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By email to: Accounting_Directive@bis.gsi.gov.uk

24 October 2014

Dear Mr Conway

UK Implementation of the EU Accounting Directive: Chapters 1-9

Deloitte LLP is pleased to respond to the consultation paper addressing the UK Implementation of the EU Accounting Directive ("the Directive"): Chapters 1-9 ("the consultation"). We have set out our detailed responses to the consultation questions in the Appendix to this letter.

Overall we support the proposals, although we have some concerns around certain aspects of the consultation. Our key comments, which we expand on in the Appendix to this letter, are as follows:

- we believe that, since compliance with UK accounting standards is generally accepted as being necessary in order to give a true and fair view, the role of UK accounting standards will be significant under the new regime in guiding directors of small companies as to whether further disclosures may be necessary, in addition to those mandated by law, in order to present true and fair accounts;

- we question the value of the proposal to permit small companies to prepare an abbreviated balance sheet and profit and loss account for shareholders as such accounts will still need to give a true and fair view;

- we strongly support the provision of increased flexibility in the layout of primary statements, particularly to accommodate the application of IFRS layouts and terminology for companies adopting FRS 101;

- we believe that there should be one single definition of a public interest entity which should be applied consistently wherever it is used in UK company law;

- we believe that the audit exemption threshold should be consulted on as part of the implementation of the Audit Directive rather than as a separate consultation, making good on the deregulatory promises made in the Government's 2011 Plan for Growth;

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- we believe that it is essential that the requirements for LLPs are aligned with the requirements for companies with effect from the same date; and

- we recommend that the Government and the Financial Reporting Council work closely together to make the new regime available to companies as soon as possible, including permitting early adoption.

We would be happy to discuss our letter and the draft proposals with you. If you have any questions, please contact Anne Cowley (0207 303 8361 or ancowley@deloitte.co.uk) or Ken Rigelsford (0207 007 0752 or krigelsford@deloitte.co.uk).

Yours sincerely

Veronica Poole
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Appendix

Responses to detailed questions

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?

Yes, we agree that the UK's existing approach should, broadly speaking, be maintained.

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?

Yes, we agree. The provision of separate regulations for small companies and for large and medium-sized companies facilitates their use by such companies, as they can easily identify the requirements applicable to their circumstances. This is in line with the 'Think Small First' approach which was seen as important in the UK when implementing the 2006 Act and by the Commission in drafting the Directive (see recital 1).

We are concerned that there may be too much emphasis by the Government on reducing the number of sets of regulations under the 2006 Act without adequate consideration of whether this is actually deregulatory. Separate regulations for different types of company is an example of a situation where more is better as simpler, more specific regulations will be cheaper to apply.

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?

For the reasons explained in our response to question 2, it would be more helpful to introduce a separate set of regulations dealing solely with those requirements applicable to micro companies. We believe this would be helpful for such companies in ensuring that they have one discrete point of reference which contains all of the requirements applicable to the micro-entity regime.

Micro companies must now read the full regulations, ignoring parts. This makes them hard to follow, both for micro companies and indeed for non-micro small companies which must ignore the micro-entity material. A separate cut down version of the existing Small Companies and Groups Regulations would replace the existing Small Companies (Micro-Entities' Accounts) Regulations 2013, meaning that the number of sets of regulations would not increase. This approach would also be consistent with the Financial Reporting Council's proposals for a separate accounting standard for micro companies.

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.

As explained in our response to question 2 above, reducing the number of sets of regulations is not necessarily deregulatory. However, we suggest that The Companies (Revision of Defective Accounts and Reports) Regulations could usefully be integrated into the respective Regulations for micro, small and large and medium-sized companies.

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Question 5 Do you agree that the new regulations should apply to financial statements for financial years commencing on or after 1 January 2016?

Yes, we agree.

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?

Yes, we strongly encourage the Government to permit early adoption of the new regime as this will provide additional flexibility for companies that are already facing significant change from 1 January 2015 with the introduction of the new UK financial reporting regime.

For instance, consider those companies currently not meeting the 'small' criteria for accounting purposes but which will meet the new criteria in 2016, many of which will be applying full UK GAAP currently. For periods beginning on or after 1 January 2015, they would need to transition to and apply the disclosure and presentation requirements of FRS 102 in its entirety, before becoming eligible for the small companies' regime in the following year. This degree of change is undesirable, both for the companies and for users of those companies' accounts.

We therefore recommend that companies should be able to adopt the new regime in respect of any accounting periods, provided that such accounts have not yet been authorised for issue before the date on which the regulations are issued. It will, of course, be necessary for the Government to work closely with the Financial Reporting Council (FRC) to ensure that related amendments to accounting standards are implemented in a timely manner to facilitate early adoption. Even should there be a short delay between finalising the regulations and finalising the revised accounting standards, it would be possible for companies to access some of the deregulatory benefits, in particular the increased thresholds, while complying with extant accounting standards.

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?

Yes, we agree that the Government should apply the maximum small company thresholds permitted by the Directive.

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.)

We have no specific evidence to offer in this regard.

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?

Yes, we agree.

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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?

Although we acknowledge that there are other sources of income not captured by the definition of 'net turnover', we believe that further consideration and consultation would be necessary in order to arrive at an appropriate alternative measure. This is not a new issue, and we are not aware of significant concern by users of financial statements arising from the use of 'turnover' in the current Companies Act size tests, particularly as public interest entities are excluded from the small companies regime.

However, we believe that charities may be a special case as explained in our response to question 44 below.

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?

No, we do not foresee any such circumstances where either of these proposals would be appropriate. We agree with the view set out in the consultation document that companies should not be prevented from accessing the small and medium-sized companies regimes unless there is a clear public interest in doing so.

However, we note that the existing requirements already require a parent company to have regard to the size of the group that it heads when deciding whether it is eligible for the exemptions. It therefore appears that further deregulation in this area would be possible although we think the benefits would be quite limited due to the complexities of mixing together small company individual accounts and large company consolidated accounts in the same document.

Question 12 Do you consider that there are circumstances where the Government should adopt either or both of the above provisions?

The provisions referred to in this question are the same as those referred to in question 11 above. As noted there, the Government has already adopted one of these provisions and so there is in fact scope for further deregulation.

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?

We believe that only the eight mandatory notes should be required by law and that any additional notes permitted by the Directive should be considered by the FRC and, if necessary, set out in accounting standards.

We understand that the Directive does not permit member states to require further statutory disclosures to be made in addition to these 13 notes. However, accounts prepared by small companies must continue to present a true and fair view. The Government acknowledges that these notes – whether eight or 13 -

will not address this requirement in all cases. As a result, directors of small companies will need to consider whether further disclosures may be necessary, in addition to those mandated, in order to present a true and fair view.

When preparing true and fair accounts, directors of small companies will wish to look to accounting standards as a source of guidance. In recent years the Financial Reporting Council (FRC) has obtained several written legal opinions which confirm that compliance with accounting standards is generally necessary in order to give a true and fair view. Consistent with these opinions, UK accounting standards do not have the force of absolute legal requirements but instead provide guidance on what is generally accepted as being necessary to give a true and fair view. We do not see a conflict between them continuing to provide such guidance for small companies and the requirements of the Directive.

Accordingly, while we agree that the additional five notes will, in most cases, be necessary to give a true and fair view, we believe that it would be more appropriate for the FRC to consider whether some or all of these notes should always be required for small companies, as well as addressing the broader issue of further disclosures that might also be necessary in order to give a true and fair view.

We understand that the Government has interpreted the restriction on gold-plating in the Directive as extending to accounting standards published by the FRC. Since the FRC is not a public sector body and does not have any role in setting statute, we question this interpretation. Also, the Government's interpretation fails to take account of the legal status of UK accounting standards, as explained above.

We believe it would be far simpler – and permissible under the Directive – to allow accounting standards to set out additional disclosures that are required (where material) to give a true and fair view – including the additional five notes permitted by the Directive. This would remove the burden on directors to perform such an assessment themselves and provide them with a clearly defined structure. We urge the Government to investigate this possibility and work with the FRC to find a solution so that each company does not have to 'reinvent the wheel'.

Question 14 Should the requirement for the five additional notes be set out in regulations or should the need for additional notes be set out in accounting standards?

As set out above, we believe that it should be left to the FRC to consider whether some or all of these five additional notes should be required for small companies; accordingly such requirements should be set out in accounting standards.

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?

In view of the significant disclosure and presentation relaxations proposed by the consultation, we question the value of this proposal. We consider that the accounts prepared by small companies will already be relatively short and we cannot envisage any benefit for shareholders in receiving even less information. For the majority of our clients, full accounts are used for other purposes, whether or not abbreviated accounts are filed, so this potential relaxation would be unlikely to be taken up. We recommend that the Government consult further with smaller companies and accountancy firms, including those who have no audit registration, to assess whether this proposal would be of benefit.

Neither do we believe that the preparation of an abbreviated balance sheet and profit and loss account for shareholders will create any cost savings for small companies. The 'full' numbers will still need to have

been prepared in order to ascertain the abbreviated numbers to be presented. Put simply, one cannot arrive at gross profit without having calculated turnover and cost of sales. The statutory accounts of small companies are commonly produced as an output from accounting software and the level of work required in producing those accounts will not change as a result of this proposals.

Finally, the accounts prepared by small companies for shareholders must give a true and fair view. We do not see how abbreviated accounts can be considered 'true and fair' unless they include all of the items required for a full set of small company accounts.

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.

Please refer to our response to Question 15 above.

Question 17 What benefits or costs might a small company see from deciding to prepare an abbreviated balance sheet and P&L?

Please refer to our response to Question 15 above.

We would, however, note that if the existing position in relation to abbreviated accounts for filing is preserved it might be possible to reduce costs for those small companies who are either still required to, or choose to, have their full financial statements audited. We suggest that the requirement for the special auditors' report called for by s449 of the Act is replaced with a simple requirement that if the full accounts have been audited, the directors should state whether the auditor's report on the full financial statements was qualified or unqualified, contained an emphasis of matter or contained any matter required by s498(2) and (3). This would comply with the requirements of Article 32(2)(c) of the Directive.

Question 18 What benefits do you believe exempting small groups from consolidation will offer to small groups of companies?

Most small groups are already exempt from preparing consolidated accounts so the benefits will be limited. However, there will be a cost saving for those small groups which are currently ineligible solely by reason of containing (a) a public limited company that does not have securities admitted to trading on a regulated market and/or (b) a MiFID investment firm, UCITS management firm or e-money issuer.

Question 19 Should the Government only exclude from the small company accounting regime those public companies whose securities are traded on a regulated market?

Yes, we agree that the Government should only exclude from the small company accounting regime those public companies whose securities are admitted to trading on a regulated market. In other words, the definition of a Public Interest Entity (PIE) should not be extended to include all public companies. This would be a particularly welcome deregulatory measure for public companies that previously had securities admitted to trading on such markets but are now privately owned.

We acknowledge that this change may allow companies with securities admitted to trading on unregulated markets (such as AIM) and companies that are otherwise regulated (such as MiFID investment firms) to access the small company accounting regime. However, we believe that any

particular restrictions for such companies would be more appropriately included in the rules of the market in question or imposed by the relevant regulator (the Financial Conduct Authority or Prudential Regulation Authority), rather than in company law.

We also acknowledge that there is a point of view held by some that a public company should be held to higher standards than a private company merely because the use of the designation 'Plc' creates expectations on the part of those it deals with. We do not agree with this point of view. Public companies are, of course, subject to additional legal requirements such as minimum capital for reasons of history and EU law. However, we do not see why a privately owned business which happens to be incorporated as a public company should, for that reason alone, be prevented from accessing the small companies regime.

Please see also our additional comments below in respect of the definition of a PIE.

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?

Yes. In our view, small companies which are members of a group which includes a PIE should be able to access the small companies accounting regime. We believe this could substantially reduce the reporting burden for otherwise small companies within what are currently termed "ineligible groups" and that the Government should take advantage of the opportunity to remove the concept of an "ineligible group" from company law.

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

Yes, we agree. The views expressed in our responses to Questions 19 and 20 above apply equally in the case of the medium-sized company regime.

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?

Yes, we agree. The views expressed in our responses to Questions 19 and 20 above apply equally in the case of the medium-sized company regime.

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?

Yes, we agree. The use of consistent criteria and terminology will increase transparency for preparers and users. In practice, this would only relax the requirements for companies traded on the NYSE or NASDAQ, which are generally unlikely to be dormant. It will also require accounts and potentially audits for dormant companies with only debt securities admitted to trading on an EEA regulated market; again, such companies are very rare.

This highlights a more general question about why the NYSE and NASDAQ are included in the definition of a quoted company when other markets outside the EU are not. We believe that it would be worthwhile

to consider more widely whether references to quoted companies should be replaced by references to companies with equity shares admitted to trading on an EEA regulated market.

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?

No. Consistent with our response to Question 20 above, we believe that companies should not be excluded from the dormant subsidiaries accounting exemptions because they are a member of a group containing a PIE. A company within a group should only be excluded if the company itself is a PIE.

Question 24 Do you agree that only permitting Formats 1 and 2 of the P&L should not impact significantly on UK companies?

Yes, we agree. In our experience the vast majority of UK companies already use Formats 1 or 2 for their P&L and this change should therefore not have any significant impact.

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

We strongly support the provision of increased flexibility in the layout of primary statements, particularly to accommodate the application of IFRS layouts and terminology. One of the most significant obstacles to adoption of FRS 101 Reduced Disclosure Framework by UK companies has been the challenge of reconciling IFRS requirements with the relatively inflexible requirements of company law. In particular, the distinction between "fixed and current assets" versus "non-current and current assets" has been problematic.

We recommend that the government implements Articles 11 and 13(2) of the Directive. For example, Article 11 could be implemented by stating in regulations that companies may present items on the basis of a distinction between current and non-current items in a different layout from that set out in the prescribed formats provided that the information given is at least equivalent to that otherwise to be provided by those formats. This is far preferable to an approach which attempted to define an 'IFRS format' for inclusion in the regulations given that IAS 1 merely specifies the minimum contents of the primary statements and provides flexibility about the description of items and the layout.

It could be left to the FRC to develop guidance about the meaning of 'equivalent' in this context. The FRC could also consider whether the use of this flexibility should be limited to companies applying FRS 101 or whether it could also be available to those applying FRS 102.

Question 26 If the UK took up this option, should flexibilities be dealt with in the regulations or in accounting standards and why?

As more fully explained in our response to question 25, in our view the simplest approach would be for the regulations to state that companies may present items in a different layout from those set out in the regulations, provided that the information given is at least equivalent to that otherwise to be provided in accordance with the regulations. Any further limitations on the acceptable use of this flexibility should then be specified by accounting standards.

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?

We agree that the law should permit (but not require) use of the equity method in individual company accounts. IFRSs have recently been amended to permit this treatment and so permitting it in company law would eliminate a potential conflict for companies applying FRS 101.

We also note that one of the amendments that the FRC made to the IFRS for SMEs when developing FRS 102 was to eliminate this treatment because of a conflict with the law. However, whether or not FRS 102 should be amended to permit this treatment, if it is permitted by law, is a matter for the FRC to consider and consult on.

Question 28 Do you agree that the Government should provide for the 10 year maximum period for write-off offered in the Accounting Directive?

No, we do not agree. The current 5-year maximum period in law and accounting standards does not need to be changed; it is in line with the requirements of the Directive. There has already been substantial confusion around the introduction and application of this requirement on publication of FRS 102. Since it is acknowledged that this provision will only apply in very narrow, exceptional circumstances, we see no reason to create further confusion by changing the maximum period again.

Question 29 Do you agree that the removal of this option [to provide information on subsidiaries included in a consolidation as part of a company's Annual Return] should take effect alongside other changes to the UK's financial reporting framework?

As set out in our response to the October 2013 consultation on the Company Filing Requirements, we do not support the inclusion of all information in relation to a company's subsidiaries within the annual report. Some groups have hundreds of subsidiaries and listing all of these, for example even if dormant or immaterial, runs contrary to current initiatives to cut clutter in annual reports. We urge the Government to reconsider this decision.

However, if the option of separate filing of the complete list is to be removed, we consider that now is as good a time as any to do so.

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?

Yes, we agree. The current requirement for micro companies to prepare a directors' report seems to add very little value for users of those accounts, particularly as details of the directors' identity are already on the public record.

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?

In our response to the Government's previous consultation on audit exemption, we welcomed alignment of the thresholds between accounting and audit exemptions. Reintroducing a difference is likely to be confusing for the preparers. While we agree that the thresholds for the small companies audit exemption may benefit from further consultation and consideration, we question the need to create a separate

consultation solely to consider this issue. In our view it would be most appropriate to consider these thresholds as part of the consultation on implementation of the Audit Directive.

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?

Yes. We believe that the exclusions from the small companies audit exemption should be amended such that they are consistent with the exclusions from the small companies accounting regime (please refer to our responses to Question 19 above).

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?

No. We believe that the exclusions from the small companies audit exemption should be amended such that they are consistent with the exclusions from the small companies accounting regime (please refer to our responses to Question 20 above).

In addition, UK law currently requires that, when assessing the size of a small company that is part of a group, that assessment must be performed with reference to the largest group of which that company is part. This is gold-plating of the requirements of both the current Fourth and Seventh Company Law Directives and the Accounting Directive. Consistent with criteria for the small company accounting regime, we recommend that this requirement is amended such that the assessment is made based on the size of the group headed by the company in question. Whilst this may once have been a helpful anti-avoidance provision to avoid slicing a group into multiple entities in such a way as to reduce the quality of a group audit, the tougher requirements of ISA (UK and Ireland) 600 introduced in 2010 should mean that the lack of statutory audit for small subsidiaries and small sub-groups should not impact on the quality of audits of larger groups.

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?

We believe that the exclusions from the subsidiaries audit exemption should be amended such that they are consistent with the exclusions from the small companies accounting regime (please refer to our responses to Question 19 above).

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?

No. We believe that the exclusions from the subsidiaries audit exemption should be amended such that they are consistent with the exclusions from the small companies accounting regime (please refer to our responses to Question 20 above).

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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?

We believe that the exclusions from the dormant companies audit exemption should be amended such that they are consistent with the exclusions from the dormant companies accounting regime (please refer to our responses to Question 23(a) above).

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?

No. We believe that the exclusions from the dormant companies audit exemption should be amended such that they are consistent with the exclusions from the dormant companies accounting regime (please refer to our responses to Question 23(b) above).

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?

Yes. We agree with the proposal, which will avoid making two changes in short succession, and avoid creating an undue cost burden for companies as auditors obtain supporting evidence for each statement in the directors' report and strategic report (including the completeness of information).

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?

With the exception of the matter referred to in question 35 above, we do not believe there would be any practical difference between the two versions of Article 28 (that inserted by Article 35 of the Accounting Directive and that inserted by Article 23 of Directive 2014/56/EU), particularly given the existing requirements of ISA (UK and Ireland) 700.

Article 28 applies to non-PIE and PIE audits alike; the more significant changes are those for the audit reports of PIEs set out in Article 10 of Regulation 537/2014. Existing ISA (UK and Ireland) 700 applies many but not all of these, at least for those companies complying with the UK Corporate Governance Code; more time may be needed for the FRC to complete any necessary amendments to that standard (and to ISAs (UK and Ireland) 570 and 720) to provide requirements to support implementation of the Regulation.

We do, however, have one further suggestion if the wording of Part 16 is being amended. S498 of the Companies Act 2006 requires the auditor to carry out such investigations as are necessary to form certain opinions, but as a matter of law to only report by exception. In 2009 the FRC amended their standards to require that where the law required an auditor to report by exception, an auditor with nothing to report had to include that fact in their report. This results in most cases in a statement that "We have nothing to report in respect of the following:" followed by a list of matters; this double negative (e.g. we have nothing to report in respect of our duty to report if adequate accounting records have not been kept) is confusing to companies and readers of audit reports alike. We suggest that you consider whether:

- the duty for the auditor to report if they have not received adequate information and explanations for their audit should be removed. This requirement goes hand in hand with either an opinion qualified “except for” on grounds of limitation of scope or a disclaimer of opinion, so is redundant; and
- the remaining duties should be recast as a positive opinion. This would result in a more readable, and hence valuable, opinion for readers of audit reports.

Question 37 Do you agree that the regulations should be amended to revoke the current requirement for disclosure of fees paid to auditors of medium sized companies for non-audit services?

The current regulations do not require fees paid to auditors of medium sized companies for non-audit services to be disclosed. We believe that this exemption should remain.

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 small and medium-sized public companies unless they have securities traded on a regulated market?

Yes, we agree. The test should be whether the company itself is a PIE.

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 small and medium-sized companies in the same group as a public company?

Yes, we agree. The test should be whether the company itself is a PIE.

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 small and medium sized companies that are members of ineligible groups?

No, we do not agree. The test should be whether the company itself is a PIE. Consistent with our response to question 20, we believe that the Government should take advantage of the opportunity to remove the concept of an ‘ineligible group’ from company law.

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

No. The test should be whether the subsidiary is a PIE in its own right; if it is, it should disclose non-audit fees payable to its auditor (whether or not that is the same as the group auditor); if not, it should not.

Paragraph 19(a) of ISA (UK and Ireland) 600 *Special Considerations - Audits of group financial statements (including the work of component auditors)* requires that the group auditor must decide whether or not “the component auditor understands and will comply with the ethical requirements that are relevant to the group audit and, in particular, is independent”. The group auditor’s initial assessment is at the planning stage and reassessed when the component auditor reports to them, which is, in almost all cases, before the subsidiary financial statements are in the public domain. In other words, the group

auditor does not rely on the disclosure of non-audit fees in the subsidiary's financial statements to form their assessment.

As groups can decide who the subsidiary's auditor is, and must do so in advance of the financial statements being prepared, they too do not rely on the disclosure of non-audit fees in the subsidiary's financial statements in deciding if the choice of subsidiary auditor is appropriate. For this reason, the disclosure is only really relevant where the subsidiary is of public interest itself and therefore there is a public interest in seeing whether the nature and level of non-audit services is appropriate (and, where relevant, compliant with EU law).

(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?

No. Whilst there is an argument that understanding the level of non-audit fees paid by subsidiaries to their statutory auditors could be helpful in deciding whether or not the group auditor has adequately challenged the independence of subsidiary auditors, the level of non-audit fees paid to subsidiary auditors other than the group auditor is meaningless without also disclosing audit fees paid to them. In addition, it could be misleading as in some cases the non-audit fees charged by the subsidiary auditor would include additional work not required for the purpose of the subsidiary's statutory audit but necessary to support the group audit opinion.

Accordingly, if the Government decides to make this change, it should also (a) require disclosure of audit fees paid by subsidiaries to auditors other than the group auditor and (b) require that the figures for both audit and non-audit services be disclosed separately for fees to the group auditor and other auditors; without this split it would not be possible to assess compliance with the 70% cap in EU law. For this purpose, references to the 'group auditor' include their associates as defined in legislation.

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?

We agree that making such a specific statement would be helpful as clarification even if this would be the legal position in the absence of such a statement. We agree it is important that charities can be subject to additional requirements, for example those required by the relevant SORP.

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?

We believe the flexibility should not only be maintained but increased. For example, under the current requirements, charitable companies are required to include, as a prominent sub-total in the statement, the charity's net income/expenditure for the reporting period. This sub-total excludes items such as movements on capital endowments, which may be a significant item for many charities. The inclusion of this sub-total, or if necessary a separate income and expenditure account, is only required to comply with the requirements of company law, does not provide any additional useful information and may cause confusion to users of charities' financial statements.

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We therefore recommend that the Government investigate whether, in implementing the Directive, there are opportunities to increase further the flexibility in presentation of financial statements of charitable companies to ensure that only the most relevant and useful information is presented by such companies and broad comparability between charities, whatever their legal form. For example, would it be possible to exclude charitable companies from the requirements of Parts 15 and 16 entirely and amend charity law on accounting and auditing to apply equally to charitable companies, charitable incorporated organisations and unincorporated charities alike? We believe that this would be worth exploring as a medium term solution but it is unlikely to be possible to develop the necessary charity law within the time constraints for finalising the regulations.

Question 44 Do you agree that a threshold based on gross income is more appropriate than its turnover for company charities?

Although, as discussed at question 10 above, we acknowledge that there are other sources of income not captured by the definition of 'net turnover', we believe that further consideration and consultation would be necessary. As we explain in our response to question 43, it may well be worth considering whether this should be a matter for charity law rather than company law in the longer term.

The Charities Act 2011 already requires that charities with gross income in excess of £500,000 must have an audit regardless of whether or not they are a company. In the shorter term, the same definition of gross income could be used for company charities, although we recommend that the threshold for accounting and narrative requirements should be set at a higher threshold than that set for audit.

In addition, we see a benefit in only requiring audit under the Charities Act (i.e. exempting them from Part 16), as this will correct a current anomaly in the law where a charitable company can be exempt from audit under the Companies Act but still require an audit under the Charities Act. This leads to a perverse situation where a charitable company is still required by sections 475(2) to (4) of the Companies Act to make a statement on the face of its balance sheet that the company has taken the exemption from audit under the Companies Act even though it is being audited under the Charities Act.

Additional comments

Definition of a public interest entity

We believe that there should be one single definition of a PIE which should be applied consistently wherever it is used. In particular, we do not believe that a different definition should be used for the purpose of the provisions of the Audit Directive and Audit Regulation, as proposed by paragraph 8.6 of the consultation. To do so would create confusion and reduce transparency for users and preparers of accounts.

'Profits made' vs 'Profits realised at the balance sheet date'

As part of implementation of the Directive, we recommend that the Government take the opportunity to amend paragraph 13(a) of Schedule 1 to SI 2008/410 The Large and Medium–sized Companies and Groups (Accounts and Reports) Regulations 2008, which states that "only profits realised at the balance sheet date are to be included in the profit and loss account". In particular, the reference to "profits realised" should be replaced with "profits made", consistent with the terminology used in the Directive.

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Within the UK, 'realised profits' has a narrower meaning which is concerned primarily with determining whether those profits are distributable in accordance with Part 23 of the 2006 Act. The original intention of paragraph 13(a) may have been to ensure only profits that would be distributable are included in the profit and loss account but that is no longer true. Paragraph 40(2) disapplies paragraph 13(a) when the fair value accounting rules are being applied so that, for example, fair value movements on financial instruments and investment property may be included in the profit and loss account even if they are unrealised profits. However, it is a source of added complexity that other unrealised profits must be excluded from the profit and loss account to comply with the law and this is an area of inconsistency with IFRSs.

We have previously, for example in connection with the progress of the 2006 Act through Parliament, suggested simplifying the rules about distributions set out in Part 23, particularly insofar as they apply to private companies which fall outside the scope of the Second Company Law Directive. However, to be clear, what we are suggesting here is a much more limited but important amendment which would simplify accounting but make no change to the circumstances in which a distribution can be made.

Limited Liability Partnerships

In our covering letter, we note that it is essential that the requirements for LLPs are aligned with the requirements for companies with effect from the same date. Many LLPs have companies in the same group, and applying different requirements for different members of a group is costly to preparers. We appreciate that because LLPs fall outside of the scope of the Accounting Directive there is no need to approve the relevant regulations by 20 July 2015 but any delay should be kept to a minimum. In any event, even if their approval has to wait until the new Parliament there should be no reason why they cannot have an effective date of 1 January 2016.

Consequential amendments to other regulations

For the same reasons, we urge BIS to work with HM Treasury to amend on a timely basis the other legislation which cross-refers or restates the Companies Act accounting and audit provisions and related secondary legislation. This includes SI 2008/565 The Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations, SI 2008/567 The Bank Accounts Directive (Miscellaneous Banks) Regulations 2008, SI 2008/1950 The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations and SI 1994/1983 The Friendly Societies (Accounts and Related Provisions) Regulations (as amended), together with the law relating to building societies. In this regard we also note a current gap arising from the introduction of the strategic report. From 30 September 2013, much of the required content for the "management report" under both the Fourth and Seventh Company Law Directives and the new Accounting Directive is now included in the strategic report rather than the directors' report. These EU law requirements are applied to credit institutions and insurance companies by the Bank Accounts Directive and Insurance Accounts Directive. At the time the strategic report was introduced, neither SI 2008/565 nor SI 2008/567 were amended to extend the obligations on entities within their scope to prepare a strategic report as well as a directors' report.