption would be of significant benefit.

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)?

We are of the opinion that any public company that has any of its securities publicly traded should be treated as being large in size. This would, for example, include public companies with securities traded on the Alternative Investment Market in addition to those with securities traded on the Main Market of the London Stock Exchange.

Public companies with no securities that are publicly traded should have access to the medium company accounting regime.

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 presumption that a company should be subject to a greater reporting burden simply because a fellow group member is a public company is erroneous, and we are of the opinion that removing this presumption would be of significant benefit.

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:

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:

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.

This is likely to have minimal impact, given that use of Formats 3 and 4 of the P&L is rare.

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.

This is already a feature of UK practice, with the adoption of the true & fair override when flexibility in the format of the layouts is required to best present financial information to the users of financial statements. Enshrining this in the regulations would be of benefit.

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.

As per our response to Question 26, we consider it appropriate for sector-specific layouts to be a matter for accounting standards.

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:

The format of financial statements is best addressed by sector-specific accounting standards, such as the existing range of Statements of Recommended Practice (SORPs) than by Regulations.

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:

UK legislation needs to reflect the options available in the financial reporting frameworks on offer to UK companies for the preparation of their financial statements

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:

With the imminent implementation of the new UK financial reporting framework, preparation has been made for a maximum 5 year period for goodwill where the useful life cannot be reliably determined. We see no reason to change this approach now. In deed if the preparers are unable to reliably determine a useful life for goodwill, we consider it highly unlikely that the useful life will be in excess of 5 years.

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:

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:

For micro-entities the directors' report provides little of use, and we agree that the requirement to produce the directors' report should be withdrawn subject to shareholder approval.

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:

The proposed changes to small company thresholds will result in companies being classified as small that could be significant trading parties to other entities, significant to their local communities or sectors.

We believe such entities should be subjected to the rigours of external examination, by means of statutory audit. Rather than further audit exemption being driven by increases to size thresholds, we believe a range of stakeholders needs are relevant. We see there is a case for further audit exemption where there are no external stakeholders' interests. In making such an evaluation the full range of potential stakeholders needs to be considered including investors, employees and trading partners.

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?

- 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?

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:

For market confidence we would like to see companies with securities traded on a regulated market subject to audit.

- 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:

For market confidence we would like to see companies which are members of an ineligible group subject to audit.

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:

The existence of securities traded on a regulated market should require an audit to be undertaken.

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:

For market confidence we would like to see companies which are members of an ineligible group subject to audit.

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:

We would welcome the extension of the audit to include greater assurance over the management report, which should help to ensure greater compliance with legislative requirements and reduce confusion as to what components of the annual report are subject to 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:

Question 37: Do you agree that the regulations¹ 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

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

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?

Yes, as *transparency around auditor fees is essential for the perception of independence.*

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?

Yes, as *transparency around auditor fees is essential for the perception of independence.*

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?

No, as *transparency around auditor fees is essential for the perception of independence.*

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:

Transparency around auditor fees is essential for the perception of independence.

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:

Yes, as *transparency around auditor fees is essential for the perception of independence.*

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 as the nature of company charities will require additional disclosures to meet the stewardship requirements of these entities.

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 as the nature of company charities will require adaption of disclosure.

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:

Turnover is not a term recognised by charities when adopting the SORP for charity accounting. Incoming resources is a more appropriate criteria, acknowledging that this is not directly comparable to turnover due to the inclusion of investment income and other items not normally included within turnover.

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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