

EXPLANATORY MEMORANDUM TO
THE COMPANIES AND LIMITED LIABILITY PARTNERSHIPS (ACCOUNTS AND
AUDIT EXEMPTIONS AND CHANGE OF ACCOUNTING FRAMEWORK)
REGULATIONS 2012

2012 No. 2301

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 These Regulations make amendments to the Companies Act 2006 (“the 2006 Act”), the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 (S.I. 2008/1911) (“the 2008 Regulations”), the Registrar of Companies and Application for Striking Off Regulations 2009 (S.I. 2009/1803), the Limited Liability Partnerships (Application of Companies Act 2006) Regulations 2009 (S.I. 2009/1804) and the Unregistered Companies Regulations 2009 (S.I. 2009/2436) which relate to the preparation and audit of the annual accounts of companies and limited liability partnerships (“LLPs”) and the delivery of accounts to the registrar of companies.

2.2 Their purpose is to widen the existing exemptions from audit for small companies and LLPs and to create new exemptions from the audit, preparation and filing of the individual accounts of subsidiary companies and LLPs for a given financial year, provided they meet certain qualifying conditions.

2.3 These Regulations also make amendments to the 2006 Act and the 2008 Regulations to give companies and LLPs more flexibility to change from preparing individual or group accounts in accordance with international accounting standards to Companies Act accounts.

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

3.1 None.

4. Legislative Context

4.1 Part 15 of the 2006 Act contains requirements regarding the preparation and publication of company annual accounts and annual reports. Part 16 contains provision with regard to the auditing of annual accounts. Council Directive 78/660/EEC (“the Fourth Directive”)¹ and Council Directive 83/349/EEC on consolidated accounts (“the Seventh Directive”)² are implemented in Parts 15 and 16 of the 2006 Act and regulations made under those Parts.

4.2 By widening the existing exemptions from audit for small companies limited by shares or by guarantee and creating new exemptions from the audit and separately from the preparation and filing of individual accounts for qualifying subsidiary companies

¹ OJ, L 222, 14.8.1978, p 11.

² OJ, L 193 18.7.1983, p 1.

limited by shares or by guarantee, the Regulations are taking advantage of optional derogations from the requirements relating to the preparation, audit and publication of accounts found in Articles 51 and 57 of the Fourth Directive, as amended, on the annual accounts of certain types of companies.

4.2 Although not within the scope of the Fourth or the Seventh Directives, LLPs and unregistered companies are subject to similar accounting and auditing provisions to those for limited companies and Parts 15 and 16 of the 2006 Act have been applied to LLPs and unregistered companies with modifications as appropriate. These Regulations apply to LLPs and unregistered companies the same exemptions from audit and from requirements to prepare and file individual accounts.

4.3. Similarly, these Regulations will give LLPs and unregistered companies the same flexibility as companies with regard to changing the accounting framework which they use to prepare annual accounts.

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 has made the following statement regarding Human Rights:

In my view the provisions of The Companies and Limited Liability Partnerships (Accounts and Audit Exemptions and Change of Accounting Framework) Regulations 2012 are compatible with the Convention rights.

7. Policy background

- *What is being done and why*

7.1 In the *Plan For Growth*, the Government committed itself to reduce the number of UK businesses required to undertake an audit and to substantially reduce the burden of financial accounting for UK businesses. At present, audit requirements in the UK do not offer as much flexibility to companies as is currently available under EU requirements. Some of this gold plating has created a market inequality.

7.2 The Government is therefore taking advantage of derogations available under Articles 51(2) and 57 of the Fourth EU Company Law Directive from the requirements of that Directive relating to the preparation, audit and publication of accounts. The Government is not taking advantage of the full extent of the derogation from the preparation and publication of accounts for qualifying subsidiaries as it is allowing only dormant subsidiaries to avail themselves of the preparation and filing exemptions. This is because HMRC use company accounts to calculate Corporation Tax, and therefore the requirement to prepare accounts cannot be dispensed with for non-dormant companies.

7.3 As a result of the Regulations, small companies will be eligible for audit exemption if they qualify as small for accounting purposes under the 2006 Act. This means they will be eligible if they meet two out of three criteria relating to turnover, balance sheet total and number of employees. These Regulations repeal the previous

additional requirement that a company must meet both the criteria as to turnover and balance sheet total.

7.4 The Regulations will also create audit exemptions for qualifying subsidiaries, and additional exemptions from the requirement to prepare and file accounts for qualifying dormant subsidiaries. Subsidiaries choosing to avail themselves of the aforementioned exemptions must deliver to Companies House:

- a statutory statement of guarantee by the parent which has the effect that the parent undertaking guarantees the outstanding liabilities of the subsidiary that exist at the end of the financial year for which an exemption is sought until they are satisfied in full;
- written notice that all the subsidiary's members have agreed to take advantage of the relevant exemption; and,
- the parent's consolidated accounts, consolidated annual report and auditor's report on those accounts.

7.4 We estimate that 36,000 additional small companies and 83,000 UK subsidiaries will now qualify for audit exemptions as a result of these changes. A further 67,000 dormant UK subsidiaries will qualify for the exemption from the requirement to prepare and file accounts.

7.5 In light of the consultation by the UK Accounting Standards Board (ASB) on changes to UK Generally Accepted Accounting Principles (UK GAAP), we have decided to allow companies who currently prepare their accounts under International Financial Reporting Standards (IFRS) more flexibility to change their accounting framework to UK GAAP. Companies who prepare their individual accounts under IFRS will now be allowed to move to UK GAAP for a reason other than a relevant change of circumstances, provided they change their accounting framework no more frequently than once every 5 years. Parent companies who prepare their consolidated group accounts under IFRS will be allowed a similar flexibility, provided they are not required to continue using IFRS by the IAS Regulation (EC) 1606/2002. This will increase opportunity for companies to select the accounting framework most appropriate for them. We believe a timescale of 5 years provides a sufficient level of flexibility whilst maintaining an appropriate level of consistency and comparability with respect to the preparation and filing of accounts.

7.6 The same conditions for exemption from the preparation, audit and filing of accounts and change of accounting framework are being applied to LLPs with minor modifications to reflect the characteristics of LLPs to ensure consistency with companies and deregulation.

- ***Consolidation***

7.7 None

8. Consultation outcome

8.1 The consultation began on 6 October 2011 and ran for twelve weeks, closing on 29 December 2011. It covered the whole of the UK, and 60 responses were received. The majority were received from accounting firms and accounting bodies; however responses were also received from large corporations, bodies representing preparers and

users of accounts, business information providers, and individuals. A summary of responses to the consultation was published on 2 March 2012 and the Government response to the consultation was published on 6 September 2012.

8.2 Respondents were broadly supportive of the proposals and welcomed the increased level of flexibility and the reduction in the regulatory burden on business offered by the proposals. To the extent that concerns were raised, they were primarily with regard to the need to protect users of accounts and creditors; the anticipated take-up rate of the audit exemption for qualifying non-dormant subsidiaries; and the level of savings available for subsidiaries. Respondents emphasised the need to protect users of accounts and creditors. In the light of these views and further discussions with stakeholders, the Government decided to introduce statutory guarantee provisions with a view to making it easier for companies to take up the exemption and to providing clarity for creditors.

8.3 Concern was expressed over the assumptions in our Impact Assessment as to the level of take up of the audit exemption for qualifying non-dormant subsidiaries. We therefore revised downwards our estimate of the take up rate to a range of 50%-75% take-up among those subsidiaries eligible to do so.

8.4 The proposal regarding the ability of companies to change their accounting framework was broadly welcomed by respondents to the consultation, and there was greater support from respondents that a change in accounting framework should be permitted no more than once every 5 years than for any of the alternatives. Strong support was received for the flexibility this proposal will offer to UK businesses.

9. Guidance

9.1 Companies House will be providing guidance on its website as to how companies can take advantage of the exemptions.

10. Impact

10.1 Our proposals will reduce the regulatory burden on UK businesses, and will provide greater flexibility to companies with respect to both audit and accounting requirements. The departmental estimate for the audit exemption measure is a saving to business of less than or equal to £390m per year. The Regulatory Policy Committee has confirmed that this measure would qualify as an “OUT”. The exact scale of the saving is to be finalised, but is likely to be at least £100m per year³. Final figures will be provided in Statement of New Regulation 5.

10.2 The net benefit of permitting companies more flexibility to change their accounting framework will be £2.4m per year.

10.3 No burdens are created on voluntary bodies, the public sector or charities.

10.4 Two Impact Assessments have been prepared and are attached to this memorandum. The first of these covers the changes to audit and accounting exemptions for companies and LLPs. The second covers the proposals on changes of accounting framework. These will be published alongside the Explanatory Memorandum at www.legislation.gov.uk.

³ HM Government One-in, One-out: Fourth Statement of New Regulation (URN12/96B), page 6 – available at www.bis.gov.uk/assets/biscore/better-regulation/docs/o/12-p96b-one-in-one-out-fourth-statement-new-regulation.pdf

11. Regulating small business

11.1 The legislation applies to small business, but is deregulatory.

12. Monitoring & review

12.1 The Impact Assessments set out the Government's plans for a post-implementation review of the operation of the policies in 2017. With regard to audit exemptions, the EU is currently reviewing the Fourth Directive, which may result in a change of audit exemption thresholds.

12.2 The review by Government will consider the number of businesses taking up the audit exemptions and the impacts of this change, including any ill effects on businesses, auditors, and their creditors, contractors and customers. Data will be collected by Companies House on the number of companies claiming the audit exemption. The success criteria will include the uptake by companies of these exemptions.

12.3 With regard to the proposal concerning accounting frameworks, the objective of the review will be to ascertain the uptake of the new flexibility in accounting regimes and any impact on users of accounts. Data will be obtained from the FAME (Financial Analysis Made Easy) database on the use of IFRS and UK GAAP by companies. The success criteria will be the uptake of this new flexibility to move between the accounting regimes.

13. Contact

Rufus Rottenberg at the Department for Business, Innovation and Skills, tel: 0207 215 0163, email rufus.rottenberg@bis.gsi.gov.uk can answer any queries regarding the instrument.

TRANSPOSITION NOTE

The table below sets out how the *Companies and Limited Liability Partnerships (Audit Exemptions and Change of Accounting Framework) Regulations 2012* implement Articles 51(2) and 57 of the Fourth Council Directive (78/660/EEC) of 25 July 1978 as amended.

Article	Objective	Implementation
51(2)	Allows Member States to exempt companies, defined as small under Article 11, from the requirement to audit annual accounts. In accordance with Article 12, it provides that the application of the exemption is only affected if the company exceeds the qualifying size limits for a period of two consecutive financial years.	Regulations 4 and 5 (amendment to sections 477 and 479 of the Companies Act 2006 (“the Act”)).
57	Allows Member States to exempt qualifying subsidiaries from the requirement to prepare, audit and publish annual accounts where all of the following conditions are met:	Regulations 6 and 7 and 19 concern all subsidiary companies (amendment to sections 475 and 1078 and insertion of sections 479A, 479B and 479C into the Act) Regulations 8,9,10 and 11 only concern dormant subsidiary companies (amendment to sections 394 and 441(2) of the Act; and insertion of sections 394A,394B, 394C 448A, 448B and 448C into the Act).
	(a) the parent undertaking must be subject to the laws of a Member State;	s479A(1)(b), s394A(1)(c), s448A(1)(c) of the Act
	(b) all shareholders or members of the subsidiary undertaking must have declared their agreement to the exemption from such obligation; this declaration must be made in respect of every financial year;	s479A(2)(a), s394A(2)(a), s448A(2)(a) of the Act
	(c) the parent undertaking must have declared that it guarantees the commitments entered into by the subsidiary undertaking;	s479A(2)(b) and s479C, s394A(2)(b) and s394C, s448A(2)(b) and s448C of the Act

	(d) the declarations referred to in (b) and (c) must be published by the subsidiary undertaking in accordance with Article 3 of Directive 68/151/EEC (now Article 3 of Directive 2009/101/EC);	s479A(2)(e), s394A(2)(e), s448A(2)(e) and paragraph 1A under the entry for “Accounts, reports and returns” in section 1078(2) of the Act.
	(e) the subsidiary undertaking must be included in the consolidated accounts drawn up by the parent undertaking	s479A(2)(c), s394A(2)(c), s448A(2)(c) of the Act
	(f) the above exemption must be disclosed in the notes on the consolidated accounts drawn up by the parent undertaking;	s479A(2)(d), s394A(2)(d), s448A(2)(d) of the Act
	(g) the consolidated accounts referred to in (e), the consolidated annual report, and the report by the person responsible for auditing those accounts must be published for the subsidiary undertaking in accordance with Article 3 of Directive 2009/101/EC.	s479A(2)(e), s394A(2)(e), s448A(2)(e) and paragraph 1A under the entry for “Accounts, reports and returns” in section 1078(2) of the Act