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A closer look
UK Implementation of the EU Accounting Directive

Overview

A new Accounting Directive became law in the European Union (EU) in 2013 and was implemented in the UK by The Companies, Partnership and Groups (Accounts and Reports) Regulations 2015 (SI 2015/980) (the '2015 Regulations'). The 2015 Regulations amend the key components of the UK legal framework for a company's annual report and accounts, namely:

- the Companies Act 2006 ('CA 2006');
- the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409) (the 'Small Company Accounting Regulations'); and
- the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410) (the 'Accounting Regulations').

All companies that are required by law to prepare accounts will be affected by the changes made in 2015.

Many of the changes to the Accounting Regulations and Small Company Accounting Regulations are relevant only to companies that prepare their accounts under UK GAAP ('Companies Act' accounts). When a company prepares its accounts in accordance with International Financial Reporting Standards (IFRSs) adopted by the EU, the changes to legal requirements on the form and content of accounts will not usually be relevant as the detailed UK legal requirements do not apply to such accounts. However, some changes will affect the form and content of accounts, even where they are prepared under IFRSs.

Most companies applying UK GAAP other than micro companies will apply FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland.* However, some companies, for example subsidiaries of a parent that prepares IFRS group accounts, may instead opt to apply FRS 101 *Reduced Disclosure Framework,* which is a standard that permits individual accounts to be prepared largely in accordance with IFRSs as adopted by the EU, but with reduced disclosures. FRS 101 accounts are nevertheless UK GAAP accounts and need to comply with the Accounting Regulations as applicable to Companies Act accounts.

Although the most significant changes are likely to affect small companies (including whether they qualify based on size), some changes will affect large and medium-sized companies.

This publication addresses the significant changes and how they will affect companies of different sizes. The law relating to accounts of micro companies is largely unchanged and such companies are not addressed in detail in this publication. In addition, the changes affecting accounts of banks and insurance companies are not addressed in this publication.

The main changes

The main changes to UK legal requirements for accounts and audit are:

- the option to file full disclosures of related undertakings such as subsidiaries and other significant investments in the annual return was abolished for accounts approved by directors on or after 1 July 2015, and all required disclosures must now be in the accounts;
- disclosures for large and medium-sized companies about their subsidiaries and other significant investments are expanded to include the address of the registered office of all such entities, whether inside or outside the UK (note that small companies not producing group accounts don't have to give these disclosures at all as a result of the 2015 Regulations);
- auditors have new reporting responsibilities in relation to the directors' report and strategic report;
- the maximum useful life of goodwill and intangible assets in exceptional cases where no reliable estimate of life is possible is set at ten years;
- small company accounting size limits are raised substantially. The new limits also apply to audit exemption (although early adoption is not permitted for this purpose);
- the scope of small company exemptions is widened meaning that some companies that were previously ineligible will become entitled to exemptions;
- small company accounts disclosure requirements are simplified significantly; and
- abbreviated accounts are abolished although small companies will be able to prepare 'abridged' accounts for shareholders and for filing at Companies House. Filing exemptions remain available.

The changes made by the 2015 Regulations do not extend to LLPs. Separate legislation making similar changes in relation to LLPs is expected during 2016.

Effective date

The legal changes are generally effective for financial years beginning on 1 January 2016, although early adoption of most aspects is permitted for financial years beginning on or after 1 January 2015. There are two exceptions to these dates:

- the increased small company size limits cannot be adopted early for audit exemption, meaning that a company may be 'small' for accounting purposes in 2015 but not entitled to the small companies audit exemption until 2016; and
- the requirement for a company to disclose a full list of subsidiaries and other related undertakings in the annual report became effective for accounts approved on or after 1 July 2015, although further disclosure changes apply from 2016 for large and medium-sized companies. For small companies, related undertakings disclosures are abolished from 2016, or earlier if the 2015 Regulations are adopted early.

Determining company size

Determining a company's size is more complex than just referring to the revised size limits (see below) and selecting whichever is applicable. There are several different factors that mean companies that, for instance, would qualify as small based on size limits alone are excluded from being classified as small due to either the nature of the company or the group to which it belongs.

Once a company has established that it is not ineligible or part of an ineligible group, it should look to the size limits to determine whether it would qualify as either a small or medium-sized company.

Ineligible companies and groups

There are several circumstances which determine that a company is ineligible for all or most small or medium-sized company exemptions. An ineligible company includes any company that is a 'public company' (i.e. a plc), banks, insurance companies and some financial services companies. In addition, a company is not entitled to the majority of the small or medium-sized company exemptions if it is part of an 'ineligible group'. Prior to the changes made by the 2015 Regulations, ineligible groups included groups containing a plc.

Although the criteria for determining whether a company is eligible for the small or medium-sized company exemptions remain broadly the same, the changes made by the 2015 Regulations may mean that more companies become eligible for the exemptions. The 2015 Regulations introduce the term 'traded company'. A traded company is defined as 'a company any of whose transferable securities are admitted to trading on a regulated market.' The definition of an ineligible group is amended such that a group is no longer ineligible simply because it contains a plc but remains an ineligible group if it includes a traded company. In other respects, the definitions of ineligible companies and ineligible groups are unchanged.

The term 'traded company' covers a much narrower range of companies than public companies in general because it excludes unlisted public companies and companies whose securities are traded on alternative markets such as AIM, which are not EU-regulated markets.

An AIM company will itself be a plc and therefore remain an ineligible company, as will an unquoted plc. However, subsidiaries of an AIM company or an unquoted plc that are themselves private companies will no longer be part of an ineligible group for that reason alone and will therefore be eligible to qualify as either medium or small companies provided that they are not ineligible for any other reason. This therefore opens the door to accounting exemptions for many more subsidiary companies.

Companies will, however, still need to review carefully the eligibility criteria before taking advantage of exemptions and simplifications. Additionally, the benefits may be limited if the information is required for consolidation purposes.

Size limits

The 2015 Regulations increase the size limits for small and medium sized companies as shown in the table below:

	Small		Medium	
	Revised	**Previous**	**Revised**	**Previous**
Turnover	£10.2m	£6.5m	£36m	£25.9m
Balance sheet total	£5.1m	£3.26m	£18m	£12.9m
Number of employees	50	50	250	250

Balance sheet total means gross assets before any deductions for liabilities.

As previously, any two out of three size limits need to be met to qualify as small or medium-sized and, other than in the first year of incorporation, the limits need to be met for two consecutive years. Once a company has qualified, it does not lose that status until it has exceeded two out of three size limits for two consecutive years.

The size thresholds for groups have also changed – meaning that more parent companies may be able to take advantage of exemptions:

	Small (Gross*)		Medium (Gross*)	
	Revised	**Previous**	**Revised**	**Previous**
Turnover	£12.2m	£7.8m	£43.2m	£31.1m
Balance sheet total	£6.1m	£3.9m	£21.6m	£15.5m
Number of employees	50	50	250	250

*'Net' means with set-off and other adjustments required by the Accounting Regulations (for UK GAAP accounts) or by IFRSs (for IFRS financial statements). 'Gross' means without those set-offs and other adjustments. A company may satisfy the relevant requirement on the basis of either the net or the gross figure. The 'net' size limits for a small or medium-sized group are the same as those for a small or medium-sized company in the table above. A group may meet any combination of net or gross figures and need not meet both sets of limits.

In general, a parent company qualifies as small or medium-sized only if it meets the company size limits individually and the group that it heads meets the group size limits.

Once the 2015 Regulations have been adopted by a company (either by early adoption or from 1 January 2016 onwards) the decision as to whether a company or group qualifies as small or medium-sized should be made as if the 2015 Regulations had always been in place.

The decision to adopt early

There are several potential benefits that companies might gain as a result of adopting these changes early. Some of the considerations for early adopting are as follows:

- companies intending to apply FRS 101 are likely to want to adopt early for flexibility to use IFRS formats for their accounts;
- small and medium-size company limits are raised substantially meaning that more companies will qualify for exemptions;
- companies that become small under the new regulations but were not previously so can avoid having to provide full disclosure under FRS 102 as applicable to larger entities for one year;
- private companies will no longer be ineligible for small company exemptions irrespective of their size solely because they are a member of a group containing a public company, unless there is a company in the group which has securities admitted to trading on an EU-regulated market. Public companies themselves remain ineligible. This change will open up small company exemptions to more companies;
- small companies will not be required to disclose a list of related undertakings once they have adopted the 2015 Regulations (unless they prepare group accounts); and
- the disclosure requirements for small companies are reduced as a result of the 2015 Regulations.

However, companies that decide to early adopt should be aware that the decision is an all or nothing choice and there may be some factors that they wish to consider before adopting the 2015 Regulations. Some items for considerations include:

- intermediate parent companies which are 90% or more owned will need to secure consent of all minority shareholders to take advantage of exemption from preparing group accounts on grounds of inclusion in the consolidated accounts of a larger group; and
- parent companies presenting group accounts will have to disclose their individual profit or loss for the year on the face of the balance sheet when they are taking the exemption from publishing their own profit and loss account.

All of these points are considered in more detail below.

Changes affecting all companies other than micro companies

A number of the changes brought in by the 2015 Regulations will affect the majority of companies – irrespective of size, other than micro companies. The exceptions that apply to micro companies are noted below.

Intangible assets and goodwill changes

The 2015 Regulations require that, in exceptional cases, where the useful life of intangible assets cannot be estimated reliably, the life must not exceed ten years. While this change has also been written into FRS 102 (changing from the current requirement for the useful life of intangible assets not to exceed five years if it cannot be estimated reliably) it is unlikely that the change in law or FRS 102 will have a significant impact on companies since this limit is only expected to be applied in exceptional cases.

The 2015 Regulations also prohibit the reversal of previously impaired goodwill. While this had been permitted under old UK GAAP and previous versions of FRS 102 in some circumstances, the new version of FRS 102 (effective from periods beginning on or after 1 January 2016 and available for early adoption) now also prohibits this.

Flexibility in account formats

The 2015 Regulations permit companies to use alternative formats to those set out in company law provided that they both give at least equivalent information to that which would otherwise have been included and that the presentation of those items is in accordance with generally accepted accounting principles or practice.

In practice, this means that companies adopting FRS 101 may elect to apply IAS 1 *Presentation of Financial Statements,* with minor adaptations, and those adopting FRS 102 will have the option to use an IFRS style layout and terminology for their profit and loss account and/or balance sheet as set out in that standard as revised in July 2015.

Profit and loss formats

The most significant changes to the profit and loss formats are the removal of the distinctions between ordinary and extraordinary items and the replacement of the term 'charges' with 'expenses' throughout the profit and loss statement. There is now a requirement to state any individual items of income or expenditure "which are of exceptional size or incidence". However, these changes are unlikely to have a practical impact since the use of extraordinary items was effectively prohibited by FRS 3 and that standard required disclosure of exceptional items.

Additionally, the 2015 Regulations have removed the option to prepare a profit and loss account under two of the previously permitted formats (3 & 4). This, however, is not expected to have a significant impact on companies since formats 3 and 4 were rarely used.

Balance sheet formats

Unlike the profit and loss formats, both of the existing balance sheet formats remain available for use. The changes to the balance sheet are minimal – the amendment of the 'other reserves' line item to 'other reserves, including the fair value reserve' for medium and large companies – and, in the rarely used Format 2, the amendment of the section heading 'Liabilities' to 'Capital, reserves and liabilities' for all companies (including micro companies).

Information in the accounts

The 2015 Regulations introduce a number of new and amended disclosure requirements. Here we note those changes and amendments that relate to all companies (including micro companies).

The changes to CA 2006 require that all companies must state in their own individual accounts:

- the part of the United Kingdom in which the company is registered;
- the company's registered number;
- whether the company is a public or private company and whether it is limited by shares or by guarantee;
- the address of the company's registered office; and
- where appropriate, the fact that the company is being wound-up.

Where group accounts are presented alongside individual parent accounts, the group accounts are also required to disclose the information above, although a single set of disclosures will meet this requirement.

In addition, the 2015 Regulations extend the original requirements of CA 2006 relating to the disclosure of directors' benefits so that information about any amounts written off or waived must be now disclosed. This is in respect to any advances and credit provided to directors.

The requirement to include a full listing of related undertakings within annual accounts

The 2015 Regulations removed the concession under s410 CA 2006 which allowed companies to list only their 'principal' subsidiaries and other significant holdings in their annual accounts and file a complete list with their annual return.

This change does not affect which entities need to provide such disclosures, nor their content. The only change is that the full list must now be included within the annual accounts. Note also that the list needs to be included within all annual accounts **approved by directors** on or after 1 July 2015 – this effective date is not in line with the rest of the 2015 Regulations.

A further change will come into force for periods commencing on or after 1 January 2016 whereby the address of the registered office of each subsidiary or significant holding must be given, even if it is in the UK.

The question as to which undertakings need to be included and what different sized companies need to disclose is a significant topic on its own which merits expanded commentary. 'A closer look' on this topic was recently published and can be accessed **here.**

Order of the notes

The 2015 Regulations include new requirements about the order in which the notes to the accounts must be presented. Essentially, they require the notes to be presented in corresponding order of presentation in the balance sheet and profit and loss account. This will not affect the order in which notes not directly related to those primary statements are presented – for instance notes in respect of accounting policies, contingent liabilities or off balance sheet arrangements.

This is expected to have an impact mostly on those reporting under FRS 101, since the IASB has been encouraging greater flexibility in the structure of notes in accounts through its disclosures initiative project.

Individual profit and loss account in group accounts

Under the 2015 Regulations a parent company may only take advantage of the exemption from publishing its own profit and loss account when presenting group accounts if the profit or loss for the year is shown on the face of its individual balance sheet (as opposed to only needing disclosure in the notes previously). This could also be in the form of a footnote on the balance sheet.

In addition, a parent company taking this exemption will be required to disclose information about its individual employee numbers and cost in its notes.

Alternative and fair value accounting rules

Another change affecting companies (other than micro companies) is the removal of the measurement of stocks and current asset investments at current cost from the alternative accounting rules. Current asset investments do, however, remain within the scope of the fair value accounting rules. Additionally, the regulations have changed so that stocks can now be measured under the fair value accounting rules with movements in fair value included in the profit and loss account.

While the 2015 Regulations have changed to allow the measurement of stock at fair value, FRS 102 is more restrictive as it only permits stock to be valued at fair value less costs to sell through profit or loss at each reporting date in circumstances where it is 'a more relevant measure of the entity's performance', i.e. there is an active market with published prices and the inventory is readily realisable. However, this is not common in practice.

Group accounts

The 2015 Regulations bring in a number of regulations specifically in relation to group accounts. The most significant is that the conditions for merger accounting have been revised. The 2015 Regulations state that the undertaking whose shares are acquired must be ultimately controlled by the same party both before and after acquisition and that that control is not transitory. When a company has applied merger accounting, additional disclosures are required covering the registered office address of the subsidiary that has joined the group and any consolidation difference eliminated in reserves.

> The effect of this change in the law is limited because the use of merger accounting for "true mergers" is already prohibited by FRS 102. However, the law is still not completely aligned with the definition of a group reconstruction in FRS 102, so the use of the true and fair override of the law may still be required in some cases.

Wider scope of audit report

The 2015 Regulations amend the auditors' responsibilities relating to the scope of the audit report in relation to the directors' report and strategic report. The amended regulations require auditors to:

- state whether, in their opinion, based on the work undertaken in the course of the audit:
  - the information given in the strategic report (if any) and the directors' report is consistent with the accounts, and
  - any strategic report and the directors' report have been prepared in accordance with applicable legal requirements;
- state whether, in the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, they have identified material misstatements in the strategic report (if any) and the directors' report; and
- if applicable, give an indication of the nature of each of the misstatements identified.

Small company changes

Restrictions

Although a company may choose to adopt the 2015 Regulations early (i.e. prior to 1 January 2016), companies that are classified as small under the new regulations but not under the previous regulations cannot apply the new size limits early for the purpose of the small company audit exemption. In effect, this means that any company which is classified as small under the new regulations only (i.e. would not have been classified as small under the previous regulations) can, at the earliest, take an exemption from an audit for periods beginning on or after 1 January 2016.

Parent company exemption from preparing group accounts

As a result of the 2015 Regulations, a parent company can now take advantage of the exemption from preparing group accounts provided that it would be entitled to the small companies regime were it not for being a public company. This is also subject to the parent company not being a traded company as defined above. This widens

the scope of the exemption to include parent companies that are public companies but not traded companies. However, a parent company taking this exemption will still need to follow the large company accounting rules in its individual accounts.

Abridged accounts option

Abridged accounts omit the third, most detailed, level of balance sheet headings, which are otherwise most commonly included in the notes to the accounts, and combine some headings in the profit and loss account into a single heading 'Gross profit or loss'. Most notably, no turnover figure is shown in an abridged profit and loss account. If a company prepares abridged accounts, there will be no 'full' accounts for shareholders.

Where an individual company qualifies as small, the 2015 Regulations introduce an option for the directors of the company to prepare either an abridged balance sheet, an abridged profit and loss or both. In order to qualify for preparing abridged accounts, the new regulations require the consent of all shareholders for each set of accounts. This means that continuing authority is not permitted. Group accounts, if prepared, may not be abridged.

Changes to disclosure requirements

There are several changes to small company statutory disclosure requirements, in terms of both additional disclosures required and disclosures no longer needed. The new disclosure requirements cover the following areas:

- off balance sheet arrangements;
- post balance sheet events;
- details of related party transactions; and
- the average number of employees for the year.

The majority of these, with exception to the average number of employees for the year, are already required in accounting standards and therefore being formalised into UK law will not have a significant effect.

The significant statutory disclosure requirements deleted include:

- details of dividends, including the amounts paid in the year for which a liability did not previously exist, the amount the company is liable to pay at the balance sheet date and cumulative dividends in arrears;
- details of amounts set aside, withdrawn, or proposed to be set aside or withdrawn, from reserves;
- share capital including classes of share capital, nominal values and details of any redeemable shares;
- listed investments;
- information where investment property and living animals and plants are included at fair value;
- movements in reserves and provisions (except the revaluation and fair value reserve, which is still required);
- turnover attributable to geographical markets outside of the United Kingdom;
- the accounting policy on which sums of foreign denominated currencies have been translated into the currency of the accounts, although this would still be covered by the general requirement to disclose accounting policies;
- dormant companies acting as agents;
- information about related undertakings (unless voluntarily preparing group accounts); and
- information regarding directors' remuneration.

Although the requirement to include detailed information in respect of directors' remuneration has been deleted from the Small Company Accounting Regulations, there is a new requirement to disclose details of related party transactions that are not concluded under normal market conditions, including those with directors.

The amended statutory disclosure requirements for small companies are set out in the new Section 1A of FRS 102.

Additionally, the 2015 Regulations allow companies that qualify as small to be fully exempt from disclosing information regarding their related undertakings in their individual accounts. However, this exemption is only available once the new regulations have been adopted in full. Because the requirement to disclose a full list of related undertakings became effective for all accounts approved on or after 1 July 2015, it is likely that a number of small companies will be required to disclose a complete list of related undertakings in their annual accounts. This will be required until such a point as those companies have prepared their first set of accounts in accordance with the new regulations, and as such early adoption may appeal to companies that may be affected by this timing difference.

Filing of accounts

Small companies continue to be able to file only their balance sheet and related notes at Companies House and omit their profit and loss and directors' report from their Companies House filings. This applies whether the accounts are prepared under UK GAAP or IFRS.

Where a company that is subject to the small companies regime has taken advantage of the exemption not to file a profit and loss account at Companies House, the 2015 Regulations state that the audit report must not be filed. Instead, the company is required to do the following:

- disclose on the balance sheet that it has not delivered a profit and loss account;
- unless the company is exempt from audit and this has been taken advantage of, the notes to the balance sheet must state:
  - whether the audit report was qualified or unqualified;
  - where it was qualified, the basis of qualification;
  - where it was unqualified, whether any matters were referred to which the auditor drew attention to by way of emphasis; and
  - the name of the auditor and (where the auditor is a firm) the name of the person who signed the auditor's report as senior statutory auditor.

Changes that affect specific company types

Intermediate parent companies

The conditions for entitlement to exemption from preparing group accounts for non-wholly owned intermediate parent companies included in the accounts of a larger group have been amended by the 2015 Regulations. The change affects intermediate parent companies that are 90% or more owned within the larger group. Under the new rules, the remaining shareholders must all approve of the exemption. An intermediate parent in this situation will need to consider this change and, where necessary, prepare to obtain minority shareholder approval.

When the immediate parent of an intermediate parent company seeking to take exemption from preparing group accounts is incorporated outside the European Economic Area ('EEA'), the law relating to the required 'equivalence' of the higher parent's consolidated accounts has been clarified. The intermediate parent company seeking exemption from preparing group accounts must be included in consolidated accounts prepared in accordance with the EU Accounting Directive, EU-adopted IFRSs or in a manner equivalent to either of those. The 2015 Regulations explicitly acknowledge that accounts drawn up under equivalent GAAPs for the purposes of Transparency and Prospectus Directives (e.g. US GAAP) are considered equivalent for the purpose of this exemption, thus providing more certainty about the equivalence of those GAAPs, although the practical effect is limited because those GAAPs were already generally accepted as being equivalent.

Medium-sized companies

Although the size limits for medium-sized companies and groups have increased, this is of little practical relevance as abbreviated accounts for medium-sized companies have been abolished and there is no exemption from preparing group accounts. Minor disclosure exemptions remain available.

Dormant companies

A dormant company which meets the 2015 Regulations definition of a traded company (i.e. has any shares or debt traded on a regulated market) at any point in its financial year will not be allowed to take an exemption from filing dormant accounts, from preparing individual accounts or from having an audit. In practice the change is not expected to have an impact on many entities.

Limited liability partnerships

While the 2015 Regulations have no impact on LLPs, the UK Government is expected to introduce regulations that are equivalent to the changes made to UK company law in the future having issued a consultation in November 2015. The amendments made to FRS 102 will also apply to LLPs to the extent that they do not conflict with the current LLP regulations.

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