

### Need to know

## BIS and FRC consult on changes to law and accounting standards as a result of the UK implementation of the EU Accounting Directive

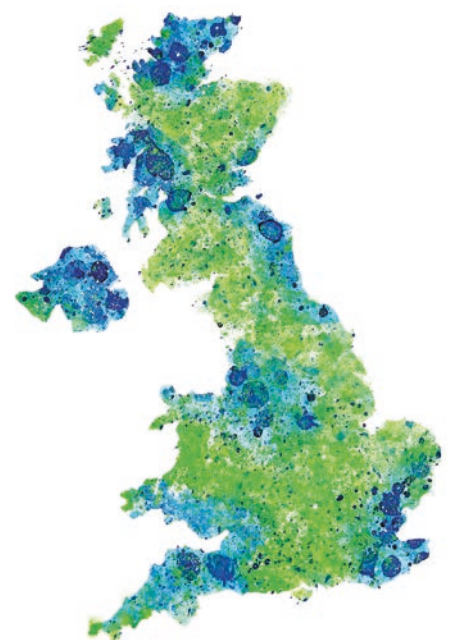
#### In a nutshell

- The Department for Business, Innovation and Skills (BIS) has issued a consultation on the UK implementation of the EU Accounting Directive 2013/34/EU ("the Directive"), which consolidates existing legislation on financial reporting and aims to reduce the regulatory burden on smaller companies.
- The BIS consultation proposes to increase the size thresholds for small and medium-sized companies, introduce a new small company regime requiring only minimal disclosures in the accounts and relax the restrictions around types of company that are considered ineligible for the small and medium-sized regimes.
- It also considers a number of other related changes to UK law, including the possibility of permitting greater flexibility in the layout of the profit and loss account and balance sheet.
- The Financial Reporting Council (FRC) has issued a linked consultation outlining proposed changes to UK Financial Reporting Standards as a result of the implementation of the Directive into UK law.
- The FRC consultation proposes to withdraw the Financial Reporting Standard for Smaller Entities (FRSSE); instead, small companies would be required to apply FRS 102 with significant disclosure and presentation exemptions. The consultation also proposes a separate, simplified standard for micro-entities. However, changes for large companies will be very limited.
- The BIS consultation period ends on 24 October 2014 while the FRC consultation is open for comment until 30 November 2014.
- With the exception of the new standard for micro-entities, which will have effect as soon as it is issued, all changes would come into effect for accounting periods beginning on or after 1 January 2016.

The BIS consultation proposes to increase the size thresholds for small and medium-sized companies and introduce a new small company regime requiring only minimal disclosures in the accounts.

#### Background

The Directive aims to simplify the accounting requirements for small companies and improve clarity and comparability of companies' financial statements within the Union. Under the Directive, small companies are only required to prepare a balance sheet, a profit and loss account and certain specified notes. Importantly, member states implementing the Directive are not permitted to 'gold-plate' the requirements applicable to small companies.



The Directive must be incorporated into UK law no later than 20 July 2015, but permits that the changes may first apply for financial years beginning on or after 1 January 2016.

### Changing thresholds for small and medium-sized companies

The Directive mandates the thresholds that may be implemented by Member States in respect of medium-sized companies but offers a range of size limits in respect of small companies. The BIS consultation proposes to implement the maximum possible thresholds for small companies in the UK. This means that a company will be small for accounting purposes if it meets at least two of the proposed criteria:

	Current criteria	Proposed criteria
Total assets	<£3.26m	<£5.1m
Turnover	<£6.5m	<£10.2m
Number of employees	<50	<50

BIS considers that this would allow approximately 11,000 additional UK companies to access the small company accounting regime. A company will be medium-sized if it meets at least two of the proposed criteria:

	Current criteria	Proposed criteria
Total assets	<£12.9m	<£18m
Turnover	<£25.9m	<£36m
Number of employees	<250	<250

These changes would only apply for the purposes of determining whether or not a company can access the small and medium-sized company **accounting** regimes; BIS is proposing that the size limits governing eligibility for the small company audit exemption remain unchanged for now subject to a later consultation.

### The new small companies accounting regime

The Directive also brings in a new small companies accounting regime which significantly relaxes the disclosure and presentation requirements for the financial statements of small companies. In addition to presentation of a profit and loss account and balance sheet, the Directive mandates only eight notes to the financial statements that must be included, although it permits that member states may require an additional five notes. BIS holds the view that neither law nor accounting standards may impose further mandatory disclosure requirements for small companies in addition to these thirteen notes.

#### Observation

Although the proposed disclosure and presentation requirements appear significantly lighter than those currently in place, small companies will still be required to prepare financial statements that provide a true and fair view. Under the proposed regime, directors, auditors and accountants of such companies will therefore need to consider whether additional notes are necessary to give a true and fair view of the company's financial position and performance. This may prove challenging in practice due to the increased level of judgement to be applied in preparing the financial statements.

The status accounting standards have in the UK is that they set out what is generally accepted as being necessary for a true and fair view. It is therefore curious that they may no longer be able to perform this function in relation to disclosures by small companies. It remains to be seen whether some compromise can be reached whereby the standards can specify which disclosures are generally regarded as necessary to give a true and fair view without them having the status of mandatory requirements which would infringe EU law.

The consultation also proposes that small companies should be able to prepare and file only abbreviated accounts. Currently small companies are permitted to file abbreviated accounts but must still prepare a full set of financial statements for shareholders. The new proposals would enable companies to prepare only an abbreviated balance sheet and an abbreviated profit and loss account with the mandatory small company notes.

### Ineligible and 'public interest' entities

The Directive introduces the term 'public interest entity' (PIE) and states that entities meeting this definition cannot apply the small, medium-sized or dormant companies accounting regimes. Broadly speaking, companies with securities admitted to trading on a regulated market (including the main market of the London Stock Exchange but excluding AIM), credit institutions and insurance companies will meet the definition of a PIE and will therefore not be able to apply the small company regime. However, the Directive additionally permits member states to bring other types of entity within the definition of a PIE, citing as examples "undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees".

In the UK, the existing definition of an 'ineligible company' currently includes public companies (PLCs), regardless of whether they are admitted to trading on a regulated market. The consultation asks for views as to whether this should continue to be the case. It also asks for views as to whether some of the small and medium-sized company exemptions should be available to members of 'ineligible groups' (those groups which contain an ineligible company) that are not themselves ineligible.

#### Observation

If the definition of a PIE in the UK was to change such that only PLCs with securities admitted to trading on a regulated market would be caught, entities with securities admitted to trading on non-regulated markets (such as AIM) could conceivably become eligible to access the small and medium-sized companies accounting regimes.

The proposal that exemptions should be available to companies that are not ineligible in their own right is welcome. For example, many UK listed groups have near-dormant subsidiaries with a handful of transactions each year going through them. These subsidiaries currently have to file full financial statements containing all the relevant notes for a large company, despite there being little public interest in their doing so.

### Other changes proposed by the BIS consultation

The consultation explores the opportunities offered by the Directive's option to allow greater flexibility in the layout of the profit and loss account and balance sheet. In particular, BIS is seeking views as to whether it would be possible to permit companies to use International Financial Reporting Standards (IFRS) formats for these statements.

#### Observation

One of the most significant challenges for companies adopting FRS 101 *Reduced Disclosure Framework* has been to reconcile the requirements of IFRSs with the requirement to use the profit and loss account and balance sheet formats mandated by UK company law. An amendment to the law to permit greater flexibility in the presentation of the primary statements could remove this obstacle and would no doubt be welcomed by companies applying – or considering applying – FRS 101.

In addition to those discussed above, the consultation contains a number of smaller proposed changes to UK company law with the aim of simplifying and/or clarifying reporting requirements for UK companies.

### The effect on UK financial reporting standards

The FRC has proposed changes to the existing UK financial reporting framework in response to the proposed changes to the size thresholds and the new small companies accounting regime in law. Under these proposals, the FRSE will be withdrawn entirely; small companies will instead apply FRS 102 *The Financial Reporting Standard Applicable in the UK and Ireland*, which will be amended to include a new section for the presentation and disclosure requirements for small companies.

Small companies applying FRS 102 will not need to prepare a cash-flow statement or consolidated financial statements and will be subject to limited disclosure requirements because of the proposed changes to law discussed above. However, the FRC does not propose any relaxation for small companies in respect of the recognition and measurement requirements of FRS 102.

This means that there will be some significant changes to the recognition and measurement criteria for small companies as a result of moving from the FRSSE to FRS 102:

- financial instruments within the scope of Section 12 of FRS 102 (including any derivatives such as foreign currency forward contracts) will be fair valued;
- financial instruments at non-market rates of interest will be accounted for differently;
- transactions and balances in foreign currency may no longer be recognised at contracted forward rates, though hedge accounting may be applied which may result in a similar outcome;
- revaluation gains and losses on investment properties will be recognised in profit and loss rather than the statement of total recognised gains and losses;
- deferred tax will be recognised on revaluations and business combinations;
- holiday pay accruals will be required; and
- equity-based share-based payment transactions will need to be accounted for when goods or services are received.

A separate financial reporting standard, the Financial Reporting Standard for Micro Entities (FRSME), will be issued for micro-entities which will include only those disclosures required by law for micro-entities. Although this standard will also be based on FRS 102, the recognition and measurement criteria will be simplified such that:

- all financial instruments are accounted for at historical cost or amortised cost (unless a derivative contract becomes onerous, in which case a provision is required);
- revaluation of tangible fixed assets, fixed asset investments and investment property is not permitted;
- there is no requirement to account for deferred taxation or equity-settled share-based payment schemes (apart from any eventual issue of shares);
- defined benefit pension schemes can be accounted for as defined contribution schemes, provided that provision is made for any agreement to fund a deficit; and
- borrowing costs may not be capitalised.

Many UK companies which meet the criteria to be small under the current thresholds will qualify as micro companies, and will therefore be eligible to apply the FRSME, although they will need to consider the pros and cons of doing so. However, there will still be a significant number of larger (non-micro) small companies for which the more complex recognition and measurement requirements of FRS 102 (compared to the FRSSE) may prove challenging.

### Further information

More information on the proposed changes to UK law and accounting standards, as well as other UK accounting, reporting and corporate governance news and publications, can be found at [www.ukaccountingplus.co.uk](http://www.ukaccountingplus.co.uk)

### Contacts

If you would like further, more detailed information on the changes proposed by BIS and the FRC, please contact your local Deloitte partner or:

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