Association of Accounting Technicians response to Department for Business Innovation and Skills (BIS) consultation paper on De-regulatory changes for Limited Liability Partnerships (LLPs) and Qualifying Partnerships

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1. Introduction

1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the consultation paper De-regulatory changes for Limited Liability Partnerships (LLPs) and Qualifying Partnerships published by the Department for Business Innovation and Skills (BIS) on 20 November 2015.

1.2. AAT is submitting this response on behalf of our membership and from the wider public benefit of achieving sound and effective financial reporting for corporate and other entities.

1.3. AAT has added comment in order to add value or highlight aspects that need to be considered further.

1.4. AAT has focussed on the key issues in the public interest in allowing certain LLPs and Qualifying Partnerships (QPs) to produce very truncated annual accounts, as well as the significant issues of protecting the public where such entities may not be audited.

1.5. The comments reflect the potential impact that the proposed changes would have on SMEs and micro-entities, many of which employ AAT members or would be represented by our operationally skilled members in practice.

2. Executive summary

2.1. AAT has in previous responses to BIS and the FRC expressed reservations about the introduction of the micro entities regime. Micro entity accounts are deemed to give a true and fair view and yet, with the severely limited disclosures they include, it is unlikely that a third party user will actually be able to understand the financial position and performance of an entity. There are, and ought to be, obligations that accompany limited liability in terms of the disclosures required to be made, particularly to third party users such as potential trade creditors in filed accounts, so they understand the risks they take on in trading with the entity. This applies to LLPs and QPs just as much as limited liability companies.

2.2. AAT has also pointed out that, due to the prevalence of standardised computer software for accounts preparation, the extent of cost saving for allowing severely curtailed disclosure regimes will be limited given that the relevant inputs must be prepared for the primary statement numbers and proper accounting records must always be kept. Moreover, if users want more information, for example a bank wanting fuller accounts before it extends credit, the entity is likely to have to prepare more extensive accounts anyway. In addition, failure to align the needs of HMRC to the regime will also mean that cost savings are limited.

2.3. These reservations are not quite so serious for small company accounts, where the directors must still consider whether they need to provide more information in order to show a true and fair view, but AAT's fear is that most companies will fail to do so and simply stick to the minimum requirements, particularly as the micro entity "deemed true and fair" approach has fundamentally undermined what ought to be the key central concept in financial reporting, a concern that was expressed by many in the responses to the original BIS consultation "Simpler Financial Reporting for Micro-entities"[1].

2.4. AAT nevertheless reluctantly agrees that it is right to keep the LLP (and QP) regime aligned with the private company regime for accounting, not least to deal with groups that have small or micro LLPs as well as small or micro companies; it will otherwise cause mismatches in accounting between different types of entity within the same group and cause additional cost and complexity in terms of understanding different accounting regimes and needing different software packages.

2.5. In relation to audit, which is also addressed in this consultation, although not properly or directly in terms of questions raised, AAT reiterates its comments made in response to previous consultations in relation to small companies[2] that AAT believes the limits for small company accounting and audit should be decoupled as they relate to completely different purposes. By attempting to keep the limits aligned, the government is confusing two objectives and is running the risk of seriously prejudicing those relying on accounts which may be both unaudited and prepared without proper trained accounting involvement.

2.6. In AAT's view, insufficient research has been carried out on the effect of a lack of mandatory audit requirement at the small company level and this work should be carried out, perhaps by the FRC, before any further decision is made to move the limits to the much higher ones now introduced for small company accounts. This applies to both small companies and LLPs (and QPs). In particular, the FRC should investigate the level of voluntary audits in the small company market; the reason such audits are requested; and the extent to which unaudited small companies produce substandard accounts or even ultimately fail compared to those that are audited. Only when such work is carried out will there be a basis for considering whether it is right to further raise the thresholds for audit. As with proper disclosure of financial position, in most contexts an audit should be seen as part of the cost of limited liability.

2.7. AAT has suggested in our responses to previous consultations, particularly to the BIS document "Auditor regulation: effects of the EU and wider reforms"[3] that, in particular where companies have some form of public interest element (not merely those already barred from the audit exemption option under the law), the threshold for involvement of qualified accountants in their preparation (including some limited assurance procedures) should be required to protect the public interest if the exemption limit is raised in line with the accounts limits from small companies. Otherwise, the limits should be set much lower and AAT has cited the charity sector where this is the case. If a full audit is required down to turnover of £500,000 where there is no involvement of an independent and professionally qualified accountant, this would provide a greater protection for those involved with such a company and may be more proportionate than a blanket approach dependent on size criteria only.

[1] See section 4 of https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/237045/bis-13-1124-simpler-financial-reporting-for-micro-entities.pdf
[2] BIS Consultation on audit exemptions and change of accounting framework
[3] https://www.aat.org.uk/sites/default/files/assets/AAT_Response_to_Auditor_regulation_effect_of_the_EU_and_wider_reforms.pdf

3. AAT response to the BIS consultation paper De-regulatory changes for Limited Liability Partnerships (LLPs) and Qualifying Partnerships

3.1. The following paragraphs outline AAT's response to the proposals outlined in the consultation paper. AAT has only listed those sections/questions where it has a comment to make.

Question 1:
Do you agree that the Government should maintain the alignment between the accounting and audit regulatory frameworks for LLPs and limited companies as implemented by the 2015 Regulations?

3.2. AAT does not believe the new micro and small company regimes are necessarily fit for purpose in the context of the overriding requirement for true and fair accounts to be produced in the public interest, as noted in our major comments above. Nevertheless, AAT accepts that practically there ought to be no difference between LLPs and companies in respect of the accounting, and therefore agrees they should continue to be aligned.

3.3. If such an alignment is to be made, it ought to be done as soon as possible as otherwise there will be a period of misalignment that will be a burden to business. It is unfortunate that the changes are being proposed so late and it will only be possible for them to be applied early, for 2015 year ends, if BIS has finalised and laid them by April 2016. Filing deadlines will otherwise make it impossible for LLPs to move in time to the new regime for 2015 year ends.

Question 2:
What opportunities or challenges do you feel maintaining the reporting alignment between LLPs and limited companies will present for preparers and users of accounts? For example, you may wish to comment on any line items that should be retained if small LLPs have the choice of preparing an abridged balance sheet and profit and loss account where this has been agreed by all members of the LLP.

3.4. In AAT's view abridged accounts do not serve any purpose as they fail to provide sufficient information to be of any value to relevant stakeholders. AAT accepts that there is protection in that it requires all members to agree to abridged accounts being produced, but that still runs the risk of disadvantaging external users, including creditors. As they are permitted for small companies, however, AAT does not see any reason why LLPs should not have the same facility.

Question 3:
It is anticipated that the regulations will come into force in the summer of 2016. Would LLPs and Qualifying Partnerships find it helpful if the regulations permitted early adoption of the revised framework for financial years commencing on or after 1 January 2015 where these had not been agreed prior to the regulations coming into force?

3.5. Yes. It is important that early adoption of the revised LLP regulations should be available for financial years commencing on or after 1 January 2015 as this will considerably aid groups that include both companies and LLPs, where companies within the group are choosing to early adopt the changes to UK company law. For example, to take advantage for the revised small company thresholds and revised small companies regime.

3.6. It is therefore of some concern that BIS only 'anticipates' that the updated regulations will be made by the 'summer of 2016'. Updated regulations issued as late as August or September 2016 would make it impossible for LLPs (particularly those with a 31 December year-end) to plan properly for preparation of their 2015 accounts and to use the new requirements. AAT therefore suggests that it is vital that the LLP Regulations are issued in draft as soon as possible in 2016 and ideally passed into law by April 2016.

Question 4:
Do you agree that the Government should introduce a micro-entity regime for LLPs which will allow LLPs that meet the eligibility criteria to access a less burdensome regulatory and administrative regime than the small LLPs?

3.7. Yes. As noted above, AAT has previously expressed serious concerns over the micro-entities regime and its appropriateness for limited liability companies. AAT acknowledges that it is now established in UK company law. Therefore, as the LLP accounting framework normally follows company law AAT does not object to the micro-entities regime now being extended to LLPs.

3.8. AAT strongly encourages BIS to monitor carefully the micro-entities regime over time to assess the effect on those entities adopting the regime, for example, in relation to access to credit, and to consider whether creditors who trade with such a company can obtain sufficient information to protect themselves when limited liability of the company or LLP may restrict their access to resources beyond the entity and expose them to loss.

Question 5:
Do you agree that the Government should introduce a micro-entity regime for Qualifying Partnerships which will allow Qualifying Partnerships that meet the eligibility criteria to access a less burdensome regulatory and administrative regime than small Qualifying Partnerships?

3.9. See the response given to Question 4 (3.7 – 3.8, above)

Question 6:
Do you agree that all LLPs that have transferable securities admitted to trading on a regulated market in an EEA State should be required to file an audit report in respect of their accounts?

3.10. Yes, not least because market regulators would require it anyway. This is a matter for securities law, not just company law.

3.11. It is not helpful, however, that this is the only question BIS has asked in relation to audit. As noted above, AAT does not believe that the limits for small companies or LLPs to take the exemption from audit should remained aligned to those for accounts derogations.

3.12. As noted on AAT's response to BIS's consultation "Auditor regulation: effects of the EU and wider reforms"[4]:

"3.7. At present, exemption from audit is available to entities of a substantial size leaving users of their financial statements, particularly suppliers and lenders, with uncertainties

[4] https://www.aat.org.uk/sites/default/files/assets/AAT_Response_to_Auditor_regulation_effect_of_the_EU_and_wider_reforms.pdf

as to whether the financial statements reflect any bias or imprudent subjectivity in their preparation, or whether they have been subjected to any independent scrutiny.

3.8. On the other hand, the regulatory requirements imposed on auditors are so demanding as to require the application of administration and technical procedures, together with experience levels, which necessitate both dedicated specialisms of audit staff and a minimum cost of audit irrespective of size of the entity subject to audit.

3.9. AAT considers that this dichotomy could be addressed by way of a compromise approach to the problem. Entities which are currently exempt from audit on the basis from being below the size threshold should be required to have their financial statements prepared by an independent firm of accountants with a recognised professional qualification and regulated by a professional body who would confirm the basis of preparation and limitations as regards reliance on the reported results and financial position. In this way the independent firm will be responsible for making judgement as regards the application of prudence in particular and for providing users with sufficient information to understand the risks attaching to the financial entitlements especially as regards significant matters of judgement, uncertainty and bias. All financial statements prepared internally by the entity itself or by other unregulated persons should be subject to audit whatever the size other than perhaps a de-minimus exemptions level of say, turnover below £500,000 to match that for the statutory audit of charities."

Question 7:
What one-off or recurring costs and benefits to LLPs, do you see arising from updating the reporting regime for LLPs? Please describe and if possible provide evidence of the scale of the identified costs and benefits.

3.13. The costs associated with the change would include updating systems and software, and some initial training for preparers. The main benefits will be an ability to align accounting framework for groups that include companies and LLPs, producing similar rules for different types of entity, and this is likely to reduce training costs in the long-run. However, there may be significant costs arising for external users of the accounts of the LLPs using the small entity and particularly the micro regime in terms of their inability to gain all their information needs and this will be more of a problem for those with no power to obtain additional information. For those, such as banks providing finance, who will certainly insist on more detailed accounts, the instances when this occurs will obviously undermine any cost reductions arising from limiting the information required to be included in the statutory accounts. This situation is exacerbated by the fact that, under the BIS proposals, these entities will not be audited (see further below) and hence external users will not be able to have confidence in the figures filed.

Question 8:
How will your organisation familiarise itself with the update of the LLP reporting regime and the introduction of a micro- entity regime for LLPs and Qualifying Partnerships? Please provide details of who will be involved, how long you expect this task will take them and data on pay levels of those involved (if possible).

3.14. As a member representative body AAT would expect to produce material to aid familiarisation for AAT members with the update to the regimes.

3.15. AAT has no further information it wishes to share in relation to this question.

Question 9:
What impact do you believe the reduction in the number of mandatory notes for small LLPs will have on your organisation? Please describe and (if possible) provide evidence of the size of this impact.

3.16. The number of mandatory notes for small LLPs will not have an impact on AAT as an organisation in itself. However, it may have an impact on members who work for small LLPs or our practising members who provide accounting services to LLPs. While AAT accepts that BIS has limited flexibility with regards to the number of mandatory notes that can be required by law in small company accounts, this does not apply to LLPs. As the limited disclosure requirements set out in law and standards have major implications for the responsibility of directors to ensure that accounts show a true and fair view, it is not clear that BIS should feel constrained by the same principle in the case of LLPs.

3.17. There are, however, benefits in aligning the LLP Regulations with the revised accounting framework for companies. On balance, AAT believes that the LLP Regulations should be updated to reflect a reduction in mandatory notes required for small LLPs.

3.18. As noted above, AAT strongly urges BIS to monitor carefully the effects of the revised regime, particularly in terms of the quality of financial statements produced by small companies and LLPs.

Question 10:
If you are an LLP, do you believe your organisation would be likely to take advantage of the flexibility to prepare an abridged balance sheet and an abridged profit and loss account?

3.19. On the basis that AAT is not an LLP it declines to make comment in respect of question 10.

Question 11:
What one-off or recurring costs and benefits do you see arising from a micro-entity accounting regime for LLPs and Qualifying Partnerships? Please describe the costs and benefits to these entities and others, and if possible provide evidence of the size of the identified costs and benefits.

3.20. See AAT's answer to Question 7 (3.13, above). Undoubtedly the downsides will be even greater for users of micro-LLP accounts, as the information in filed accounts will be useless in making any judgement about the performance, financial position or credit-worthiness of the LLP.

Question 12:
What proportion of eligible LLPs and Qualifying Partnerships would you expect to take advantage of the micro-entity regime? Please provide supporting evidence for your view.

3.21. AAT has no evidence to offer in respect to question 12.

4. Conclusion

4.1. The introduction of much higher threshold limits for reduced disclosure accounts for small companies and potentially now LLPs is being framed as deregulatory, but AAT has serious concerns that the resulting accounts as filed at Companies House are fit for purpose.

4.2. These concerns are intensified for micro-entities, where the deemed true and fair view now allowed in company law has seriously undermined and prejudiced the gold standard "true and fair" concept.

4.3. In AAT's view, at some point abuse of the proposed regime could lead to serious loss for shareholders and creditors, at a time when the government is calling on businesses to be more transparent, ethical and honest.

4.4. AAT also takes the view that aligning the thresholds for accounts and audit for small companies is not prudent, where the purpose of allowing derogations is very different in each case.

4.5. There is a need for more research to be carried out across different types and sizes of entity and their users before allowing companies or LLPs as large as those with £10.2m turnover to be exempt from audit. In particular, and even allowing for the fact that some types of entity are already unable to exempt themselves from audit even if small, it may be that the criteria from exemption should be much more focused on the type and number of shareholders and other stakeholders in a company or LLP, not just its size. Much may be learned from the more nuanced but more conservative approach taken with charities, with lower thresholds in relation to audit, but also with the possibility of other forms of assurance. Further work is required before the thresholds are raised for audit, for both companies and LLPs.

5. About AAT

5.1. AAT is a professional accountancy body with over 49,500 full and fellow members[5] and 80,400 student and affiliate members worldwide. Of the full and fellow members, there are over 4,200 members in practice who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.

5.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

6. Further information

If you have any questions or would like to discuss any of the points in more detail then please contact AAT at:

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[5] Figures correct as at 30 Sept 2015