Department for Business Innovation & Skills

UK IMPLEMENTATION OF EU ACCOUNTING DIRECTIVE

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

RESPONSE FORM

AUGUST 2014

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

Consultation response form

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

The closing date for this consultation is 24 October 2014

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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)*

x☐ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

We support continuity of financial reporting requirements except where the Directive requires a change or introduces new options that would be useful for the UK to take up. However, we encourage BIS to review areas where Member State options have been taken in the past and to consider whether the positions previously taken remain appropriate in light of, for example, consistency with new UK accounting standards or IFRS (FRS 101 financial statements largely follow IFRS recognition and measurement principles). In most cases, we would agree that the previous decisions on Member State options remain appropriate.

This is more of an issue where Member State options require a treatment that may be incompatible with newer accounting standards. For example, Article 22.2 of the Directive appears to provide a Member State option to require an undertaking managed on a unified basis with another undertaking to draw up consolidated accounts. While in our experience, rarely used, this does not fit well with concepts of control in accounting standards. Another example is Article 12.10 which says that where the difference between the amount repayable on account of a debt is greater than the amount received, Member States may permit or require that the difference is shown as an asset. 1 Sch 25 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ('the Regulations') which implements this is only permissive, but the accounting treatment included therein does not accord with accounting standards.

We also note that because the Consultation Paper understandably focuses on areas where there is a new Member State option, it does not highlight all changes in the Directive. In implementing the Directive, care will be needed to identify these changes, particularly where they impact existing Member State options or where the FRC can provide additional guidance. One example is that Article 23.8(b) extends the concept of 'equivalence' for the purpose of what is section 401 of the Companies Act 2006, to include 'in a manner equivalent to IAS as determined in accordance with Commission Regulation (EC) NO 1569/2007'. Including this in the Companies Act 2006 would provide more statutory underpinning to decisions made by preparers on 'equivalence' and could then be incorporated in updated guidance on equivalence in FRS 100, as issued by the FRC. We also note that the wording in the Directive in some cases differs slightly to that in the current Regulations, e.g. the fair value accounting rules refer *to ‘the fair value reserve’ in 1 Sch 41 to the Regulations whereas Article 8.8 refers to ‘a fair value reserve’ which is more helpful as it suggests a number of such reserves can be established. Fair value changes outside profit or loss can arise from different causes, such as cash flow hedges or available for sale financial assets or exchange differences associated with net investments in a foreign operation.*

We would encourage BIS to communicate clearly all the changes necessary to the Regulations to implement the Directive at an early stage as this will help preparers take these into account when converting to new accounting standards. This is particularly important in light of the truncated timescale for implementation of the Directive.

We would also support BIS in working closely with the FRC to identify and highlight any apparent incompatibilities with accounting standards, so these (and any implications thereof) can be clearly identified in accounting standards. In this regard, we highlight that:

- *it is not clear how all the requirements of IFRS 9, which is permitted to be followed under FRS 102 (and in due course, once endorsed, will be permitted to be followed under FRS 101) are consistent with the fair value or alternative accounting rules. An example is the measurement of financial liabilities at fair value with the effects of own credit risk recognised in other comprehensive income. This would not appear to be consistent with the fair value accounting rules set out in Article 8.8.*
- *Article 24.13 states that ‘’Deferred tax balances shall be recognised on consolidation provided that it is probable that a charge to tax will arise within foreseeable future for one of the undertakings included in the consolidation’. This is not a new requirement in the Directive but It is not clear that all deferred tax required by UK accounting standards meets this requirement – indeed in some cases (e.g. raising deferred tax on fair value adjustments on an acquisition), there may be no cash tax involved at all.*
- *Article 25 limits merger accounting to business combinations under common control, i.e. where the undertakings in the business combination are ultimately controlled by the same party (note the use of the singular) before and after the business combination and that control is not transitory. This scope of business combinations under common control is not fully aligned with the definition of a group reconstruction, for which merger accounting can be used in UK accounting standards. In particular, inserting a new holding company above an existing group would not always meet the definition of a business combination under common control, since there will probably be more than one ultimate shareholder. Even if the rights of the ultimate shareholders are unchanged, the undertakings are not necessarily controlled by the same party before and after the transaction.*

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)*

x☐ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

We support a continuation of separate regulations for small companies, and for large and medium-sized companies. Preparers and auditors are familiar with the current structure and with the simpler disclosure requirements for small companies. Two sets of regulations means that companies can refer to shorter regulations appropriate to their requirements.

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)*

x☐ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

We agree that there is merit in combining the Small Companies and Groups Regulations with the micro-entity regulations, as both types of companies would be eligible for the small companies regime and it is therefore useful to have both sets of requirements in one place. We would encourage BIS to set out the requirements for micro-entities in full. At present, the Small Companies (Micro-entities) Regulations 2013 is written as a set of amendments to the Companies Act 2006 and the Small Companies and Group Regulations. This makes it more difficult for micro-entities to follow.

However, the Small Companies and Groups Regulations relate to companies subject to the small companies regime. The small companies exemption (in relation to the directors' report and strategic report) is distinct and applies to a wider range of companies than those subject to the small companies regime. We consider that the small companies exemption should continue to be dealt with in the Companies Act 2006 itself. It may however, be appropriate to cross refer to these requirements from the Regulations and the Small Companies and Groups Regulations.

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)*

x☐ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

We consider that the Regulations should contain all the content of annual reports and accounts that is currently in statutory instruments. For example, disclosure of liability limitation agreements and auditor remuneration disclosure is currently included in SI 2008/489 (as amended by SI 2011/2198).

The implementation of the Directive would also be a good opportunity to issue replacement regulations that consolidate all previous amendments made to The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008, The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, and the equivalent regulations for other types of entities.

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)* x☐ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

We consider the maximum time should be allowed for implementation of the Directive but see our comments in response to Q6 on early adoption.

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)*

x☐ 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:

The Directive provides, in particular, significant deregulatory provisions available for small companies. We would strongly encourage BIS to allow early adoption of the changes, in light of the implementation of new accounting standards in the UK. One key legal question here is whether, if early adoption is allowed, this must apply to all the changes – or whether it is possible to early adopt aspects such as new size limits for small and medium-sized companies and groups.

It would be a significant burden for a company that did not qualify for the small companies regime in 2015 to have to prepare group accounts for one year (if it did not benefit from one of the other group accounts exemptions) or to have to apply FRS 101, FRS 102 or IFRS in 2015 but in 2016, would be eligible to apply FRS 102 as modified for small companies (with significant disclosure exemptions, and exemption from preparation of a cash flow statement and group accounts available).

If the increase in size thresholds was implemented early, companies that qualify for the small companies regime in 2014, but would qualify in 2015 and onwards only using the new size thresholds, could apply the FRSSE (effective January 2015) in 2015 if they wished. The FRSSE has similar recognition and measurement principles to the FRSSE (effective April 2008) and previous UK GAAP. This would give an extra year, in effect, for converting to the new accounting standards for small companies. This is important in light of the truncated timescale for implementation of the Directive. While it was always envisaged that some 'replacement' for the existing FRSSE would be required due to implementation of the Directive, the nature of the 'replacement' was not clearly explained in earlier FRC consultations on the Future of UK and Irish GAAP. Consequently, small companies will have considerably less time to prepare for conversion to the new accounting standards than other companies. Many small companies no doubt have only simple accounting issues but this may not be the case for all such companies. Small companies are less likely to have access to the resources available to their larger counterparts. If early adoption of the legislation implementing the Directive was allowed, the FRC would need to explain that the disclosure requirements of the FRSSE do not apply – in the same way as proposed for FRS 102 as amended for small entities.

While we understand it is not possible for the FRC to finalise its proposed amendments to FRS 102 until the legislation is finalised, we consider that if the FRC's proposals to amend FRS 102 are clearly communicated well in advance of finalisation of the standards, some small companies may be in a position to adopt FRS 102 in 2015 (if wished), given that companies with calendar year ends are not required to report until the end of September 2016.

Other aspects of the Directive provide flexibility that will facilitate the implementation of FRS 101 and FRS 102, e.g:

- *Article 8 restricts which financial instruments may be held at fair value. However, Article 8.6 now allows Member States to permit or require the recognition, measurement and disclosure of financial instruments in conformity with IAS as adopted by the EU under Regulation 1606/2002) whereas previously this was restricted to EU-adopted IFRS on or before 5.9.2006. This is therefore less restrictive than the current 1 Sch 36(4) to the Regulations and would facilitate some IFRS-based accounting treatments (required by FRS 101 or FRS 102) that would not currently be permitted. except where the true and fair override was invoked (assuming it were appropriate to do so).*
- *Other examples are flexibility over formats (Articles 11 and 13.2), which will be of particular benefit for companies adopting FRS 101; a higher maximum life for goodwill (where this cannot be reliably estimated) (Article 12.11); and prohibition from reversals of impairment of goodwill (Article 12.6(d)).*

It is not desirable that companies adopting new accounting standards in 2015 will either have to change accounting treatments in the following accounting period or do not have the flexibility to adopt formats that could align closer with IFRS (particularly where IFRS is used for group reporting).

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)*

x☐ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

We support the Government's proposals to maximise the small company thresholds and thereby reduce the regulatory burden on more companies.

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)*

We have not carried out any surveys in this area.

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)*

x☐ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

We agree that the size thresholds should continue to refer to balance sheet total, net turnover and average number of employees as these terms are currently applied and well understood by most companies.

However, we do recognise that for some companies with particular business models, judgement may be required in identifying whether certain types of income, eg interest and investment income, rental income or grants, are net turnover or not (particularly as the formats provide other headings for such line items where Companies Act accounts are prepared). The definition of net turnover in the Directive refers to 'amounts derived from the sale of products and the provision of services'. So does a finance subsidiary or a finance company (that is not a banking or insurance company, which would presumably be a PIE for the purposes of the Directive in any case) have interest income or net turnover for the purpose of the size limits – and does it make a difference whether this is reported in the interest income heading or in the position of turnover and as part of gross profit? It is not obvious that interest income would fall within the provision of services. We note also that IFRS reporters may report as revenue under IAS 18, items that would not fall within the definition of turnover.

Nevertheless, there would be difficulties in extending the concept of net turnover to all forms of income. For example, some companies may have gains or losses, eg due to disposal of assets or fair value gains on financial instruments – which may be high in one year but not another. There might also be questions over whether losses should be netted off gains in arriving at gross income. It is not obvious that it would be desirable for companies to be constantly falling in and out of the size thresholds.

We note that charitable companies have various sources of income, including donations, grants, sometimes trading income and investment income. We note however that the Charities SORP 2008 (Appendix 4) and Charities SORP 2015 (FRSSE) already equate turnover with gross income for the purposes of assessing the small size thresholds. Therefore, we would expect consistency of application in this sector.

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 x☐ 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:

We support continued use of net turnover, unless there is evidence that use of this size measure is inappropriately including companies in the small companies regime (with the consequent access to lighter disclosure, audit exemptions and preparation of group accounts).

Net turnover is defined in section 474(1) of Companies Act 2006 consistently with the Directive. This definition may not work well for companies with certain business models (see our response to Q9) but if BIS considers it is being interpreted too narrowly, BIS could consider providing regulatory guidance. If a change to the size measure is made, it is important that what is included in the size measure is clearly defined.

As noted above, we have a concern over whether gains and losses on assets and fair value gains should affect size thresholds. Any change would likely reduce the population of small companies and the effects of this should be carefully evaluated. Even if a size measure based on the definition of revenue in IAS 18, which is wider than that of net turnover, was used, this might capture companies with high gross interest income (even if net interest income was low).

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 x☐ 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 the current requirements to assess whether a parent company is a small company in section 383 of the Companies Act 2006 remain appropriate.

We note that Article 3.12 allows Member States to require affiliated undertakings (ie two or more group undertakings) 'to calculate their thresholds on a consolidated or aggregated basis where such undertakings have been established for the sole purpose of avoiding the reporting of certain information'. While we can see that a group could in principle arrange its affairs such that all its entities in the UK qualify as small, we are not aware that this is a significant problem in practice and, as a practical point, it may be difficult to identify that such arrangements are for 'the sole purpose of avoiding the reporting of certain information'. Therefore, without a fuller understanding of the problem that BIS might consider needs to be addressed here, we would not support an extension to require affiliated undertakings to calculate their size thresholds on a consolidated or aggregated basis.

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

x☐ Yes **TO Q11(a) ONLY BUTSEE BELOW** ☐ 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 support a continuation of the current requirements in section 383 of Companies Act 2006, i.e. no change to the current position where the size limits for a parent are assessed based on the size of its subgroup. See response to Q11.

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)*

x☐ 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:

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)*

x☐ Yes ☐ No ☐ Not sure

Please provide any information to support your views:

These are statutory requirements that the Government intends to implement. These should, therefore, be included in regulations. However, it would be helpful if FRS 102, as amended for small entities, also repeated these disclosures (in the same way as the FRSSE currently incorporates the statutory disclosures for small companies and companies that are micro-entities). We would particularly encourage inclusion in FRS 102 of these disclosures as certain requirements, such as the extension of disclosure on off-balance sheet arrangements to companies subject to the small companies regime, are new.

We are not sure whether the restrictions on Member States mandating disclosures beyond those required or permitted in the Directive extend to interpretative guidance on statutory disclosures. However, if interpretative guidance was considered helpful, we consider this should be located in accounting standards, i.e. in FRS 102.

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 x☐ No ☐ Not sure

Please provide information in support of your answer:

We note that companies subject to the small companies regime are still required to prepare financial statements that give a true and fair view and unless a company is eligible for, and takes advantage of, an audit exemption, the auditor must opine on whether the financial statements give a true and fair view. Without clear guidance on what a 'true and fair view' means for this purpose, it would be difficult for auditors and preparers to make these judgements against a consistent framework, particularly if highly abridged formats are permitted by the legislation.

For example, while 'true and fair' is a matter of judgement, a profit and loss account that starts at 'gross profit or loss' (and does not even include turnover) may be hard to reconcile with a general understanding of this concept. These formats also appear to be more abridged than the formats required by micro-entities that are companies, which does not seem appropriate. Consequently, we do not support preparation of financial statements for members using the abridged formats, particularly in relation to the profit and loss account. We note that companies subject to the small companies regime can already simply file a balance sheet without using the abbreviated accounts regime.

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)*

See response to Q15 above.

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)*

Small company preparers are better placed to answer this question.

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)*

Exempting small groups from consolidation reduces the cost burden. Many UK subgroups do not prepare group accounts, where exempt under section 400 or section 401 of the Companies Act 2006. We consider that it is consistent with BIS's general deregulatory approach, to continue to make available the exemption from preparing group accounts to small groups.

As noted in the Consultation, Member States are required to exempt small groups from consolidation unless a member of the small group is a PIE. Consequently, the only way that the scope of the exemption can be affected, is by defining what types of company are PIEs (see response to Q19) for this purpose or the size limits (see response to Q7).

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 x☐ No ☐ Not sure

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

We note that generally, only public companies are able to offer shares or debentures to the public (Part 20 of Companies Act 2006). While many public companies do not do so, it is open to them to reregister should they not need public company status and the responsibilities that come with it.

If only public companies with securities traded on a regulated market were excluded from the small companies regime for accounting purposes, this would mean that public companies quoted on AIM or quoted companies (as defined in section 385) or publicly traded on other non-regulated markets could fall within the small companies regime. This could easily be the case for asset rich groups with low turnover and employees (such as extractive companies engaged in exploration and evaluation). Such companies would not need to prepare group accounts and if applying FRS 102, would benefit from a light disclosure regime. Our view is the requirements to be met when determining whether or not an entity is excluded from the small accounting and auditing regimes should be linked to whether or not the small entity meets the definition of a PIE (as applied in the UK). If it does, it should not be able to take up the advantages of exemptions in respect of the small companies regimes.

In relation to all our responses on questions concerning ineligible companies, we consider that the exclusions should be consistent for the purposes of the small companies audit exemption and accounting exemptions, unless there is a good reason.

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)*

x☐ 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)?

We presume that Article 2.1(d) of the Directive allows Member States to define a PIE by reference to being a member of an ineligible group as well as whether the company itself is ineligible. The question of whether a group which includes a public company should be ineligible for the small companies regime is linked to whether a public company is identified as a PIE (see Q19)

Even if a public company is identified as a PIE, we are not convinced that a company that is a subsidiary of or a fellow subsidiary of a public company should be excluded from the small companies regime, but consider that there is an argument that a company that is a parent of a PIE should not be able to access the small companies regime.

Question 21: Should the Government only exclude from the medium-sized company regime those public companies whose securities are traded on a regulated market? *(Para 8.26)*

☐ Yes x☐ 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)?

See response to Q19.

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)*

x☐ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

But see response to Q20. The same principles should apply for small and medium-sized companies and groups.

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 x☐ No ☐ Not sure

Please provide information in support of your answer:

The Companies Act 2006 currently distinguishes between quoted and unquoted companies, principally quoted companies are required to prepare an extended strategic report and directors' remuneration report. In addition, as the question notes, the exemptions available to dormant subsidiaries supported by an EEA parent guarantee do not apply to quoted companies. However, in other places, the Companies Act 2006 distinguishes between companies with securities admitted to trading on a regulated market and other companies (e.g. in respect of preparation of corporate governance statements, section 400 and section 401 group accounts exemptions etc.) It is difficult to understand the rationale for this. We would encourage BIS to consider carefully what is the key distinction between companies that should be drawn for different purposes.

We note that Article 40 restricts the availability of exemptions to PIEs (unless expressly provided for in the Directive). This may mean that the dormant subsidiary accounting exemptions (where the subsidiary has a parent company guarantee) are not available to a PIE, e.g. a company with securities admitted to trading on a regulated market. We consider that neither quoted companies, nor companies with securities admitted to trading on a regulated market, should qualify for the exemptions available for dormant subsidiary companies supported by an EEA parent guarantee (which extend to preparation, filing and audit of the financial statements).

In practice, we suspect that few dormant subsidiaries supported by a parent guarantee would be quoted companies or companies with securities admitted to trading on a regulated market. In any event, market rules may well require preparation and dissemination of audited financial statements

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 x☐ No ☐ Not sure

Please provide any information in support of your answer:

Dormant subsidiaries supported by an EEA parent guarantee are not currently excluded from the exemptions from preparation of, filing of and audit of financial statements on the grounds of being a member of an ineligible group. In addition, dormant companies are not excluded from the audit exemption available in section 480 of the Companies Act 2006 on the grounds that they are a member of an ineligible group.

We do not support restricting the use of the dormant company accounting exemptions on the grounds that the dormant company is a member of an ineligible group, particularly as group accounts of the EEA parent in which the dormant subsidiary is consolidated will be available.

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)*

x☐ 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.

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

x☐ Yes ☐ No ☐ Not sure

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

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

We consider there should be more flexibility over layouts provided for in the Regulations. In particular, this might facilitate formats closer to the requirements of IAS 1 which may be favoured by FRS 101 reporters (e.g. if reporting under IFRS for group reporting).

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)*

x☐ Yes IN REGULATIONS ☐ No ☐ Not sure

Please provide information in support of your answer:

The Regulations would need to provide for the flexibility included in Articles 11 and 13.2 of the Directive. We do not support the Regulations setting out additional layouts or providing sector specific layouts.

However, we would support the inclusion in accounting standards of guidance on formats consistent with the Regulations (including guidance on what might be viewed as 'at least equivalent to that otherwise to be provided in accordance with Annexes III and IV' (i.e. the prescribed formats) (Articles 11 and 13.2). This would help preparers understand the boundaries, and in particular, whether IAS 1 compliant formats would be regarded as 'equivalent'. Sector specific layouts recommended are best left to relevant SORPs.

We note that the FRC have recently finalised XBRL taxonomies suitable for IFRS, FRS 101 and FRS 102 financial statements and therefore may be best placed to consider whether the implementation of more flexible formats would impact these taxonomies.

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)*

x☐ Yes ☐ No ☐ Not sure

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

In light of the recent amendment to IAS 27 (subject to EU endorsement) to permit use of the equity method in separate financial statements, we agree that companies legislation should *allow participating interests to be accounted for using the equity method in individual company financial statements.*

IFRS distinguishes between separate financial statements prepared by a parent, an investor or venturer (in accordance with IAS 27) and individual financial statements prepared by an investor or venturer (in accordance with IAS 28). Until the recent amendment to IAS 27, investments in a subsidiary, associate or joint venture were carried at either cost or at fair value in separate financial statements. Unless an exemption applies, individual financial statements prepared in accordance with IAS 28 generally require use of the equity method in accounting for investments in joint ventures and associates. IFRS reporters which only have investments in associates or joint ventures, unless they meet certain conditions, are not permitted to prepare separate financial statements as their only accounts. Tech 02/10 para 10.3-10.4 notes that it is unclear whether 'IAS individual accounts' are required to be prepared as separate financial statements or as individual financial statements in accordance with IAS 28 (and the then IAS 31). However, the amendment to IAS 27 would enable the accounting in separate financial statements and individual financial statements to be aligned. The Regulations apply to UK companies preparing FRS 101 financial statements but do not allow investments in associates or joint ventures to be carried using the equity method in individual accounts. Including the option to account for participating interests using the equity method in the Regulations would align the accounting in FRS 101 financial statements with IFRS.

We note that Tech 02/10 para.10.6 addresses the implications for realised profits where the equity method is applied in individual accounts. Therefore, we do not consider it would be necessary to take up the options in Article 9.7(b) to restrict the amount of profit or loss recognised to the dividends received or payment of which can be claimed. To do so, would mean the advantages of aligning the accounting in individual and group accounts would be lost. It appears that Article 9.7(c) requires any difference between the profit attributable to the participating interest recognised in profit or loss and the dividends received or payment of which can be claimed to be recognised in a non-distributable reserve in any case.

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)*

x☐ 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:

Any maximum limit is inevitably arbitrary. However, some companies that determine that they cannot reliably estimate the life of goodwill may nevertheless be confident that it has a life in excess of 5 years. A maximum life of 10 years rather than 5 years is therefore less restrictive and we cannot see a good reason not to align the maximum limit with that set out in the Directive.

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)*

x☐ 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)*

x☐ 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:

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 x☐ No ☐ Not sure

Please provide information in support of your answer:

We consider that the size thresholds for audit exemption purposes should be aligned with the thresholds for the small companies regime for accounting purposes. The changes made in 2012 to align these introduced welcome simplicity in this area.

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 x☐ No ☐ Not sure

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

See our response to Q19. We consider that the exclusions should be consistent for the purposes of the small companies audit exemption and accounting exemptions, unless there is a good reason.

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)*

x☐ Yes BUT SEE COMMENTS BELOW ☐ No ☐ Not sure

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

We consider that the exclusions should be consistent for the purposes of the small companies audit exemption and accounting exemptions, unless there is a good reason.

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)*

x☐ Yes x☐ No ☐ Not sure

Please provide information in support of your answer:

We have answered both 'yes' and 'no', since we believe that both types of companies should be excluded.

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 x☐ No ☐ Not sure

Please provide information in support of your answer:

There is no restriction placed on members of an ineligible group at present and this audit exemption is likely to be used by many groups that would include excluded companies. The nature of the audit exemption for subsidiaries supported by a parent guarantee differs to that for small companies and we see no reason to introduce this as a restriction.

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)*

x☐ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

We believe that this question is referring to the section 480 dormant company audit exemption.

In our view, dormant companies with securities admitted to trading on a regulated market should be excluded from this audit exemption (consistent with BIS's proposals in relation to the small companies audit exemption). We note that this may, in any case, be required by Article 40, which restricts the availability of exemptions to PIEs (unless expressly provided for in the Directive). There may be merit in further extending the exclusion to dormant companies that are public companies for the same reasons as discussed in our response to Q19.

However, we note that few publicly traded companies will be audit-exempt in practice, as they will likely either not meet the remaining criteria for use of the dormant company audit exemption (such as preparation of group accounts) or an audit will be required by market rules.

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 x☐ No ☐ Not sure

Please provide information in support of your answer:

This is not a current exclusion from use of the section 480 dormant company audit exemption, although a company that is ineligible itself (other than a public company) would be excluded. We see no reason to exclude dormant companies from the audit exemption on those grounds.

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)*

x☐ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

We agree that the changes in the Audit Directive on the wording of the auditor’s report, which clarify that the new opinion and statement is based on the work undertaken in the course of the audit, should be implemented at the same time as related changes on the wording of the auditor’s report in the Accounting Directive. The Audit Directive clarifies the scope of the work required which otherwise could be a significant extension of auditor responsibility.

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)*

x☐ Yes ☐ No ☐ Not sure

Please provide information in support of your answer:

Article 28 of the Audit Directive relates to the content of the audit report, we consider that this should be implemented at the same time as the changes made by the Accounting Directive.

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

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

x☐ Yes BUT SEE COMMENTS BELOW ☐ No ☐ Not sure

The current regulations only require details of auditors' remuneration for the audit of the accounts to be given by medium-sized companies in their financial statements. However, we agree that disclosure of fees paid to auditors of medium-sized companies for non-audit services is not required. However, we consider that companies that meet the medium-sized limits but are excluded from the medium-sized company exemptions for accounting purposes, should also disclose the fees paid to their auditor for non-audit services.

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?

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 x☐ 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?

See our responses to Q19 and Q21. The requirements to disclose fees paid to the auditor for non-audit services should be aligned with the same PIE definition used for the small and medium-sized company exemptions for accounting purposes.

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)*

x☐ Yes BUT SEE COMMENTS BELOW ☐ 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?

See our responses to Q20, Q22 and Q38. Companies excluded from the small and medium-sized company exemptions for accounting purposes should also disclose the fees paid to their auditor for non-audit services. Note that we consider that a company that is a PIE or a parent of a PIE (as applied in the UK) should be excluded but we are not convinced that a company that is a subsidiary of or a fellow subsidiary of a public company should be excluded.

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)*

x☐ Yes ☐ No ☐ Not sure

Please provide information in support of your response:

See our response to Q39 and Q40. The same exclusions should be applied as for the small and medium-sized accounting exemptions. Information on non-audit services is of public interest where a company is a PIE or a parent of a PIE, and this information could otherwise be lost.

Where group accounts are prepared by a UK parent undertaking that provide the information on non-audit fees on a consolidated basis, SI 2008/489 exempts the individual accounts of the parent company or subsidiary companies included in those group accounts from disclosing fees for non-audit services (but use of the exemption must be stated).

We consider that companies that are excluded from the small and medium-sized accounting exemptions should continue to report full information on non-audit services, unless they make use of the disclosure exemption available in individual accounts described above. Otherwise, relevant information may not be publicly reported.

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)*

x☐ a ☐ b ☐ Not sure

Please provide information in support of your response:

As noted in our response to Q40, where group accounts are prepared by a UK parent undertaking that provides the information on auditors' remuneration for non-audit fees on a consolidated basis, the individual accounts of the parent company or subsidiary companies are exempt from disclosing fees for non-audit services. However, the group accounts only disclose information about remuneration of the parent's auditor (and its associates) and so the exemption should not be available where the auditor is not the group auditor. For the avoidance of doubt, we do not consider that small and medium-sized companies (that are not excluded from the accounting exemptions) are, or should be, required to provide information on non-audit fees (see our response to Q37).

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)*

x☐ Yes ☐ No ☐ Not sure

Please provide information in support of your view:

While we consider that the SORP and other resources available on the Charities Commission website provide good quality information on the reporting requirements for charitable companies, we can see merit in clarifying the above matter in the regulations.

Question 43: Do you agree that the current flexibility in presentation of financial statements of charities, in particular the requirement for an income and expenditure account and to adapt the arrangement, headings and sub-heading of financial statements to reflect the special nature of the company's activities, should be retained? *(Para 10.7)*

x☐ Yes ☐ No ☐ Not sure

Please provide information in support of your view:

We agree this flexibility is necessary in order for charitable companies to report income and expenses in a manner more appropriate to their activities than the formats would require if they could not be modified.

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

x☐ Yes ☐ No ☐ Not sure

Please provide information in support of your view:

We agree that the approach of assessing the small size criteria based on gross income is more appropriate than net turnover for charities, given the significance of grants, donations and investment income. However, we note that this is how the current reference to net turnover is interpreted in the SORP 2008. See our response to Q9.

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 ☐x

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?

x☐ Yes ☐ No

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