Need to know

Accounting, auditing and corporate governance – legal and regulatory changes arising from Brexit

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Under the European Union (Withdrawal) Act 2018 (EUWA 2018), the UK ceased to be a member of the EU on 31 January 2020 ('Exit day'). Under the withdrawal agreement, enacted in UK law by the European Union (Withdrawal Agreement) Act 2020 (WAA 2020), there is an implementation period, which ended on 'IP completion day', defined as 31 December 2020 at 11.00 p.m. UK time.

The EUWA 2018 gave the Government the power to amend or repeal both EU-derived domestic legislation and retained direct EU law if it was necessary to do so to make UK law function as intended once the UK has exited the EU and EU law ceases to apply in the UK. The government has made a number of such statutory instruments which affect the UK accounting, corporate reporting, auditing and corporate governance regimes.

- The government has enacted several Statutory Instruments (SIs) addressing the UK accounting, corporate reporting, auditing and corporate governance regimes.
- UK companies continue to have the choice, or be required, to adopt IFRS Standards, as relevant to their circumstances. However, from IP completion day, IFRS Standards for use in the UK need to be adopted by the UK rather by the EU, with a UK endorsement mechanism overseen by the Secretary of State and delegated to the UK Endorsement Board.
- The Companies Act 2006 has been amended to change references to the European Economic Area (EEA) to refer instead to the UK, affecting a variety of provisions including eligibility for the small companies regime and the availability of audit exemption for subsidiaries.
- These changes are generally effective for periods beginning on or after IP completion day, defined as 31 December 2020 at 11.00 p.m. UK time, but some changes may require more immediate thought or action.

For more information please see the following websites:

www.ukaccountingplus.co.uk

www.deloitte.co.uk

Background

The UK's accounting, corporate reporting, auditing and, to a lesser extent, corporate governance regimes have their roots in European law. In many cases these laws have been implemented by the Companies Act 2006 and related SIs (EU-derived domestic legislation); in some cases they are directly binding EU law. EU-derived domestic legislation continues to form part of UK law after IP completion day, while previously directly binding EU law which is not repealed under EUWA 2018 forms a new body of UK law described as "retained direct EU law".

This Need to know summarises the effect on corporate reporting of the complex changes made to the Companies Act 2006 (CA 2006), the Financial Services and Markets Act 2000 (FSMA 2000)-, retained direct EU law and related regulations and FCA rules.

The extent to which UK companies are affected by these changes will depend on the extent of their relationships with European parents and subsidiaries, where (if anywhere) their securities are traded, and the choices they have made previously.

Choice of accounting framework

Under the Companies Act 2006, companies have a choice of preparing 'Companies Act' accounts (i.e. under UK Financial Reporting Standards (FRSs)) or 'International Accounting Standards' accounts. Prior to the UK's exit from the EU, those companies with securities admitted to trading on an EEA regulated market were required to prepare their consolidated accounts under IFRS as adopted by the EU. 'IFRS as adopted by the EU' means those international standards adopted after an endorsement mechanism under the European IAS Regulation EC 1606/2002.

The *International Accounting Standards and European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2019* (SI 2019/685) repeal the provisions of the IAS Regulation so that it no longer applies to the UK. Via the EUWA 2018, EU-adopted IFRS is frozen as at IP completion day, which means that EU endorsement after that date no longer applies in the UK. The Regulations therefore introduce a new legal term 'UK-adopted international accounting standards' for IFRS as adopted by the UK. They also incorporate into the Companies Act 2006 the requirement for UK companies with securities admitted to trading on a UK regulated market to prepare their consolidated financial statements under IFRS as adopted by the UK for periods commencing on or after IP completion day.

Transitional provisions exist for companies whose year-end straddles IP completion day or whose year-end is before IP completion day but whose accounts are filed after IP completion day. These permit such companies to adopt any new IFRS standards or amendments that are endorsed by the UK after IP completion day in addition to 'frozen' IFRS as endorsed by the EU at IP completion day. The FRC has issued **guidance for affected companies** which sets out the rationale for this and recommended wording for the basis of preparation of such accounts. In particular there are further considerations for companies subject to the FCA's Disclosure Guidance and Transparency Rules (DTR).

The Regulations provide for a UK mechanism for the adoption of IFRS – this provides that endorsement will be by the Secretary of State but allows for delegation of this function. The government has established a **UK Endorsement Board** to perform this function. The UK endorsement mechanism envisages:

- Consultation as to whether a standard should be adopted – including with users and preparers of accounts, based on certain principles (not being contrary to the requirement to give a true and fair view; conducive to the long term public good; understandability, relevance, reliability and comparability of the financial information).
- The possibility of adopting a standard in part, although only in exceptional circumstances.
- A requirement to publish a decision as to whether to adopt a standard in whole, in part, to extend the scope of undertakings eligible to use an option in the standard or not to adopt the standard.
- A requirement to publish a consolidated text of IFRS as adopted by the UK on a website.
- A requirement to carry out a post-implementation review of any standard which is likely to lead to a significant change in accounting practice within five years of that standard first being applied.

Similar changes are made to the Building Societies Act 1986, the Friendly Societies Act 1992 and related regulations, and to the regulations which apply the Companies Act requirements to Limited Liability Partnerships (LLPs).

Changes to accounting and audit exemptions available to UK companies after Brexit

The Companies Act 2006 (and the equivalent provisions applicable to LLPs) contain a number of optional exemptions. In some cases these are not available to certain classes of entity. Many of these are changing (but without any substantive effect) because the underlying definitions refer to EU law but will now need to refer to UK law. These changes are made by the *Accounts and Reports (EU Exit) Regulations 2019 (SI 2019/145),* the *Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019* (SI 2019/177) and the *Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2020* (SI 2020/108). Some of the key changes are set out here, all of which apply for periods commencing on or after IP completion day.

1) **Audit exemption:** The exemption from audit (and, if also a dormant company, from preparing and filing accounts) for subsidiaries whose liabilities are guaranteed by an EEA incorporated parent will only be available where the guarantee is given by a UK incorporated parent.

2) **Group accounts exemption:** The exemption from preparation of group accounts on the grounds of consolidation into a larger group changes. The exemption in s400 of the Companies Act 2006 is narrowed to situations where the larger group is headed by a UK parent, and that in s401 is broadened to include all non-UK parents. In practice this is likely to have little initial effect; however, if in future IFRS as adopted in the EU diverges from IFRS as adopted in the UK the availability of this exemption may change.

3) **Small companies regime:** Some exemptions (adoption of the small companies regime (s384 of the Companies Act 2006), small groups not required to prepare consolidated financial statements (s399), medium-sized companies (s467)) rule out companies that are members of an ineligible group. Groups will no longer be ineligible if this had been solely because they contained a company with securities admitted to trading on an EEA regulated market (which now excludes the UK). This means that small subsidiaries of a parent listed in the EEA may now be able to take these exemptions.

4) **Non-financial information statement:** Large public interest entities must include a 'non-financial information statement' within their strategic report (s414CA) unless they are included within a consolidated non-financial information statement prepared by an EEA parent undertaking. For accounting periods commencing on or after IP completion day, this exemption will only be available to those entities with a UK parent that prepares a consolidated non-financial information statement.

5) **Political donations:** In the directors' report, the requirements to disclose information in respect of political donations and expenditure will change for accounting periods commencing on or after IP completion day. The detailed disclosures of individual donations and expenditure will be restricted to the UK (previously it applied throughout the EEA). Political donations and expenditure in the EEA will be included in a single worldwide aggregate figure.

Impacts on EEA incorporated subsidiaries of UK incorporated parent undertakings

There are indirect effects of the UK ceasing to be a 'member state' which apply immediately from IP completion day to companies incorporated elsewhere in the EEA:

- Subsidiaries that wish to rely on the audit, preparation and filing exemptions (if available in their member state) on the grounds of being consolidated into an EEA parent which guarantees their liabilities will no longer be able to rely on the UK parent to give such a guarantee. This may necessitate additional audits in those countries unless another holding company can be found to give such a guarantee.

- Subsidiaries which are in turn parent entities that rely on being included in a UK consolidation for their own exemption from preparation of consolidated financial statements will only be able to do so if their member state has taken the option to exempt subsidiaries of non-EEA parents – not all member states have.

- Subsidiaries which cannot take certain exemptions in their national law solely because they are included in a group with a UK financial institution may now be entitled to exemptions as those UK entities will no longer be EEA regulated entities.

- Large public interest entities reliant on a UK parent's non-financial information statement to exempt them from preparing their own will lose that exemption.

Changes to the accounting requirements for qualifying partnerships after Brexit

The *Partnerships (Accounts) Regulations 2008* require certain partnerships, known as qualifying partnerships, to prepare accounts unless they are exempt on the grounds that they are dealt with on a consolidated basis in the financial statements of an entity incorporated under the laws of an EEA member state. With immediate effect from IP completion day, the exemption is only available if the qualifying partnership is dealt with on a consolidated basis in the financial statements of a UK parent.

Impact on UK companies with a branch or place of business elsewhere within the EEA

UK companies with a branch or place of business in another EEA country will now count as a non-EEA company in that country. Under that EEA country's law there may be additional overseas companies filing requirements which cannot be met by simply filing the UK annual report and accounts.

Changes to the accounting requirements for overseas companies and those Societas Europaea with a registered office outside the UK which have a branch or place of business in the UK

The *Overseas Companies Regulations 2009* require overseas companies with a branch or place of business in the UK to file accounts in the UK. These regulations have two regimes:

- One for entities required to prepare, have audited and disclose accounts under their national law, who can simply file their national law accounts in the UK.

- One for entities that have no such requirement – for which more detailed requirements apply.

Prior to IP completion day, a company incorporated in an EEA state that was required by its parent law to prepare and disclose accounts could use those accounts to meet the UK filing requirement, even if it was not required by its parent law to have its accounts audited or deliver its accounts. With immediate effect from IP completion day, this is no longer the case.

This will have little effect for many such companies; but for small EEA companies with a UK branch additional disclosures may be required, and a profit and loss account will need to be filed even if it is not needed in the home state.

A Societas Europaea is a company treated as incorporated 'in Europe' – it adopts the company law requirements of the member state in which its registered office is located. Currently, if the registered office is not in the UK then no accounts need to be filed in the UK, even if it has a place of business or branch here. For financial years commencing on or after IP completion day, they will be treated like any other overseas company – requiring accounts to be filed in the UK if there is a branch or place of business here.

Changes relating to Societas Europaea with a registered office in the UK

The *European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2018* (SI 2018/1298) provide that a Societas Europaea with a registered office in the UK becomes a UK Societas on IP completion day. It will be subject to the normal UK Companies Act accounting, reporting and audit requirements applicable to a PLC.

Changes to audit committee and corporate governance exemptions

In the UK the statutory requirement to have an audit committee contained in Article 39 of the Audit Directive is dealt with in two places.

DTR 7.1 requires most issuers of securities admitted to trading on an EEA regulated market with the UK as their 'home state' to have an audit committee or equivalent body. This requirement changes in two ways for financial years:

- Firstly, with immediate effect from IP completion day, the rules apply to all entities admitted to trading on a UK regulated market; previously, if an entity was listed on more than one EEA regulated market, it may have designated another country as its 'home state' – and comply with that country's rules instead.
- Secondly, issuers that are subsidiaries of a parent undertaking that is in turn subject to Article 39 have previously been exempt. For periods commencing on or after IP completion day, this is narrowed to those with a parent subject to DTR 7.1 – i.e. with securities admitted to trading on a UK regulated market. This means that, for example, a UK listed debt issuer of a parent listed in the Netherlands will need a UK audit committee or equivalent body.

DTR 7.2 also previously required most issuers of securities admitted to trading on an EEA regulated market with the UK as their home state to make certain corporate governance disclosures. With immediate effect from IP completion day, these apply to all entities listed on a UK regulated market, regardless of their current 'home state'.

Cross-border listings

Impact on UK incorporated companies listed on a regulated market in another EEA country

The UK will no longer be treated as a 'member state' after IP completion day. This means that:

- Companies will need to adopt a GAAP that is 'equivalent' to IFRS as adopted by the EU. IFRS as adopted by the UK has not yet been determined to be equivalent. Until such time as it is, companies will (as long as it remains true) need to state compliance with both IFRS as adopted by the UK and either IFRS as issued by the IASB and/or as adopted by the EU.
- UK auditors will no longer be EEA auditors, and so will need to register in the relevant EEA country as a Third Country Auditor.
- The UK will no longer count as a "home state" under EU law, and so the annual report will need to be filed in both the UK and the new "home state" within the EEA. UK companies may wish to contact the relevant state's regulator to tell them of their new "home state".

These are not specific rule changes – they are a consequence of applying existing EU legislation to the UK as a third country.

Impact on EU incorporated companies listed on a UK regulated market

- Companies will need to adopt a GAAP that is 'equivalent' to IFRS as adopted by the UK. The *Prospectus (Amendment etc.) (EU Exit) Regulations 2019 (SI 2019/1234)* clarify that, for non-UK issuers, IFRS as adopted by the EU will continue to be allowed (as well as IFRS as issued by the IASB and the GAAPs of the US, Japan, Peoples' Republic of China, Canada and South Korea). The law will extend the existing UK 'third country auditor' regime to EEA auditors, and so EEA auditors of entities with equities or retail debt securities admitted to trading on a UK regulated market will need to register in the UK.

- The FCA's DTR will apply in all cases even if there is also a listing in the EEA. This means that the annual report will need to be filed in the UK and comply with the FCA's rules, rather than just relying on a non-UK "home state" regulator.

Further information
The Regulations discussed above are available from legislation.gov.uk:

- **The Accounts and Reports (Amendment) (EU Exit) Regulations 2019** (SI 2019/145)

- **The Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019** (SI 2019/177)

- **The Statutory Auditors, Third Country Auditors and International Accounting Standards (Amendment) (EU Exit) Regulations 2019** (SI 2019/1392)

- **The Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2020** (SI 2020/108)

- **The International Accounting Standards and European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2019** (SI 2019/685)

- **The International Accounting Standards, Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2020** (SI 2020/335)

- **The Companies, Limited Liability Partnerships and Partnerships (Amendment etc.) (EU Exit) Regulations 2019** (SI 2019/348)

- **The European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2018** (SI 2018/1298)

- **The Official Listing of Securities, Prospectus and Transparency (Amendment etc.) (EU Exit) Regulations 2019** (SI 2019/707)

- **The Prospectus (Amendment etc.) (EU Exit) Regulations 2019** (SI 2019/1234)

The Financial Reporting Council and the Department for Business, Energy and Industrial Strategy (BEIS) have also published letters for auditors and accountants with information regarding auditing, accounting and corporate reporting standards during the transition period. These are available **here**.

If you have any questions about the proposals, please speak to your usual Deloitte contact.

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