

Title: 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 IA No: Lead department or agency: Department for Business, Innovation and Skills Other departments or agencies: No	Impact Assessment (IA)		
	Date: 27/06/2014		
	Stage: Development/Options		
	Source of intervention: EU		
	Type of measure: Secondary legislation		
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Summary: Intervention and Options	RPC Opinion: RPC Opinion Status
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Cost of Preferred (or more likely) Option			
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Two-Out? Measure qualifies as
£86.6m	£86.6m	£-8.0m	Yes OUT

What is the problem under consideration? Why is government intervention necessary?

UK incorporated undertakings prepare and file statutory accounts in compliance with rules set down in the Companies Act 2006. These rules are derived from EU Directives. The EU has updated and consolidated existing Directives for statutory annual accounts and reports to produce a single new 'Accounting Directive'. The Directive introduces greater harmonisation of the small company regime and provides a large number of options and flexibilities to allow Member States to reflect national frameworks and accounting traditions. Implementation of the Directive is required by July 2015. The Government must now decide how best to implement the Directive with the aim of reducing the number of unnecessary regulations that hold back businesses whilst maintaining confidence in the integrity of the UK's well-established accounting framework.

What are the policy objectives and the intended effects?

To make the UK one of the best places in Europe to start, finance and grow a business by reducing unnecessary regulatory burdens associated with the preparation and publication of statutory annual reports. In particular, to ensure that the implementation of the EU's harmonised small company regime effectively reduces the burdens for small companies whilst protecting the interests of third parties such as creditors and tax authorities and minimising any adverse impacts on the UK's established accounting framework.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

- Do nothing – this is not feasible, as the UK is required to demonstrate transposition of the Directive into UK law and must implement the mandatory elements introduced by it. Nevertheless, it should be considered as the status quo and the counterfactual against which to compare the impacts of each of the options. This option therefore maintains all parts of company law as it is.
- Take the minimum action required by the Directive. Implement only those mandatory changes to the current system which are required by the Directive.
- Take the minimum action required and take up the option to maximise the size threshold for small companies. (The preferred option)
- Implement the EU baseline – reduce the notes to the accounts to the mandatory 8 notes, and take up the option to increase the size threshold for small companies.

Will the policy be reviewed? It will be reviewed. If applicable, set review date: 12/2020					
Does implementation go beyond minimum EU requirements?				Yes	
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.		Micro Yes	< 20 Yes	Small Yes	Medium Yes
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)				Traded:	
				Non-traded:	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible SELECT SIGNATORY: _____ Date: _____

Summary: Analysis & Evidence

Policy Option 0

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	High: Optional	Best Estimate: £0

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional	Optional	Optional
High	Optional	Optional	Optional
Best Estimate	£0	£0	£0

Description and scale of key monetised costs by 'main affected groups'

Not feasible. The Directive must be implemented by 20 July 2015. In the do nothing option we do not expect changes to the cost of reporting as there are no changes planned to the UK's accounting framework which are not linked to the Accounting Directive.

Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional	Optional	Optional
High	Optional	Optional	Optional
Best Estimate	£0	£0	£0

Description and scale of key monetised benefits by 'main affected groups'

Other key non-monetised benefits by 'main affected groups'

Key assumptions/sensitivities/risks	Discount rate (%)	
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BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:	In scope of OITO?	Measure qualifies as
Costs:	Yes	Zero net cost
Benefits:		
Net:		

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: 16.5	High: 312.7	Best Estimate: 86.6

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	1.5	0	1.5
High	5.0	0	5.0
Best Estimate	2.9	0	2.9

Description and scale of key monetised costs by 'main affected groups'

Option 1 will have familiarisation costs for companies totalling an estimated £2.7m. Familiarisation costs will apply both to companies preparing their own accounts and to accountants and book-keepers who prepare accounts for small companies. There will also be transition costs to Companies House relating to upgrading their systems. These have been estimated at around £200,000, resulting in total familiarisation costs of £2.9m. The familiarisation cost is estimated at £4.10 per company compiling their own accounts, and £3.80 for each accountancy firm.

Other key non-monetised costs by 'main affected groups'

There will be costs (unquantifiable) of implementing the minimum disclosure requirements of the new small company regime. These costs include a loss of information for stakeholders, and possibly to the company itself, resulting from reduced disclosures.

There will also be costs for HMRC as a company's accounts are the starting point for its corporation tax computation. These costs have not been quantified but will arise from staff costs associated with familiarisation with the new regulatory environment and potential adaptations to assessment processes.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	2.5	21.5
High	0	36.5	314.2
Best Estimate	0	10.4	89.5

Description and scale of key monetised benefits by 'main affected groups'

There will be benefits to 3.022m existing small businesses and a further 1000 medium sized companies which will be classified as small as a result of the harmonisation of the small company regime. These benefits total an estimated £10.4m per annum and result from time savings due to the reduction in the number of required disclosures to the accounts.

Other key non-monetised benefits by 'main affected groups'

There will be additional non-monetised benefits to companies and stakeholders due to the simplification of accounts and a greater level of comparability and consistency of financial reporting across the EU, particularly for small companies. This is due to harmonised formats and group thresholds.

Key assumptions/sensitivities/risks	Discount rate (%)	3.5
<p>- Estimated savings from reduced notes to the accounts are based on survey evidence from the European Commission. However there is a risk that this overestimates the savings as anecdotal evidence suggests that the preparation of notes is largely automated in the UK. This assumption is based on information obtained in response to the consultation to inform the Micros Impact Assessment (IA No: RPC12-FT-BIS-1676) in 2013 which indicated that information presented in the annual accounts are generated through an automated process using accountancy software and is based on a standard set of underlying data. This indicates that changes to the reported data and information therefore have relatively little impact on the costs of preparation. We will test this assumption in consultation.</p>		

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: 0.2	Benefits: 8.2	Net: 8.0	Yes	OUT

Summary: Analysis & Evidence

Policy Option 2

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: 16.5	High: 313.5	Best Estimate: 86.6

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	1.5	0	1.5
High	5.0	0	5.0
Best Estimate	2.9	0	2.9

Description and scale of key monetised costs by 'main affected groups'

Option 2 will have the same nature of costs as Option 1, but familiarisation costs will also be incurred by an additional 360 medium-sized UK companies which fall into the scope of the increased thresholds for the small company regime, prepare their own accounts, and will take up the exemption. The familiarisation cost is estimated at £4.1 per company affected, with a total additional one-off cost above option 1 of £1,500.

Other key non-monetised costs by 'main affected groups'

Non-monetised costs will be as in Option 1, but with the costs affecting those medium-sized UK companies who which fall into scope of the increased thresholds for the small company regime, who prepare their own accounts and who will take up the exemption. The non-monetised costs for this group resulting from the loss of information and transparency may be higher than for existing small companies.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	2.5	21.5
High	0	36.6	315.0
Best Estimate	0	10.4	89.5

Description and scale of key monetised benefits by 'main affected groups'

Benefits will be as in Option 1, but these will also apply to medium-sized UK companies which fall into the scope of the increased thresholds for the small company regime. We estimate benefits from the reduced number of notes of £20 per company, which will be realised by an estimated 130 companies who compile information especially to prepare the disclosures, prepare their own accounts and will take up the exemption. This results in an estimated additional benefit of £2,600 per annum above those achieved by Option 1.

Other key non-monetised benefits by 'main affected groups'

There will be additional non-monetised benefits to companies and stakeholders due to the simplification of accounts and a greater level of comparability and consistency of financial reporting across the EU, particularly for small companies. These would be expected to be greater than in Option 1 due to the wider coverage of the simplification i.e. more companies will be classified as small and will therefore be able to take advantage of the simplification if they wish.

Key assumptions/sensitivities/risks	Discount rate (%)	3.5
Estimated savings from reduced notes to the accounts are based on survey evidence from the European Commission; however there is a risk that this overestimates the savings as anecdotal evidence suggests that the preparation of notes is largely automated. We will test this assumption in consultation by seeking information on cost savings.		

BUSINESS ASSESSMENT (Option 3)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies
Costs: 0.2	Benefits: 8.2	Net: 8.0	Yes	OUT

Summary: Analysis & Evidence

Policy Option 3

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: 44.0	High: 708.6	Best Estimate: 197.6

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	1.5	Optional	1.5
High	5.0	Optional	5.0
Best Estimate	2.9		2.9

Description and scale of key monetised costs by 'main affected groups'

Monetised costs in option 3 will be of the same scale and nature as Option 2. Familiarisation costs may be slightly higher in Option 2 as it represents a greater diversion from the status quo, but any difference has not been quantified. We will test this assumption further in the consultation.

Other key non-monetised costs by 'main affected groups'

Option 3 will have greater non-monetised costs than option 2 resulting from the removal of the 5 additional notes from the accounts. UK generally accepted accounting principles (GAAP) requires companies' financial statements to present a 'true and fair' view of their financial affairs. Whilst the information provided in some notes is considered non-essential for small companies i.e. dispensable without resulting in adverse impacts, these specific optional notes are considered essential to underpin the basis of the 'true and fair' view as required within UK company law. Without these notes, companies would need to consider further whether their annual accounts met this requirement, and if not, would have to present the necessary information to comply. This could lead to further costs and burdens and would risk jeopardising the integrity of the UK accounting framework as perceived by third parties such as creditors and tax authorities.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	5.7	49.1
High	0	82.5	710.1
Best Estimate	0	23.3	200.6

Description and scale of key monetised benefits by 'main affected groups'

Benefits will be as in Option 2, with further benefits resulting from additional time savings from the removal of a further 5 notes from the accounts. Benefits will apply to the same companies as in Option 2.

Other key non-monetised benefits by 'main affected groups'

There will be additional non-monetised benefits to companies and stakeholders due to the simplification of accounts and a greater level of comparability and consistency of financial reporting across the EU as a consequence of abridged reporting formats and largely standardised reporting based on company size. Comparability is improved particularly for smaller companies as a result of a harmonised small company regime.

Key assumptions/sensitivities/risks

Discount rate (%)

3.5

Estimated savings from reduced notes to the accounts are based on survey evidence from the European Commission; however there is a risk that this overestimates the savings as anecdotal evidence suggests that the preparation of notes is largely automated. We will test this assumption in consultation.

UK GAAP requires companies' financial statements to present a 'true and fair' view of their financial affairs. Through discussions with stakeholders, including professional bodies, during the negotiation stage of the Directive, there was consensus that these notes are the minimum necessary to enable a company to provide a 'true and fair' view. Without these notes companies would certainly need to consider further whether their annual accounts met this requirement, and if not, would have to present the necessary information to comply. This could lead to further costs and burdens, and risks of compliance failure as the 'true and fair' view stands regardless.

BUSINESS ASSESSMENT (Option 4)

Direct impact on business (Equivalent Annual) £m:				In scope of OITO?	Measure qualifies		
Costs:	0.2	Benefits:	18.4	Net:	18.1	No	NA

Evidence Base (for summary sheets)

Executive summary

The Accounting Directive introduces updated terminology and refers to undertakings and financial statements. It provides a definition of financial statements (as a minimum) which will comprise the balance sheet, the profit and loss account and the notes to the financial statements. For the purposes of this document we have continued to use the terms 'company' and 'accounts' which are commonly used in the UK.

1. Problem under consideration and rationale for intervention

The Accounting Directive applies to all incorporated companies and establishes the minimum legal requirements for the preparation and publication of annual statutory accounts at EU level. The EU has identified the preparation of financial statements as one of the most burdensome obligations for incorporated companies¹. The previous Accounting Directives focused on the requirements for large and listed companies, to ensure the accounts provide relevant and adequate information to assist shareholders and management to make informed decisions on the allocation of capital, and to protect the interests of users of those accounts and reports. The previous Directives provided a range of exemptions and Member State options to relieve SMEs from certain requirements/obligations, but on the whole, SMEs were still required to prepare accounts in compliance with burdensome and complex financial reporting procedures that are designed for large and listed companies.

The Accounting Directive provides over 100 Member State options to enable Member States to adapt the Directive effectively and in accordance with national accounting frameworks. It also introduces, for the first time, a harmonised small company regime, which will enable greater simplification and burden reduction for small companies within the EU. The harmonised regime will also lead to a greater level of comparability and consistency of financial reporting across the EU, particularly for small companies.

The Government's objective of reducing administrative burdens, particularly for small companies, is of key importance, and aspects of the Accounting Directive support these aims. However, the Government recognises that any changes to the rules governing statutory accounts should not impact on the integrity of the UK's well established accounting framework; and companies must continue to provide assurance on the information contained in the accounts for third parties such as creditors, shareholders and tax authorities.

The **rationale for intervention** is to address the disproportionate impact of **government failure** in some Member States to reduce the unnecessary administrative burdens on small companies, to enable them to focus their resources on growing their businesses, innovating products and services, and creating employment opportunities, as part of wider economic growth. The UK has taken up options previously available to reduce the mandatory obligations on small companies. However, the new small company regime offers the opportunity to reduce burdens further by increasing the small company threshold criteria and bringing more companies within the scope of the regime.

2. Options and policy objectives

The Government's objective is to reduce administrative burdens associated with the preparation and publication of statutory annual accounts, in particular to implement effectively the new harmonised small company regime, whilst maintaining the integrity of the UK's established company law framework.

- **Option 0: Do nothing.**

Not feasible. The Directive must be implemented by 20 July 2015.

- **Option 1: Take the minimum action required by the directive. Implement only those mandatory changes to the current system which are required by the Directive**

¹ http://ec.europa.eu/internal_market/accounting/docs/sme_accounting/review_directives/SEC_2011_1289_1_en.pdf

Reduce the notes to the accounts to the mandatory 8 notes, take up the member state option in Article 16(2) of the Directive to require small companies to provide an additional 5 disclosures in the notes to the accounts which are currently required in UK company law and support the presentation of a true and fair view of the financial position of the company, and implement the new mandatory small company threshold criteria of €8,000,000 net turnover and €4,000,000 balance sheet total (approximately £6.8 million and £3.3 million, up from £6.5 million and £3.26 million respectively).

- **Option 2: Take the minimum action required, plus take up the option to increase the size threshold for small companies.**

As Option 1, plus take up the Member State option to increase the size threshold for small companies to a maximum of €12,000,000 net turnover and €6,000,000 balance sheet total (approximately £10.2 million and £5.1 million respectively).

- **Option 3: Implement the EU baseline – reduce the notes to the accounts to the mandatory 8 notes, and take up the option to increase the size threshold for small companies.**

This option is considered the EU baseline and will create the lowest administrative burden on companies. However the removal of the 5 additional notes risks jeopardising the integrity of the UK accounting framework for third parties such as creditors and tax authorities.

- **Option 2 is our preferred option.**

3. Costs and Benefits

Option 0 is not considered feasible. The Directive imposes changes – e.g. raised thresholds, changes to the small company regime and removal of some notes etc. - which are not consistent with the UK's existing legal framework. The Directive must be implemented by 20 July 2015, and the Government's objective is to ensure that companies obtain the maximum benefit from the changes, whilst maintaining the integrity of the UK's accounting and company law framework. Therefore the focus of the analysis is limited to options 1, 2 and 3.

The **benefits** associated with implementing the Directive primarily result from the reduction in administrative burdens for small companies due to the reduced disclosures mandated by the harmonised small company regime, and to further simplification of financial reporting. This has the aim of enabling small companies to focus resources on other aspects of their businesses.

Option 1

- This option will impact all small companies, as well as around 1000 medium-sized companies who will fall under the revised small company thresholds.
- There will be one-off familiarisation costs for preparers of accounts, including 327,000² accountants, 3500 book-keepers³ and an estimated 345,000⁴ companies who prepare their own accounts and are expected to take-up the exemption and file abbreviated accounts.
- There will be one-off development costs for providers of accountancy software.
- There is a potential for non-monetised costs which could arise from a loss of transparency for stakeholders in small companies, leading to increased costs of raising capital for these companies, where there may be uncertainty over the financial health of the company.
- There will be on-going benefits associated with the time savings from the reduction in the number of disclosures required on the accounts to 13 (8 mandatory and the additional 5). These time savings are associated with inputting data into the system, rather than preparing/collecting data for the accounts, as the latter won't change.

² Financial Reporting Council 'Key facts and trends in the Accountancy Profession' (2014)

³ The Institute of Certified Book-keepers advised in response to the 'Micro-entities exemption' consultation in March 2013 that there are around 3,500 practising book-keepers in the UK.

⁴ See assumptions and calculations later in main text based on 3.027m small companies (FAME database)

- Savings may also be limited if companies are required to provide the information no longer in the public domain to lenders and other third parties. In these cases, it may be in the company's interest to file full accounts, which we assume 50% of existing small companies and 70% of medium sized companies reclassified as small will do. Before the changes introduced by the Directive are implemented, it will be very difficult for stakeholders to predict the extent to which they will be required to provide the additional information, so we will continue to apply these assumptions relating to uptake of the exemption, and assume all those who do take up the exemption will benefit from the reduced disclosures.

Option 2

- Costs will be as Option 1, with potentially greater non-monetised costs resulting from reduced transparency for stakeholders of the medium-sized companies falling into scope.
- Benefits will be as Option 1, with additional benefits in the form of time savings for medium-sized UK companies which fall into scope of the new increased thresholds for the small company regime, taken up as a Member State flexibility. We used the FAME database to identify the number of current medium-sized UK companies which fall into the scope of the new increased thresholds for the small company regime as approximately 10,000, in addition to the 1,000 which will fall into scope through the changed threshold covered by Option 1.

Option 3

- There are additional non-monetised costs, compared to Option 2, associated with this option, associated with the risk to the integrity of the UK accounting framework for third parties such as creditors and tax authorities. These costs are considered to create a significant risk of this option.
- Benefits will be as option 2, with additional benefits in the form of time savings to all those companies within scope which file abbreviated accounts, associated with the removal of the additional 5 additional notes from the accounts.

The consultation will seek views on approximately 10 Member State options where changes have been introduced by the new Directive. We will explore further any costs or related benefits of those options in greater detail.

Option 3 is the EU baseline and therefore is out-of-scope of OITO.

Option 2 takes up a Member State flexibility to maintain additional notes for small company disclosures already required by UK Company Law and UK accounting standards. These additional notes will go beyond the minimum requirement of the Directive and therefore this option is in-scope of OITO. However this option represents a reduction in the number of notes currently required by UK regulation and reduces the gold-plating compared to the existing higher-standards. This option therefore carries a negative EANCBS of £-8.0m and therefore counts as an OUT of £-8.0m.

A. Background

This Impact Assessment relates to proposals to implement the measures contained in Chapters 1 – 9 of the Accounting Directive (2013/34/EU). Chapter 10, which deals with the reporting of payments to governments by companies active in the extractive industries, will be implemented separately.

B. Problem under consideration

The EU has identified the preparation of the statutory annual accounts as one of the most burdensome obligations for incorporated companies⁵. EU level consultations and analysis indicate that micro and small companies face higher administrative burdens compared to medium and large companies. The analysis highlights that a large company may spend €1 per employee to comply with a regulatory duty; this cost rises to €4 per employee for a medium sized company, and for small companies with the highest burden may be up to €10 per employee. The Directive aims to simplify the statutory accounts to make them less burdensome and more suited to users' needs.

Current EU accounting requirements subject small companies to the same financial reporting obligations as larger companies. In particular, disclosures in the notes to the accounts at the same level of detail as large companies are required. The EU IA noted that without a definition of materiality in the previous directives, many small companies are providing unnecessary information to meet regulatory requirements.

The UK's existing small company regime incorporates Member State options exempting small companies from certain financial reporting obligations. The Companies Act 2006 requires all companies to prepare and circulate the full accounts to all members of the company, but permits medium sized and small companies to file abbreviated accounts at Companies House.

The Accounting Directive updates the current 4th and 7th Company Law directives which set down the financial reporting obligations for limited liability companies. It modernises the language to adopt current terminology and consolidates the rules for individual statutory accounts and group accounts into the one measure. The EU has introduced a principles based approach to the rules and restructured the measure to reflect a building block approach. The Directive now sets out more clearly the information that all companies must provide, with increasing levels of disclosure dependent on company size, resulting in the largest companies, and those categorised as public interest entities, providing the greatest level of disclosure.

The Directive has introduced a harmonised small company regime with mandatory minimum thresholds for small companies to bring about greater consistency and comparability across Member States. The Directive also revises, and makes mandatory, the financial thresholds for medium and large companies.

A small company is defined as not exceeding two out of the following three criteria:

Balance sheet total:	€4,000,000	(£3,392,800) ⁶
Net turnover:	€8,000,000	(£6,785,600)
Average number of employees during the financial year:	50	

A medium sized company is defined as not falling into the small company definition and not exceeding two out of the following three criteria:

Balance sheet total:	€20,000,000	(£16,965,000)
Net turnover:	€40,000,000	(£33,930,000)
Average number of employees during the financial year:	250	

In addition, the EU has introduced a further flexibility enabling Member States to increase the small company thresholds at domestic level to the following:

Balance sheet total:	€6,000,000	(£5,089,200)
Net turnover:	€12,000,000	(£10,178,400)
Employees as above		

⁵ http://ec.europa.eu/internal_market/accounting/docs/sme_accounting/review_directives/SEC_2011_1289_1_en.pdf

⁶ 1Euro = £0.84820

The UK Government proposes to take up this flexibility to enable more companies who meet the criteria to opt into the small company regime. The FAME⁷ database indicates that approximately 11,000 companies currently classified as medium-sized will be in scope of the harmonised small company regime following an increase to the thresholds. 1,000 of these would be classified as small as a result of the new minimum threshold, and a further 10,000 would be classified as small as a result of taking up the flexibility to increase the threshold to the higher level.

The new harmonised regime is deregulatory in effect. It limits the amount of information Member States may obtain from small companies by introducing a mandatory level of disclosure consisting of eight notes to the accounts, and provides a Member State option for a further five notes specified in the Directive. These disclosures currently are considered to underpin the basis of a 'true and fair' view of companies' financial affairs in the UK's accounting framework.

The UK has already adopted the existing options that enable UK companies to take advantage of certain exemptions to assist in the reduction of administrative burdens, most of which are now an integral part of the Companies Act 2006 small company regime. However, there are some new Member State options contained in the Directive on which the Government will consult e.g. the period over which goodwill should be amortised if, exceptionally, its useful life cannot be reliably estimated.

The Government is now considering how best to implement the Accounting Directive in the UK.

C. Rationale for intervention

The Government wants to reduce the number of unnecessary regulations that hold back businesses whilst retaining the integrity of the UK accounting and company law frameworks. The EU measures are designed to address a regulatory failure where existing regulations are not fit for purpose and impose a disproportionately high burden relative to the benefits achieved. The measures are expected to reduce the unnecessary administrative costs imposed on small companies by the previous directives, and enable companies to focus on growing their businesses and creating employment opportunities. This deregulatory aspect of the Directive could potentially lead to a small cost in terms of lost transparency for investors. However, some stakeholders (banks, other finance providers and HMRC) have the power to request extensive financial information from companies, and do not necessarily rely only on company financial statements.

The rationale for company reporting requirements is best represented as a principal-agent problem. Shareholders (the principal) delegate the responsibility of company management to company executives (the agent). It is this separation of ownership and control, which generates a potential informational asymmetry because shareholders, and other stakeholders⁸, do not have full information on the performance of their executives. Financial reporting requirements for companies aim to reduce this asymmetry by making companies as transparent as possible.

However, for many small companies, this principal-agent arrangement does not hold as strongly as the financial statements are not the main source of information for shareholders and other stakeholders in small companies. Of the 3.022m (*FAME database*) small companies on the UK register, 67%⁹ have only 2 or fewer shareholders. In such circumstances, the shareholder is likely to be closely associated with the management of the company and have access to its financial records. Therefore the costs associated with financial reporting requirements may be disproportionate to the value of the financial statements for shareholders and other stakeholders and may not deliver significant benefit to them.

D. Policy objectives

The 'Plan for Growth'¹⁰ published in March 2011, set out the Government's ambition "to make the UK one of the best places in Europe to start, finance and grow a business". It identified that this could be achieved, partly, by lessening the domestic regulatory burden on business. The Accounting Directive offers government the opportunity to assess further how the regulatory burden on small businesses

⁷ FAME description

⁸ E.g. lenders, trade creditors, employees etc.

⁹ Collis 2012, Determinants of voluntary audit and voluntary full accounts in micro- and non-micro small companies in the UK

¹⁰ <https://www.gov.uk/government/publications/plan-for-growth--5>

might be reduced and how real benefits to small companies might be provided by allowing them to focus on their business performance and growth rather than admin.

The policy objectives are:

- to reduce administrative burdens associated with the preparation and publication of statutory annual accounts,
- to implement effectively the new harmonised small company regime,
- to ensure the changes are implemented effectively whilst maintaining confidence in the integrity of the UK's established accounting framework

The proposed policy will simplify statutory financial reporting for small companies whilst continuing to protect the interests of third parties such as creditors, shareholders and tax authorities.

E. Options considered

We propose four options, including do nothing. Option 0 is not considered feasible. The Directive introduces changes which are not compatible with the UK's existing framework – e.g. the UK currently has around 17 notes to the accounts which are required to meet minimum requirements, and these must be reduced to a maximum of the mandatory 8 and optional 5 notes. The Directive must be implemented **by 20 July 2015**. Certain aspects of the Directive are mandatory and will be implemented. There are a very large number of Member State options. We do not propose to make changes where there are no meaningful changes to the options over those previously available and considered as part of the implementation of the earlier directives.

The Government's objective is to ensure that undertakings obtain the maximum benefit from the changes, whilst maintaining the integrity of the UK's accounting and company law framework. Full implementation of all the options permitted the Directive could result in confusion and a loss of confidence in the UK's accounting framework, potentially leading to wider economic consequences. *Therefore the focus of the analysis is limited to options 1, 2 and 3.*

• Option 0: Do nothing.

Not feasible. The Directive must be implemented by 20 July 2015.

• Option 1: Take the minimum action required by the directive. Implement only those mandatory changes to the current system which are required by the Directive

- Reduce the number of notes to the accounts to the mandatory 8 notes, plus the Member State option in Article 16(2) of the Directive to require small companies to provide an additional 5 disclosures in the notes to the accounts. Adjust the small company threshold in line with the mandatory requirement. The inclusion of the 5 additional notes specified in Article 16(2) for small companies will ensure that these companies will more readily continue to comply with UK Generally Accepted Accounting Practice (UK GAAP). Small companies with the simplest business models will not need to consider the need to provide more information. This will reduce the burden imposed upon those companies. This approach will enable UK companies to benefit from simplification and burden reduction measures in the preparation and publication of their accounts, whilst enabling the UK to retain key disclosures in the financial statements that stakeholders consider necessary to underpin the presentation of the 'true and fair' view required by company law. All small companies may voluntarily continue to disclose more information if they wish - some small companies will continue to need to provide additional disclosures, as relevant, where their more complex business structures/activities trigger additional requirements.

• Option 2: Take the minimum action required, plus take up the option to increase the size threshold for small companies.

As Option 1, plus take up the Member State option to increase the size threshold for small companies to a maximum of €12,000,000 net turnover and €6,000,000 balance sheet total (approximately £10 million and £5 million respectively). The increased threshold would enable

around 11,000 UK companies currently classified as medium sized to take advantage of the small company regime.

- **Option 3: Implement the EU baseline – reduce the notes to the accounts to the mandatory 8 notes, and take up the option to increase the size threshold for small companies.**

This option is considered the EU baseline and will create the lowest administrative burden on companies, however the removal of the 5 additional notes risks jeopardising the integrity of the UK accounting framework for third parties such as creditors and tax authorities. The additional notes are considered by stakeholders and professional bodies as necessary to underpin the presentation of a true and fair view of a company's financial position i.e. they provide information which is necessary for the user to reasonably form an opinion.

Option 2 is our preferred option.

We will consult on the take up of options where significant alterations have been made relative to previous Directives. We propose to take up the Member State option in Article 16(2) of the Directive to require small companies to provide an additional 5 disclosures in the notes to the accounts. These notes underpin the basis for determining if the accounts present a “true and fair” view of the undertaking's financial affairs in the UK, and are therefore make up an important and necessary part of the accounts. We are seeking views in the consultation on the costs and benefits of retaining these notes.

F. Monetised and non-monetised costs and benefits of each option

Option 1: Take the minimum action required by the directive. Implement only those mandatory changes to the current system which are required by the Directive

Benefits

The new small company regime will consist of the minimum disclosures, a total of eight mandatory notes. Option 1 takes up the option to require an additional 5 notes to the accounts. This nonetheless represents a reduction in the number of disclosures required to the accounts.

The EU's impact assessment identified that of the numerous disclosures required by the accounting directives, the preparation of the notes are the most laborious and time consuming. This is because the notes are descriptive and require additional analysis which is not always possible to obtain directly from accounting software. It finds that approximately 50% of the time allocated to preparing the accounts is spent on the preparation of the notes. There will be some benefit in the number of notes being reduced.

However, respondents to the consultation on the implementation of the ‘Micro entities’ exemption in March 2013 noted that in many instances the process is largely automated where the relevant data are input into the accountancy software, and the notes are automatically produced. On occasions, where changes have occurred in the company, the input of an accountant/book-keeper is required to offer additional narrative. We do not have information as to how regularly accountants need to feed into the notes but it was suggested that it would be limited, and likely to occur when the control environment of the company changed in some way, such as when a small company becomes a parent company and is required to prepare consolidated accounts.

This narrative is supported by our own subsequent discussions with stakeholders comprising of professional accountancy bodies and practitioners, as well as by responses to the 2009 European Commission consultation paper¹¹ on the review of the Accounting Directive. The latter found that out of 22 responses 8 said they had to compile information specially to prepare the disclosures, whilst 5 said no further information needed to be prepared. Some respondents stated that additional information needed to be produced to prepare disclosures in the areas of fair value, financial

¹¹ European Commission summary report on the responses received to the consultation paper on review of the accounting directive. http://ec.europa.eu/internal_market/accounting/docs/200910_accounting_review_consultation_report_en.pdf

instruments, deferred tax, contingent liabilities, other financial commitments and remuneration. The decision as to which notes will require additional information to be produced depends on the specific circumstances of the company and is difficult to generalise or predict. Furthermore, the majority of the disclosures identified will remain within the revised mandatory requirements on accounts; so cannot represent a saving.

Costs of preparing disclosures:

Two respondents provided range estimates of cost that were between £86 and £215¹². In order to estimate the impact of a partial reduction in the number of notes to the accounts, we assume the reduction in the number of notes is reflected in a proportionate reduction in the cost of preparing the relevant disclosures.

The Companies Act 2006 sets down numerous requirements for particular disclosures (20 plus). However, the company may not be required to prepare all 20 plus notes; the number needed will depend on the company's financial affairs in the preceding year. Therefore, it is difficult to identify the typical number of notes contained in small company accounts. For the purposes of this assessment, it is presumed that approximately 17 notes are prepared on average as we understand that there are around 17 which are most commonly prepared, but we recognise that the actual average may be slightly lower or significantly higher. Based on this, the estimated saving per company of preparing the reduced number of notes (totalling 13 notes, including the 5 additional notes covered by the Member State option in Article 16(2) of the Directive) is:

$((\text{Current number of notes} - \text{reduced number of notes}) / \text{current number of notes}) * \text{cost of preparing full set of notes}$

Best estimate: $((17 - 13)/17) * £86 = £20$

High estimate: $((17 - 13)/17) * £215 = £51$

Based on the information above suggesting that the most burdensome notes will remain to the accounts, we use £20 as the best estimate of savings resulting from the removal of notes from the accounts, and savings of £51 as a high estimate.

We are seeking further information in the consultation on the level of notes typically contained in small companies' accounts and the related costs of preparing these notes; and on the potential benefits that may be gained from a reduction in the notes to the accounts.

Savings to companies preparing own accounts:

As 8 out of 22 respondents suggested they had to compile additional information, our best estimate would be that 36% of companies would incur this saving, though it could in principle apply to all.

We apply this percentage to all small companies defined as currently set out in the Companies Act , 3.022m based on FAME, as well as a further 1,000 who fall into the new revised mandatory threshold set out in section B of this impact assessment. At this stage we assume that the savings from the reduced requirements on medium-sized companies are the same as for small companies.

We estimate the benefits to those who compile their own accounts separately from those who use an external accountant or book-keeper.

Analysis undertaken by Collis in 2012¹³ estimated that 23% of small companies compile their own accounts and research by POBA and Companies House suggests between 50-70%¹⁴ of small companies file small company accounts. Based on the evidence available, we use 50% as the central assumption and 70% as the high estimate.

¹² Between €100 and €250

¹³ Collis, J. (2012) 'Determinants of voluntary audit and voluntary full accounts in micro and non-micro small companies in the UK' found that 77% of small companies used an external accountant.

¹⁴ The Professional Oversight Board for Accountancy (POBA) reported that research it commissioned to examine 355 sets of accounts at Companies House in 2006 found approximately 60% were abbreviated, which was comparable with the findings of its questionnaire survey of 600 small and medium-sized companies, where just over 50% reported they had filed abbreviated. Collis 2012 finds that in 2006 49% of those surveyed had filed abbreviated accounts. Companies' house data suggests that around 70% of small companies file small company accounts.

Those medium-sized companies who move into the small company regime as a result of the revised threshold are larger companies, and have different characteristics. Companies with a greater number of external investors and external lenders are more inclined to produce full disclosures in the accounts. We expect that a number of the companies at the upper end of the new threshold limit will have a larger number of investors, so are more likely to voluntarily file full accounts, and are also more likely to use an external professional to prepare their accounts.

A BERR report¹⁵ from 2006 suggests that 88% of medium sized firms use an external accountant to prepare their accounts, indicating that 12% prepare their own accounts. This reflects the fact that larger companies are more likely to have more complex businesses for which there is a greater need for the use of external professionals to prepare the statutory annual accounts.

At present, medium-sized companies (who meet eligibility criteria) have the option to file abbreviated accounts. FAME provides information which suggests that at least 20% of medium-sized companies file abbreviated accounts. The BERR report¹⁶ indicates that over 70% of medium-sized companies would voluntarily audit their accounts; companies who choose to undertake a voluntary audit are also likely to file full accounts. Based on this, and assuming that those eligible medium-sized companies who currently choose to file abbreviated will take up the option to abbreviate further as a small company, and that those who file full accounts will continue to do so under the small company regime, we estimate that between 20 and 50% (based on the best estimate for current small companies) of eligible medium sized companies will file abbreviated accounts under the small company regime, with a best estimate of 30%.

At this stage we assume that the savings from the reduced requirements on medium sized companies are the same as for small companies.

We therefore estimate a saving from the removal of the notes from the accounts for companies who prepare their own accounts of £2.5m, with a high estimate of £8.9m. This is based on the following calculation: (number of small companies * percentage that requires additional information to be compiled for notes * percentage that takes up exemption * percentage that prepares own accounts * cost per company of preparing notes) + (number of medium-sized companies captured by revised threshold * percentage that requires additional information to be compiled for notes * percentage that takes up exemption * percentage that prepares own accounts * cost per company of preparing notes)

Company size	Case	No. of companies	% requiring additional info to prepare notes	% that take up exemption	% that prepare own accounts	Cost to company of preparing accounts
Small	Low	3.022m	36	50	23	20
	Best	3.022m	36	50	23	20
	High	3.022m	36	70	23	51
Medium	Low	1000	36	20	12	20
	Best	1000	36	30	12	20
	High	1000	36	50	12	51

Low estimate = $(3.022m * 36% * 50% * 23% * £20) + (1,000 * 36% * 20% * 12% * £20) = £2.5m$
 Best estimate = $(3.022m * 36% * 50% * 23% * £20) + (1,000 * 36% * 30% * 12% * £20) = £2.5m$
 High estimate = $(3.022m * 36% * 70% * 23% * £51) + (1,000 * 36% * 50% * 12% * £51) = £8.9m$

¹⁵ BERR, Collis, Directors' Views on Accounting and Auditing Requirements for SMEs.

¹⁶ See footnote 11

Savings to companies using external accountants:

Assuming that the notes to the accounts are prepared by the company owner/ corporate directors, £86 (the estimated cost of preparing a full set of notes) equates to 3.5 hours of time. Using the Annual Survey of Hours and Earnings (ASHE), the wage for a corporate manager or director is £24.31 (again including 17.8% uplift for non-wage costs).

The median wage for an accountant is £22.64¹⁷, which indicates that the cost to accountants of preparing notes to the accounts is £80 as the best estimate and £200 as the high estimate (£215/£24.31 * £22.64 = £200). A low estimate of costs would be £0 based on the assumption that accountants would not adjust their charges on the basis of a small change to workload. Adjusted for the proportion of the notes which will be removed we obtain an estimated saving per company of £19, within a range of 0 to £47.

We therefore estimate a saving from the removal of the notes to the accounts for companies who hire an external accountant to prepare their accounts of £7.9m as a best estimate, a low estimate of £0 and a high estimate of £27.6m. This is based on the following calculation: (number of small companies * percentage that requires additional information to be compiled for notes * percentage that takes up exemption * percentage that uses an external accountant to prepare accounts * cost per company of preparing notes)

Low estimate = (3.022m * 36% * 50% * 77% * £0) + (1,000 * 36% * 20% * 88% * £0) = £0m

Best estimate = (3.022m * 36% * 50% * 77% * £19) + (1,000 * 36% * 30% * 88% * £19) = £7.9m

High estimate = (3.022m * 36% * 70% * 77% * £47) + (1,000 * 36% * 50% * 88% * £47) = £ 27.6m

This results in a total estimated annual saving of between **£2.5m – £36.5m**, with a best estimate of **£10.4m**.

	Savings for small companies preparing own accounts	Savings for medium companies preparing own accounts	Savings for small companies using accountant	Savings for medium companies using accountants	Total benefits
High	£2.5m	£170	£0	£0	£2.5m
Best	£2.5m	£260	£7.9m	£1,800	£10.4m
Low	£8.9m	£1,100	£27.6m	£7,500	£36.5m

This is a best estimate based on the information available, but we believe this may overestimate the savings which may result from removing mandatory notes from the accounts. As stated above, respondents to the consultation on the implementation of the ‘Micro entities’ exemption and other stakeholders consulted since, have noted that the process is largely automated and additional work is only required when changes have occurred in the company. This is likely to occur only when the control environment of the company changes in some way – given that this will happen to a minority of companies, and would not occur on an annual basis, the actual savings resulting from removal of notes from the accounts are likely to be lower. We have informally consulted with stakeholders to try and better understand the frequency of these occurrences, and the costs of reporting in these cases, but due to the fact that they are significant changes which happen to a minority of companies any given year, stakeholders have found it difficult to predict when they may impact their reporting processes. We will test this further with stakeholders as part of the consultation.

There will also be benefits to an estimated 3300¹⁸ large companies, who will be classified as medium sized as a result of changes to the company size thresholds. We would estimate that between 20-50% of these (with a best estimate of 30%) would take up the option to file medium sized company abbreviated accounts. However, at this stage we do not have estimates of savings which will apply to these companies as a result of this reduced requirement. We will seek views on the potential savings which would result from this as part of the consultation.

¹⁷ ASHE data 2013

¹⁸ Based on FAME data

Wider Non-monetised benefits:

- The removal of unnecessary information from small company financial reports will make the accounts more user friendly and easier to understand for both preparers and users. It may encourage more small companies to prepare their own accounts if they feel confident about the changes and simplifications to the accounts.
- It will relieve administrative burdens on existing companies and support the development of a 'light touch' regulatory environment for small UK businesses; and may further encourage individuals to set up their own companies. The proposals are part of the general movement towards deregulation, particularly for smaller companies.

Costs

1. One-off costs

Minimum implementation would require only the mandatory aspects of the Directive to be implemented and only those options where a significant change from the UK's current approach has occurred to be considered. This would limit the level of familiarisation required by preparers and users of statutory annual accounts.

There will nevertheless be one-off costs associated with familiarisation around the reduced number of disclosures to small company accounts. These costs will apply to those who prepare company accounts of understanding the new requirements and regulations. This will apply to all chartered and certified accountants as well as practising book keepers, who will compile company accounts. In addition to this, an estimated 23%¹⁹ of small companies will prepare their own accounts, and around half of these will take up the exemption and prepare abbreviated accounts and incur familiarisation costs.

It should be noted that the accountancy and bookkeeping professional bodies require their members to maintain up-to-date knowledge as part of their day-to-day work. Each body sets down its own requirements for the number of hours expected to maintain a satisfactory level of CPD. This includes reading latest notices, keeping up to date with articles etc., through to understanding the application and implications of any new or revised accounting standards, directives etc. We assume that these additional changes will result in an opportunity cost of their time.

We expect familiarisation costs to be in line with those experienced in understanding the changes made in the Micro-Exemption Impact Assessment²⁰. This analysis estimated the time taken to familiarise with presentational changes to be between 5 and 15 minutes, with a best estimate of 10 minutes to understand the changes. This is on the basis that the changes in the accounting regulations which will apply in the UK are also mainly presentational and are therefore relatively straightforward to familiarise with.

In terms of the number of accountants and book-keepers in the UK, the Financial Reporting Council notes in its report of 'Key facts and trends in the Accountancy Profession' (2014) that in 2013 there were over 327,000 members of the seven accountancy bodies in the UK. The Institute of Certified Book-keepers advised in response to the 'Micro-entities exemption' consultation in March 2013 that there are around 3,500 practising book-keepers in the UK. We have assumed that these figures provide reasonable estimates of the number of professionals affected by the Accounting Directive.

Analysis undertaken by Collis in 2012 estimated that 23% of micro-entities compile their own accounts and around half of all micro-entities had taken up the exemption allowing them to file small company accounts.

¹⁹ Based on 2006 accounts. Collis, J. (2012) 'Determinants of voluntary audit and voluntary full accounts in micro and non-micro small companies in the UK' found that 77% of small companies used an external accountant.

²⁰ http://www.legislation.gov.uk/ukia/2013/162/pdfs/ukia_20130162_en.pdf

In terms of the number of companies who prepare their own accounts, there are currently approximately 3.022m small companies and a further 1,000 that will fall under the small company regime as a result of the mandatory changes to the small company threshold criteria. Of the 3.022m small companies, 23% (700,000) are assumed to prepare their own accounts²¹ and 50-70%²² of these will prepare abbreviated accounts. On this basis around 350,000 small companies are expected to undertake some familiarisation with the changes²³, with a high estimate of 490,000. Of the 1,000 medium sized companies which will become small companies, 12% are assumed to prepare their own accounts and 20-50% of these will prepare abbreviated accounts (see assumptions in benefits section). On this basis around 350,000 small companies are expected to undertake some familiarisation with the changes, with a high estimate of 490,000.

We expect the familiarisation will take a company preparing their own abbreviated accounts around the same amount of time as an accountant or book-keeper.

Using the Annual Survey of Hours and Earnings, the wages for accountants and book-keepers (plus non-wage labour cost uplift of 17.8%²⁴) are £22.64²⁵ per hour and £13.23 per hour respectively. We assume for companies preparing their own accounts, the company manager/ corporate director would be responsible for familiarising themselves with the revised regulations. The wage for corporate manager or director is £24.31 (again including 17.8% uplift for non-wage costs).

Thus the total one-off familiarisation costs will be £1.3m to £4.8m, with a central case of **£2.7m**. The detailed calculations are the same for each exemption with a difference around the amount of time taken for each one. The calculation is as follows:

Time x (((Accountant wage + 17.6% uplift) x (Number of accountants)) + ((Book-keeper wage + 17.6% uplift) x (Number of book-keepers)) + ((Company owner wage + 17.6% uplift) x (Number of companies completing own accounts x percentage that prepare small company accounts)))

Low: $5/60 * ((£22.64 * 327,000) + (£13.23 * 3500) + (£24.31 * 3.022m * 23% * 50%) + (£24.31 * 1,000 * 12% * 20%)) = £1.3m$

Central: $10/60 * ((£22.64 * 327,000) + (£13.23 * 3500) + (£24.31 * 3.022m * 23% * 50%) + (£24.31 * 1,000 * 12% * 20%)) = £2.7m$

High: $15/60 * ((£22.64 * 327,000) + (£13.23 * 3500) + (£24.31 * 3.022m * 23% * 70%) + (£24.31 * 1,000 * 12% * 20%)) = £4.8m$

The total one-off familiarisation costs to business will be:

	Costs for accountants	Costs for book-keepers	Costs for small companies	Total costs
High	£1.9m	£12,000	£3.0m	£4.8m
Best	£1.2m	£8,000	£1.4m	£2.7m
Low	£0.6m	£4,000	£0.7m	£1.3m

2. Software changes

There will be one-off development costs associated with the updating of accounts software to incorporate the changes to the accounts. Companies and accountancy firms may opt to use the web-based filing service offered by Companies House or more bespoke platforms offered by alternative software providers.

There are approximately 20 accounting software companies which provide software systems that enable the electronic filing of accounts by firms with HMRC and Companies House. We have engaged with Companies House on this issue in order to try and obtain estimates of the development

²¹ See note 5

²² See note 7

²³ We assume that those companies who use accountants will not incur familiarisation costs, as this will be left to the accountant

²⁴ Based on Eurostat data: http://europa.eu/rapid/press-release_STAT-13-54_en.htm?locale=en

²⁵ ASHE data 2013

costs which will be incurred by these companies based on past experience. However, Companies House are unable to obtain estimates from the software companies before there is more certainty around the changes which will be implemented. It is only at this point that software companies will go through the process to consider what changes are necessary to their software and what the associated development costs will be (or even if they consider there is a market for a revised product.) We therefore currently do not have estimates for these development costs and will seek further detail during the consultation.

There are likely to be implementation costs incurred by certain public sector bodies i.e. Companies House, who will need to consider what changes may need to be made to their systems etc. However, certain decisions will only be made following the consultation which would then enable such costs to be determined more accurately. Our experience of implementing the 'Micros' Directive, which required the development of a new interface to enable micro-entity accounts to be filed at Companies House, resulted in costs of approximately **£220,000**. Therefore, this figure has been used as an indicative cost and will be refined following the consultation.

3. *Non-monetised costs*

There is a potential loss of transparency for stakeholders, particularly for those medium-sized companies that may qualify as small companies under the increased thresholds. The reduced disclosures could lead to a loss of information for stakeholders, and possibly the company themselves.

Business information providers, such as credit rating agencies, use information contained in the annual accounts to supply information on companies to the market. Therefore, such providers may find it more difficult to provide information on small companies if they have to rely on requests for additional information. However, the EU's IA for the Accounting Directive states that many of the notes required by the previous directives are not relevant to the stakeholders of small businesses.

It is not certain that the removal of these notes will impact on the data used in the scoring models in the credit granting process. A reduction in the information provided would impact on these models and lead to more investigations and data-gathering to cater for the absence of data. This could result in slower credit decisions and potentially raise the cost of capital for the companies where uncertainty over the financial health of the company remains. Further information relating to this issue will be sought in the consultation.

Option 2: Take the minimum action required, plus take up the option to increase the size threshold for small companies.

Benefits:

Benefits will be as in Option 1, but with additional benefits accruing to those companies which will fall within the increased small company threshold criteria. The flexibility to increase the small company threshold above the minimum threshold required by the Directive will bring an additional 10,000 companies currently classified as medium-sized into the scope of the small company regime, over and above those falling within the new mandatory small company threshold criteria. As in Option 1, we assume that the savings to this group of companies from the reduced filing requirements are the same as for small companies.

We apply the same assumptions to this group of companies as we applied to those medium-sized companies falling within the new mandatory threshold in Option 1.

On this basis we estimate a saving to companies preparing their own accounts from the take up of the Member State flexibility to increase the small company threshold to the higher level of **£1,700 - £10,900**, with a best estimate of **£2,600**. This is based on the following calculation: (number of medium-sized companies falling within the higher threshold * percentage that requires additional information to be compiled for notes * percentage that takes up exemption * percentage that prepares own accounts * cost per company of preparing notes)
Low: $(10,000 * 36\% * 20\% * 12\% * £20) = £1,700$

Best estimate: $(10,000 * 36\% * 30\% * 12\% * £20) = £2,600$

High: $(10,000 * 36\% * 50\% * 12\% * £51) = £10,900$

We make the same assumptions regarding savings to new “small” companies who use external accountants or book-keepers to prepare their accounts as applied to companies in Option 1. This estimates a saving from the change in the small company threshold criteria for medium sized companies who use external professionals of **£0 - £75,000**, with a best estimate of **£18,000**. This is based on the following calculation: (number of companies * percentage that requires additional information to be compiled for notes * percentage that takes up exemption * percentage that uses an external accountant to prepare accounts * cost per company of preparing notes)

$= (10,000 * 36\% * 30\% * 88\% * £0) = £0m$

$= (10,000 * 36\% * 40\% * 88\% * £19) = £17,900$

$= (10,000 * 36\% * 50\% * 88\% * £47) = £74,500$

Added to the benefits for Option 1, we get total benefits for Option 2 of between **£2.5m – £36.6m**, with a best estimate of **£10.4m**.

Costs:

Monetised costs will be as in Option 1 with additional familiarisation costs for those medium sized companies who fall into scope as a result of the revised threshold.

Time x (((Company owner wage + 17.6% uplift) x (Number of companies * percentage completing own accounts * percentage that prepare small company accounts)))

Low: $5/60 * (£24.31 * 10,000 * 12\% * 20\%) = £500$

Central: $10/60 * (£24.31 * 10,000 * 12\% * 30\%) = £1,500$

High: $15/60 * (£24.31 * 10,000 * 12\% * 50\%) = £3,600$

Accountants and book-keepers will have no additional familiarisation costs as a result of the additional companies eligible to file small company accounts, as their familiarisation costs have already been included in Option 1.

Total one off costs for option 2 will therefore be between **£1.3m** and **£4.8m** with a best estimate of **£2.7m**. The additional familiarisation costs for this option compared to option 1 are small.

There may be additional non-monetised costs relating to the loss of transparency for stakeholders as described in Option 1, but applying to those medium sized companies who are eligible, and take up the option to file small company accounts. The cost of this may be greater for those medium-sized companies that may qualify as small companies under the increased thresholds, as they are more likely to be raising external finance and capital.

Option 3: Implement the EU baseline – reduce the notes the accounts to the mandatory 8 notes, and take up the option to increase the size threshold for small companies.

Benefits:

Benefits are of the same nature as those set out in Option 2. There may be some additional benefits resulting in the further reduction in the number of notes to the accounts.

We use the same approach as used in Options 1 and 2 to estimate the scale of these additional benefits:

Additional saving per company from removal of the 5 additional notes:

Best estimate: $(5/17) * £86 = £25$

High estimate: $(5/17) * £215 = £63$

We first estimate the savings for all companies who prepare their own accounts:

Low estimate = $(3.022m * 36% * 50% * 23% * £0) + (11,000 * 36% * 20% * 12% * £0) = £3.2m$

Best estimate = $(3.022m * 36% * 50% * 23% * £25) + (11,000 * 36% * 30% * 12% * £25) = £3.2m$

High estimate = $(3.022m * 36% * 70% * 23% * £63) + (11,000 * 36% * 50% * 12% * £63) = £11.1m$

There will also be savings to companies who use an external accountant to prepare their accounts:

Based on methodology above,

Savings per company using an accountant = (Cost to corporate director/ median wage of corporate director) * medium wage of accountant

Best estimate = $((£25/£24.31^{26}) * £22.64) = £23$

High estimate = $((£63/£24.31) * £22.64) = £59$

Based on these estimates, the additional saving to companies resulting from the removal of the 5 additional notes would be:

Low estimate = $(3.022m * 36% * 50% * 77% * £0) + (11,000 * 36% * 20% * 88% * £0) = £0m$

Best estimate = $(3.022m * 36% * 50% * 77% * £23) + (11,000 * 36% * 30% * 88% * £23) = £9.7m$

High estimate = $(3.022m * 36% * 70% * 77% * £59) + (11,000 * 36% * 50% * 88% * £59) = £34.7m$

Summing these estimates provides additional saving of between £3.2m and £45.9m with a best estimate of £12.9m.

Adding this to the benefits of Option 2 provides a total benefit of Option 3 of between **£5.7m** and **£82.5m** with a best estimate of **£23.3m**.

As stated above, discussions with stakeholders have indicated this may be an over estimate of the savings, due to the fact that additional information needs to be gathered for the preparation of notes only when the control state of the company changes. We will test the assumption regarding the scale of the burden resulting from the preparation of notes and how frequently it is incurred further as part of the consultation.

Costs:

One-off costs are assumed to be the same as in Option 2, as the same groups will be affected. There may be slightly higher familiarisation costs for this option as it represents a greater change from the status quo; however any difference in the familiarisation costs has not been quantified.

UK GAAP requires companies' financial statements to present a 'true and fair' view of their financial affairs. The additional notes underpin the basis of the 'true and fair' view. Companies would need to consider further whether their annual accounts met this requirement, and if not, would have to present the necessary information to comply. This could lead to further costs and burdens as this additional task would have to be undertaken each time the annual statutory accounts were prepared.

Rationale and evidence that justify the level of analysis used in the IA (proportionality approach)

Our analysis of the changes introduced by the Directive and discussions with stakeholders have informed the assessments of the costs and benefits of the options outlined, as well as information obtained from the limited research currently available. As the main changes impacting on business are brought about by the harmonised small company regime, and further information on the potential impacts of the new Member State options is being sought in the consultation, we consider this level of analysis to be appropriate. In particular, in the consultation we will consult further on:

²⁶ ASHE data 2013

- views on the new Member State options contained in the Directive
- the level of notes typically contained in small companies' accounts and the related costs of preparing these notes, in particular the extent to which the preparation of notes is automated and the extent to which savings will be achieved through a reduction in the required disclosures.
- the estimated savings relating to the specific notes which will be removed, and the optional notes, and test the relative burden of these notes compared to others which remain mandatory
- the size of any familiarisation costs, including any additional familiarisation costs relating to Option 2 due to it representing a greater diversion from the status quo.
- the development costs incurred by accounting software companies which provide software systems that enable the electronic filing of accounts by firms with HMRC and Companies House.
- the level of savings to the estimated 3300²⁷ large companies, who will be classified as medium sized as a result of changes to the company size thresholds and therefore will have the option of filing abbreviated accounts for medium sized companies.

Risks and assumptions

The key assumptions in terms of costs and benefits are:

- that accountants and book-keepers can familiarise themselves relatively quickly with the changes, but these actions are additional to the Continuous Professional Development requirements
- that owners of small businesses can familiarise themselves with the changes to the small company regime in the same amount of time that it would take an accountant or book-keeper
- the owner or corporate director within the company would be responsible for preparing the accounts and familiarising themselves with any changes
- that the number of small companies who produce their own accounts and who take up the small company exemptions reflects the analysis undertaken by Collis in 2012²⁸.
- that the number of medium sized companies who produce abbreviated accounts reflects Companies House data and estimates from Collis, 2008²⁹.
- that the number of medium sized companies who prepare their own accounts reflects the analysis undertaken by Collis in 2012³⁰.
- that estimates of the cost of preparing notes are reflective of the true costs, and that the reduction in the number of notes reflects a proportionate reduction in the cost of preparing these notes. Anecdotal evidence suggests this may not be the case, and that some notes are more burdensome than others. We will test this assumption in the consultation.
- that, as suggested by survey responses, less than a third of companies will benefit from a reduction in costs as a result of the reduced number of notes to the accounts. This reflects

²⁷ Based on FAME data

²⁸ Collis, J. (2012) 'Determinants of voluntary audit and voluntary full accounts in micro and non-micro small companies in the UK' found that 77% of small companies used an external accountant.

²⁹ BERR, Collis, Directors' Views on Accounting and Auditing Requirements for SMEs

³⁰ Collis, J. (2012) 'Determinants of voluntary audit and voluntary full accounts in micro and non-micro small companies in the UK' found that 77% of small companies used an external accountant.

anecdotal evidence that the burden of preparing notes is not incurred every year, but instead is only incurred when the control state of the company changes.

The underlying risks arise from the potential loss of transparency. As highlighted in the non-monetised cost section, there is a potential risk to small companies in terms of access to finance and cost of capital. However, as mentioned, many of the notes required by the previous directives are not relevant to stakeholders in small companies. Therefore, key stakeholders will still have access to the same information as they currently have now, which will act to mitigate this risk.

There is a greater risk associated with Option 3 in relation to the removal of the five notes specified as a Member State option in the Directive. These disclosures currently form the basis of a 'true and fair' view of companies' financial affairs in the UK's accounting framework. UK GAAP requires companies' financial statements to present a 'true and fair' view of their financial affairs. In the absence of these notes, companies would need to consider further whether their annual accounts met this requirement, and if not, would have to present the necessary information to comply. This could lead to further costs and burdens as this additional task would have to be undertaken each time the annual accounts were prepared.

Direct costs and benefits to business calculations (following OITO methodology)

The direct costs to business are calculated based on the costs to understand the changes to the financial reports and the preparation of the annual statutory accounts. The measure is an EU Directive and falls out scope for OITO. The Member State option included in policy option 2 to include additional notes on the account above the mandatory requirement is in scope of OITO due to the fact it gold-plates the EU minimum. However it reduces the burden on business compared to the current requirement in UK Company Law, and represents a negative EANCBC, therefore counts as an OUT.

Wider impacts

Statutory Equality Duties

After screening the potential impact of this proposal on race, disability and gender equality, it has been decided that there will be no impact. It is not expected to have any impact on the Convention Rights of any person or class of persons as the measure regulates incorporated businesses rather than individuals, and applies to all businesses within the stated size threshold.

Economic Impacts

Competition Impact Test

There are no obvious direct concerns in this area.

Small and Micro Business Assessment

The measure introduces further simplifications for small companies in the preparation of annual statutory accounts and reduces administrative burdens. Simplifications for micro businesses arising from the Directive were introduced in December 2013. At this point all the micro exemption options were taken up, except one³¹ which was not and still is not deemed suitable for the UK.

Environmental impacts

There are no obvious direct concerns in this area.

³¹ The option to exempt micro-entities from the obligation to present 'Prepayments and accrued income' and 'Accruals and deferred income' in respect of certain transactions only was considered inappropriate. The option would create a form of hybrid accounting (neither cash nor wholly accruals-based) and was and is considered to pose a risk to confidence in the UK's financial reporting system.

Social Impacts

Health and Well-Being:

No obvious concerns in this area.

Human Rights:

No obvious concerns in this area.

Justice System

No obvious concerns. No changes are envisaged to the existing system of criminal sanctions or civil penalties for non-compliance.

Rural Proofing

No obvious concerns in this area.

Summary and preferred option with description of implementation plan

The Accounting Directive updates the 4th and 7th company law directives for individual and consolidated annual statutory accounts. It seeks to reduce burdens in the preparation and publication of financial statements, and provide a greater level of comparability and consistency of financial reporting in EU Member States. The Directive provides Member State options to further reduce burdens on undertakings through the additional flexibility to increase the small company threshold at domestic level, thereby enabling more undertakings (where eligible) to benefit from the new harmonised small company regime.

We propose Option 2 as the preferred approach to implementation, and will consult on proposals to obtain further information on benefits and potential costs.