UK implementation of the new EU Accounting Directive heralds a major shake-up of small company accounts and changes for all other companies too

In 2013, a new Accounting Directive became law in the European Union (EU) and must be implemented in EU Member States by July 2015 and apply no later than for annual periods beginning on or after 1 January 2016. The UK Department for Business, Innovation and Skills (BIS) consulted on implementation in 2014 and legislation was passed in March 2015 to implement the Directive in the UK. Implementation means amending the Companies Act 2006 (CA 2006) and the accounting regulations made under that Act.

Key changes
The key changes to UK law on accounts and audit are:
- small company accounting size limits are increased substantially. In a change of policy, these new increased limits also apply to the audit exemption although this latter change is the subject of further consultation
- small company accounts are simplified and the UK cannot add to the presentation and disclosure requirements set out in the Directive for small companies
- auditors will have additional reporting duties in relation to the strategic report and directors’ report
- the option of filing a full list of subsidiaries with the annual return instead of including details in the notes to the accounts is abolished for accounts approved by the board of directors on or after 1 July 2015
- country-by-country reporting has been implemented separately for annual periods commencing on or after 1 January 2015 and imposes a requirement for large and public interest entities which are active in extractive industries or logging of primary forests to disclose material payments made to governments in the countries in which they operate
- there are few major changes to accounts for large and medium-sized companies, but the size limits for medium-sized companies are increased substantially.

Entities prohibited from the small companies regime
Under the Directive, public interest entities (PIEs) are prohibited from taking advantage of the small company reporting and audit regime, or being treated as medium-sized companies, irrespective of size. Broadly, PIEs are:
- companies with securities admitted to trading on an EU-regulated market, such as the Main Market of the London Stock Exchange (but not AIM) – these are called ‘traded companies’
- credit institutions such as banks, and
- insurance undertakings.

In the UK, any company that is a plc remains prohibited from preparing small company accounts or taking the small companies audit exemption, although a plc parent company that otherwise meets the small companies exemption from preparing group accounts will be able to take up that exemption provided it is not a traded company. In addition, a private company in a group that includes a plc will be able to use the small companies regime, whereas previously this was not permitted.

Relevance of the Accounting Directive
The Directive is central to the law governing the content and publication of financial statements, the strategic report and the directors’ report.

The Directive is relevant to IFRS accounts as well as UK GAAP accounts, except that the form and content of IFRS accounts is governed by the EU Regulation on IFRS not the Directive. The Directive imposes the requirements to prepare and publish those accounts, as well as have them audited.

The Directive is of central importance to UK GAAP accounts because it is the source of the statutory formats, basic measurement rules and many disclosure requirements.

Timetable for implementation
Apart from Chapter 10 of the Directive on country-by-country reporting, the changes generally apply for annual periods beginning on or after 1 January 2016. However, the prohibition on filing a full list of subsidiaries with the annual return applies to accounts approved by the board of directors on or after 1 July 2015. Other than the audit exemption size limit change, earlier adoption is permitted for annual periods beginning on or after 1 January 2015.

Substantial rise in small company thresholds
The headline change for small company accounting and audit is that the maximum size limits increase to:
- turnover not more than £10,200,000 (previously £6,500,000)
- gross assets not more than £5,100,000 (previously £3,260,000)
- no more than 50 employees (unchanged).

As previously, two out of three limits need to be met, normally for two years, in order to qualify for the small companies regime. The small groups limits are increased similarly with the gross thresholds (before inter-company set-offs etc) being 20% greater than the net figures for turnover and gross assets, which are the same as for a small company. As previously, small
companies will be able to elect to follow accounting and reporting requirements applicable to larger companies if they wish to do so, including applying EU-adopted IFRS.

**Small company audit requirements**

Member States retain the option to impose a statutory audit on small companies, although European law does not require it. BIS originally proposed not raising the small companies audit exemption threshold when implementing the Directive. However, following consultation, this decision has been reversed and the audit exemption size thresholds will increase in line with the small companies accounting size limits, although BIS has consulted further on whether this change to audit exemption should be reversed.

**Small company accounts**

The simplified accounting requirements for small companies in the new Directive are on a ‘maximum harmonisation’ basis with regard to presentation and disclosure. This means that there is no scope for Member States to add additional presentation and disclosure requirements for small company accounts either in legislation or in accounting standards.

Small companies will be required to present a balance sheet and profit and loss account in their accounts for shareholders. No other primary statements can be required for small companies, although BIS has consulted further on whether this change to audit exemption should be reversed.

The Directive requires only eight notes to the accounts (if relevant) covering:
* accounting policies
* fixed asset revaluations
* financial instruments carried at fair value
* advances to directors
* exceptional items
* creditors due after more than five years and secured creditors, and
* employee numbers.

In addition, Member States have the option to require a further five notes covering:
* a fixed assets table
* the name of the undertaking drawing up consolidated accounts
* off balance sheet arrangements
* post balance sheet events, and
* some related party disclosures.

The additional five notes will be required by UK law.

The true and fair requirement still applies to small company accounts and this includes the Directive requirement to give additional disclosures if necessary to achieve a true and fair view in the particular circumstances of an individual case.

Therefore, the directors will still need to consider this issue in relation to their company’s circumstances, but accounting standards cannot mandate additional disclosures.

**Abbreviated accounts and Companies House filing**

There are significant changes to the abbreviated accounts regime. Under the old system, small and medium-sized companies could prepare abbreviated accounts for filing at Companies House. These were separate, albeit derived, from the accounts for shareholders. Under the new law, this distinction disappears. Abbreviated accounts for medium-sized companies are abolished. For small companies, the accounts prepared for shareholders will be those that are filed at Companies House, although there will be filing exemptions.

Small companies will continue to be able to file only a balance sheet and related notes at Companies House and omit their directors’ report and profit and loss account from what is filed. The balance sheet and related notes filed will be copies of those provided to shareholders, rather than a separate document.

In addition, small companies will be permitted to prepare abbreviated accounts for shareholders instead of full financial statements, but only when all members of the company consent. If such accounts are prepared for shareholders, there would be no ‘full’ accounts for them. Abbreviated accounts for shareholders can omit completely the third, detailed, level of balance sheet headings, which means for example that there would be no analysis of debtors or creditors. The profit and loss account can begin at gross profit, meaning that there would be no turnover figure in the accounts. The notes listed above would still be required and the true and fair requirement would still apply. As with full accounts, only the balance sheet and related notes would need to be filed at Companies House. If the abbreviated accounts have been audited, the auditor’s report will not be included in the copy filed but a note in the filed accounts will provide information about the auditor’s report.

**Micro-entity accounts**

The micro-entity simplified accounting regime introduced in 2013 remains for very small companies meeting the micro-entity size limits and other conditions. Broadly, micro-entities must meet two out of three size limits: turnover not exceeding £632,000, gross assets not exceeding £316,000 and 10 or fewer employees. One change is to abolish the requirement for micro-entities to prepare a directors’ report.

**Impact on accounting standards**

The changes to small company reporting will have major implications for the Financial Reporting Standard for Smaller Entities (FRSSE) and the Financial Reporting Council (FRC) has issued proposals to revise accounting standards to align with the legal changes.
The FRC is proposing to withdraw the FRSSE. The FRC plans to issue a Financial Reporting Standard specifically for micro-entities, which will be a cut-down and simplified version of FRS 102. The Financial Reporting Standard applicable in the UK and Republic of Ireland. For small companies that are not micro-entities, the FRC is planning a new Section 1A in FRS 102 which will set out the reduced disclosure and presentation requirements for small companies to align with the Directive, and which will disapply all other FRS 102 disclosure and presentation requirements. However, FRS 102 accounting will apply to small companies that are not micro-entities, including, for example, carrying derivatives and some other financial instruments at fair value.

Audit opinion and statement on the strategic report and directors’ report

The new law expands auditor reporting requirements in relation to the strategic report and directors’ report. These expanded audit requirements will place the strategic report and directors’ report under increased scrutiny.

There will be an additional requirement for auditors to express an opinion on whether the strategic report (if presented) and directors’ report have been prepared in accordance with the applicable legal requirements.

Auditors will also be required to make an additional statement as to whether, in the light of the knowledge and understanding of the undertaking and its environment obtained in the course of the audit, the auditor has identified material misstatements in the strategic report and directors’ report, and give an indication of the nature of any such misstatements.

The existing requirement to report on consistency of the strategic report and directors’ report with the financial statements remains unchanged.

Other main changes

The new law permits alternative formats for the balance sheet and profit and loss account. These allow a presentation based on a current/non-current distinction in the balance sheet and a statement of performance instead of the prescribed profit and loss account formats. In both cases, the information presented must be at least equivalent to that set out in the statutory formats. This will make it easier to prepare accounts under FRS 101 Reduced Disclosure Framework in a format closer to the presentation required by IFRS. The FRC intends to amend FRS 101 accordingly.

The size limits for medium-sized companies are increased to turnover of £36m and gross assets of £18m, with the limit on employee numbers remaining at 250. As now, two out of three limits need to be met, normally for two years, in order to qualify as medium-sized. Although medium-sized abbreviated accounts are abolished, there will still be limited disclosure exemptions for medium-sized companies, including omitting non-financial key performance indicators in the strategic report.

In the rare cases where no reliable estimate of useful life can be made, the Directive permits Member States to specify a useful life for goodwill and development costs of between five and ten years. The new law includes the upper limit of ten years, but this will apply only in those rare cases where no reliable estimate of life can be made, and only under UK GAAP. The FRC plans to amend FRS 102 accordingly.

Although it is restricted in application, merger accounting will remain available for group reconstructions.

The option to file full details of subsidiaries with the annual return is abolished for accounts approved by the board of directors from 1 July 2015 onwards and all relevant disclosures will need to be included in the accounts.

There are many changes at a more detailed level, some of which necessitate amendments to the new UK GAAP standards FRS 101 and FRS 102 and the statutory disclosure requirements.

Limited liability partnerships

Limited liability partnerships (LLPs) are outside the scope of the Directive. The BIS consultation issued in August 2014 did not address LLPs. However, it is likely that changes to the law on company accounts will be applied to LLPs but that, as now, LLPs will not be subject to statutory narrative reporting requirements, although the timing of any changes is uncertain.

Charitable companies

Charitable companies are covered by the CA 2006 accounting requirements but are outside the scope of the Directive. BIS is to engage in further discussions with the charities sector. The key decisions that BIS has taken so far are that:

• the limit on number and content of notes to the accounts for small companies would not apply to charitable companies, although this will not be stated in law
• the current flexibility in presenting the financial statements of charitable companies will be retained
• further consideration will be given as to whether small charitable company thresholds should be based on gross income rather than turnover.

Any questions?

This factsheet can serve only as an introduction to the main issues raised by changes to the law to implement the Directive and the associated changes to accounting standards proposed by the FRC. The impact will vary from entity to entity. If you wish to discuss this further, then please contact your usual Grant Thornton representative to discuss how we can help you assess the implications of these proposals. Alternatively, please contact our office location nearest to you for assistance, which can be found on our website at www.grant-thornton.co.uk.