EXPLANATORY MEMORANDUM TO

THE COMPANIES, PARTNERSHIPS AND GROUPS (ACCOUNTS AND REPORTS) REGULATIONS

2015 No. XXXX

1. This explanatory memorandum has been prepared by the Department for Business, Innovation and Skills and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 The Regulations update and consolidate existing legislation on the content and presentation of company accounts. The Regulations are deregulatory in nature and limit the burden of financial reporting and audit obligations, particularly for small companies.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 This SI replaces the original Regulations which were laid on 26 January 2015. The amendments have been made to correct a few typographical errors that were identified in the original version and to deal with two implementation issues.

3.2 Regulation 5(8)(b) amends section 401(2)(b)(iv) of the Companies Act 2006 and the words "in accordance with accounting standards which are equivalent to such international accounting standards," have now been substituted for "in accordance with international accounting standards" which appeared in the original regulations. This change is made to more closely implement the intention of the provision being implemented, which is Article 23(8) (b)(iv) of Directive 2013/34/EU.

3.3 Regulations 33(7) and 36(6) of the original Regulations are now omitted. Regulation 33(7) would have resulted in an inconsistency between the wording of the provision at paragraph 72(1) of Schedule 1 of the Large and Medium sized Companies and Groups (Accounts and Reports) Regulations 2008 (S.I. 2008/410) and the corresponding provision at paragraph 92(1) of Schedule 2, applying that provision to Banking Companies. Similarly, Regulation 36(6) would have resulted in an inconsistency between the wording of the provision at paragraph 72(1) of Schedule 1 of the Large and Medium sized Companies and Groups (Accounts and Reports) Regulations 2008 (S.I. 2008/410) and the corresponding provision at paragraph 90(1) of Schedule 3, applying that provision to Insurance Companies. The policy intention is to maintain consistency between these provisions which has now been achieved.

4. Legislative Context

4.1 The Regulations implement chapters 1-9 of Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660EEC and 83/349/EEC (OJ No L 182, 29.6.13, p 19) ("the Accounting Directive") to the extent that amendments to UK law are required. Chapter 10 of the Directive was transposed into UK law ahead of the

transposition deadline of 20 July 2015 to demonstrate the UK's commitment to the global company transparency agenda.

4.2 The proposal for a Directive of the European Parliament and of the Council on the annual financial statements and related reports of certain types of undertakings 16250/11 was submitted to the Commons and Lords Scrutiny Committees on 20 December 2011. The proposal was cleared by the Commons Scrutiny Committee in Report 50, Session 2012. The Lords Scrutiny Committee cleared the proposal on 24 July 2012.

4.3 The Accounting Directive provides a wide range of options to accommodate different accounting systems across the EU. The consultation drew attention to areas of mandatory and optional change on the preparation, presentation and filing of accounts. The approach to implementation set out in the Regulations enable business to benefit from potential deregulatory savings whilst recognising the interests of other stakeholders, such as shareholders and regulators.

4.4 The Accounting Directive updates and consolidates earlier legislation on financial reporting. Consequently the Regulations largely amend existing domestic legislation and although the Regulations do not exceed the voluntary and mandatory options in the Accounting Directive the use of copy-out (otherwise than in relation to a limited number of provisions) was not appropriate.

4.5 A transposition note is attached at annex A.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 The Parliamentary Under-Secretary of State for Employment Relations and Consumer Affairs has made the following statement regarding Human Rights:

"In my view the provisions of The Companies and Groups (Accounts and Reports) Regulations 2015 are compatible with the Convention rights".

7. Policy background

- ***What is being done and why***

7.1 The Government's overall objective is to support growth and encourage enterprise, whilst reducing unnecessary burdens on businesses. In the *Plan for Growth,*[1] published in March 2011, the Government set out its ambition "to make the UK one of the best places in Europe to start, finance and grow a business". It identified that this could be achieved in part by lessening the domestic regulatory burden on business.

7.2 The Regulations implement the Accounting Directive which updates and consolidates a substantial body of EU legislation for annual reports and accounts that are required of limited companies. It establishes the minimum legal requirements for

[1] http://cdn.hm-treasury.gov.uk/2011budget_growth.pdf

statutory annual reports and accounts at EU level, and provides a wide range of options to enable Member States to adapt the Accounting Directive to their national accounting frameworks. As the main intention is consolidation the Directive will not have a significant impact on the UK's approach to financial reporting.

7.3 Nevertheless, Chapters 1-9 of the Directive are broadly de-regulatory and of benefit to business as they raise the thresholds used to determine a company's size and reduce the reporting requirements for small companies. These changes will allow more companies to access the less burdensome regimes for both financial reporting and audit. The Regulations will enable business to benefit from these savings whilst addressing the interests of other stakeholders, such as shareholders, creditors and regulators.

7.4 In summary the most significant provisions of the Regulations will:

- Adopt the maximum thresholds available in the Accounting Directive to determine the size of small companies and enable the highest number of medium-sized companies to be re-categorised and access the less burdensome small companies regime. Mandatory increases in the thresholds for medium-sized companies will also be applied.

- Reduce the number of mandatory notes required of small companies to 13 notes, where these are appropriate.

- Permit small companies to prepare an abridged balance sheet and abridged profit and loss account if approved by all of the company's shareholders.

- Give companies in the same group as a public company which is not a listed company access to the small or medium-sized companies regimes.

- Provide companies with the opportunity to use alternative layouts when preparing their profit and loss account and balance sheet provided that the information given is at least equivalent to the information otherwise required by the standard formats. (This option is intended to reduce the burden of consolidation for those in a group using international accounting standards.)

- Remove the requirement for micro-entity companies to prepare a Directors' Report;

7.5 Public interest in the implementation of the Directive came from accounting and audit practitioners, representative bodies and national regulatory bodies. Many of these stakeholders provided detailed and expert advice during the consultation process and when drafting the SI.

- ***Consolidation***

7.6 The Accounting Directive updates and consolidates earlier legislation on financial reporting. Consequently the Regulations largely amend existing domestic legislation. The most important of this legislation is:

(i) Part 15 of the Companies Act 2006;
(ii) Part 16 of the Companies Act 2006;
(iii) The Small Companies and Groups (Accounts and Directors Report) Regulations 2008; and
(iv) The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

8. Consultation outcome

8.1 Throughout the negotiation and development of the Directive, the department informally consulted interested parties on the financial reporting requirements. Stakeholders were informed of policy developments and their views helped inform the negotiation process.

8.2 Formal consultation ran from 29 August to 24 October 2014. The consultation drew attention to all areas of mandatory change and, in addition, considered approaches to new options to establish positions relating to the preparation, presentation and filing of accounts. The consultation also explored a number of issues relating to the audit regime.

8.3 In total, 33 consultation responses were received most of which were full and detailed and the department published all consultation responses on its website;

https://www.gov.uk/government/consultations/eu-accounting-directive-smaller-companies-reporting

8.4 In addition to the written responses to the consultation, the policy and its supporting analysis has been informed by discussions and an expert working group which includes senior representatives from the accountancy and audit sector.

8.5 The Department had broad support for the proposed approach to implementation. This was to maintain the current provisions for financial reporting, and only introduce mandatory changes or those that support the existing framework and bring real benefits to users and preparers of accounts. These savings include adopting the maximum thresholds available to determine the size of small companies for both accounting and audit, greater flexibility in the presentation of financial statements, raising the audit exemption thresholds for small companies and a limit of 13 on the number of mandatory notes to accounts.

8.6 There were however two significant areas of controversy with stakeholders. The majority of consultation respondents were opposed to the increased abridgement of small company financial statements. The Department recognised the importance of performance information for shareholders: therefore the Regulations provide that companies can prepare fully abridged financial statements but only if they are approved by stakeholders.

8.7 Stakeholders expressed mixed views on whether the small company thresholds for audit and accounting should remain aligned. Consequently Regulations permit these to rise automatically in step with the increase in the small company accounting thresholds which it is estimated will offer savings to 7,400 small companies. A final decision on the alignment will be taken with the implementation of the Audit Directive and Audit Regulation. If it is concluded that the accounting and audit thresholds should remain aligned no further action will be taken.

9. Guidance

9.1 The implementation of the Regulations will be supported by the Financial Reporting Council's accounting standards: FRS 101 and FRS 102.

10. Impact

10.1 The Government has identified benefits to business with an Equivalent Annual Net Benefit of £34.7m. This saving reflects the de-regulatory options in the Regulations. The validated Impact Assessment will be published at www.legislation.gov.uk

10.2 The impact on the public sector is £267,000. This is the estimated cost of the development of a new interface to enable accounts to be filed at Companies House

11. Regulating small business

11.1 The legislation applies to small business, in that it exempts very small companies from certain financial reporting requirements.

11.2 Because the legislation is deregulatory there was no need to minimise its impact on small business.

12. Monitoring & review

12.1 The EU Commission will review the Directive by 21 July 2018. A parallel UK review will inform the wider review by the EU Commission. The review will be the responsibility of the Department for Business, Innovation and Skills.

12.2 The success criteria for the Regulations are that they implement the objectives of the Accounting Directive by successfully consolidating and streamlining the UK's financial reporting framework. They should also deliver a less burdensome accounting regime for small companies without harming the interests of other stakeholders such as shareholders, creditors and regulators.

13. Contact

13.1 John Conway at the Department for Business, Innovation and Skills.

Tel: 020 7215 6402 or email: john.conway@bis.gsi.gov.uk can answer any queries regarding the instrument.