EXPLANATORY MEMORANDUM TO

THE INTERNATIONAL ACCOUNTING STANDARDS, STATUTORY AUDITORS AND THIRD COUNTRY AUDITORS (AMENDMENT) (EU EXIT) REGULATIONS 2020

2020 No. 335

1. Introduction

1.1 This Explanatory Memorandum has been prepared by the Department for Business, Energy and Industrial Strategy and is laid before Parliament by Command of Her Majesty.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 The purpose of this instrument is to amend the International Accounting Standards and European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2019 (SI 2019/685) ("IAS SI"). The IAS SI addressed failures of retained EU law to operate effectively and other deficiencies arising from the withdrawal of the UK from the EU, in the field of accounts and reports of UK corporate bodies. This instrument provides a transitional arrangement for companies whose financial years 'straddle' the Implementation Period completion day ("IP completion day"), for the purposes of the IAS SI. The instrument also makes minor amendments to correct errors in the IAS SI and ensures that the Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019 (SI 2019/177) ("Audit SI") functions as intended. The instrument will apply to companies and other undertakings, but companies are referred to throughout for ease of reference.

2.2 **Note**: the Implementation Period ("IP") is the period that will commence on EU Exit Day (31 January 2020 at 11:00 pm) and end on 31 December 2020 at 11:00 pm. IP completion day is the day on which the European Communities Act 1972 will no longer have effect.

Explanations

What did any relevant EU law do before IP Completion day?

2.3 EU Regulation (EC 1606/2002) sets out the requirements for the application of International Accounting Standards ("IAS") in the EU. This requires that publicly traded companies apply a single set of high-quality IAS in the preparation of their consolidated financial accounts. It also sets out the provisions for an endorsement process to adopt IAS for use in the EU. International Financial Reporting Standards ("IFRS") are included within the definition of IAS in the EU Regulation. IFRS are a set of IAS which are issued by the International Accounting Standards Board ("IASB"). EU Member States may also either permit or require IAS for non-publicly traded companies to prepare their consolidated and/or annual accounts.

2.4 The effects of the legislation were transposed into UK law by Part 15 of the Companies Act 2006 and Regulations made under that Part. This means that UK publicly traded companies are required to apply IFRS as endorsed and adopted by the

EU to their consolidated accounts. Some UK companies use IFRS on a voluntary basis. All other companies must use UK Generally Accepted Accounting Practices ("UK GAAP") which is a UK specific set of accounting standards issued by the Financial Reporting Council ("FRC"). UK GAAP are influenced by and frequently incorporate IFRS requirements.

2.5 The IAS SI was laid in March 2019. It transfers the power to endorse and adopt IAS from the EU Commission to the Secretary of State. It also provides for a domestic regime for the endorsement and adoption of IAS after the UK's departure from the EU.

Why is it being changed?

2.6 The instrument provides an additional transitional provision for companies whose financial years 'straddle' IP completion day. These are financial years that:

(i) begin before IP completion day but end on or after IP completion day; and

(ii) end shortly before but file their accounts after IP completion day.

2.7 Companies with accounting years that straddle IP completion day can rely on the Companies Act 2006 provisions permitting them to use IAS adopted by the EU in Commission Regulation (EC) No 1126/2008 when preparing their accounts for that year.

2.8 On IP completion day, the standards adopted by the EU will be 'frozen' and brought into UK law. After IP completion day, companies will not be able to use any standards subsequently adopted by the EU and will instead be required to use those adopted by the UK under the new framework. However, for accounts relating to financial years which straddle IP completion day, the IAS SI does not permit the use of standards adopted by the UK under the new framework. This is a transitional problem only. For all financial years beginning after IP completion day, companies will fall under the new post-exit UK framework.

What will it now do?

2.9 This SI inserts a provision which relates to the preparation of accounts for financial years that straddle IP completion day into Regulation 1 of the IAS SI. It permits companies which have their financial year beginning before but ending on or after IP completion day, or which have a financial year ending before IP completion day but file their accounts after that date, to use IASs that are adopted by the UK after IP completion day, in addition to IAS as adopted by the EU before IP completion day.

2.10 The new Regulation 1(7) requires companies that take advantage of this optional use of UK-adopted IAS to put a note in their accounts stating that they have used this option. This is consistent with existing requirements in the Companies Act for companies to state that they have produced their accounts in accordance with IAS as adopted by the EU if they have done so.

2.11 The SI also makes some minor amendments to the Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019 (SI 2019/177). These amendments are minor consequential amendments following a previous amendment in the Statutory Auditors, Third Country Auditors and International Accounting Standards (Amendment) (EU Exit) Regulations 2019 (SI 2019/1392) and two amendments to remove EU legislation that has already been implemented into UK legislation and so will not be needed after the end of the IP.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 This statutory instrument was laid for sifting as required under the European Union (Withdrawal) Act 2018. The European Statutory Instruments Committee and the Secondary Legislation Scrutiny Committee considered the instrument on 25[w] February 2020 and both agreed that the instrument should follow the negative resolution procedure.

3.2 This instrument corrects defects in the IAS SI. Therefore, it is appropriate to apply the free issue procedure to this instrument.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.3 As the instrument is subject to negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is the United Kingdom.

4.2 The territorial application of this instrument is the United Kingdom.

5. European Convention on Human Rights

5.1 The Minister for Small Business, Consumers and Corporate Responsibility, Kelly Tolhurst has made the following statement regarding Human Rights:

"In my view the provisions of the International Accounting Standards, Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2020 are compatible with the Convention rights."

6. Legislative Context

6.1 It is expected that in 2020, before the end of the IP, a further statutory instrument will be laid before Parliament for debate that will sub-delegate the function to adopt IAS for use in the UK to a dedicated body (see the Explanatory Memorandum to the IAS SI for further explanation).

7. Policy background

What is being done and why?

7.1 UK listed companies are currently required to prepare their group consolidated accounts in accordance with IAS as endorsed and adopted for use in the EU by the European Commission. The current framework for adoption of IAS is set out in the EU's IAS Regulation (EC 1606/2002) which mandates the use of IAS for the consolidated accounts of companies whose securities are admitted to trading on a regulated market. Its requirements apply directly to EU listed companies producing group accounts, therefore requiring no transposition into Member State legislation. Other companies are permitted under the Companies Act 2006 to prepare their accounts in accordance with IAS if they so choose.

7.2 The IAS SI reflects the view of Government and industry that it is in the UK's interest to maintain convergence with IAS after EU Exit. IAS bring consistency to financial statements and are widely recognised by investors who value the transparency afforded in company reporting and the ability to compare the financial statements of companies globally. Indeed, IFRS are used internationally, by over 125 countries and including 15 out of the 20 G20 countries. By ensuring that the IAS SI will apply to all relevant companies, this instrument is consistent with the UK Government's policy that after departure from the EU, the UK will maintain its reputation as a global hub for business and investment. On-shoring (as far as possible) the endorsement and adoption of IAS should also support consistency and avoid costs from unnecessary disruption.

7.3 The IAS SI provides that the IAS adopted for use within the UK on IP completion day are those which were contained in Commission Regulation (EC) No. 1126/2008, as it had effect immediately before IP completion day. The IAS SI also specifies the Secretary of State as the decision maker with regard to the adoption of IAS and gives power to the Secretary of State to delegate the function to a designated body.

7.4 This instrument (by Regulation 4) amends the IAS SI to ensure that it has effect for the financial year of companies which 'straddle' IP completion day. It permits these companies to use IAS that are adopted by the UK after the end of the IP period, in addition to IAS as adopted by the EU before IP completion day. This will ensure that the intention of the IAS SI is fully provided for and does not represent a policy change.

Miscellaneous amendments

7.5 The instrument also contains a small number of miscellaneous amendments, correcting a minor defect in the IAS SI and ensuring the Audit SI functions effectively.

7.6 Regulation 4 provides an additional transitional provision for the IAS SI and regulation 5 makes a minor correction to clarify the effect of changes made by the IAS SI.

7.7 As set out in Section 2, Regulations 7, 8 and 9 make minor amendments to the Audit SI to ensure that it works effectively and to revoke retained EU legislation that is no longer needed.

Northern Ireland

7.8 This instrument applies to Company Law which is a transferred matter for Northern Ireland under section 4 of the Northern Ireland Act 1998. The Companies Act 2006 provides for a single company law regime applying to the whole of the UK, so that companies are UK companies rather than GB companies or Northern Ireland companies. EU Exit legislation which amends the Companies Act or legislation made under it therefore applies to the whole of the UK. This does not affect the legislative competence of Northern Ireland: company law remains a transferred matter, and the Companies Act could be separately amended or repealed in Northern Ireland if that were so desired.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument is being made using the power in section 8 of the European Union (Withdrawal) Act 2018 in order to address failures of retained EU law to operate effectively or other deficiencies arising from the withdrawal of the United Kingdom from the European Union.

9. Consolidation

9.1 This is not a consolidation.

10. Consultation outcome

10.1 The primary purpose of this instrument is to amend the IAS SI and the Audit SI so that they achieve their intended purpose. As such a consultation is not necessary.

11. Guidance

11.1 Companies House and other regulators will update their existing guidance to reflect the changes in reporting requirements for companies to be available when the IAS SI comes into force. Specific guidance for this instrument is not required as its primary purpose is to ensure that the IAS SI functions as intended.

11.2 Information regarding the establishment of a UK IAS endorsement framework will be made available in time for IP completion day.

12. Impact

12.1 The primary purpose of this instrument is to provide continuity and avoidance of unnecessary disruption to all relevant companies. Neither this instrument nor the IAS SI or Audit SI place any new reporting obligations on companies. Neither will it have an impact on charities or voluntary bodies.

12.2 As these Regulations simply ensure that the IAS SI functions as intended and updates the Audit SI, an impact assessment was not conducted. De minimis impact assessments were conducted for both the IAS SI and the Audit SI.

12.3 A de minimis impact assessment was produced and cleared in April 2018 for the IAS SI. It concluded that since the direct and indirect costs to business (including familiarisations) would fall below the de minimis threshold of £5m per annum, a full impact assessment was not required. A de minimis impact assessment for the Audit SI also concluded that the impact would fall below £5m per annum.

13. Regulating small business

13.1 The primary purpose of this instrument is to ensure that the IAS SI provides for all relevant business that benefit from the IAS. Since we would expect most of these companies to be large, we do not expect the legislation to affect activities that are undertaken by small business. Further, the amendments to the Audit SI will not have any impact on small companies.

14. Monitoring & review

14.1 As this instrument is made under the EU Withdrawal Act 2018, no review clause is required.

15. Contact

15.1 Daniel Makevic at the Department for Business, Energy and Industrial Strategy. Telephone: 020 7215 1108 or email: daniel.makevic@beis.gov.uk can be contacted with any queries regarding the instrument.

15.2 Andrew Death, Deputy Director for Business Frameworks, at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.

15.3 The Minister for Small Business, Consumers and Corporate Responsibility, Kelly Tolhurst at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.