

1 Case studies on the Impact of Brexit on UK Financial Reporting and Auditing

Brexit will involve several changes to accounting and auditing requirements in the UK. The following is a summary of the Regulations made to date. Changes under these Regulations will apply from "IP completion day" which is 31 December 2020 (2300 hours). Therefore, there will be no impact on financial reporting or auditing for 2020, but consideration should be given to future periods. The requirements will apply to accounting periods commencing after 31 December 2020. It must also be borne in mind that these may change as a result of any negotiations before this date.

1.1 Background

UK company law and reporting requirements have been developed over the period the UK has been part of the EU. At this time, the UK requirements are aligned to EU requirements. For example, the UK reporting regime is aligned with the EU Accounting Directive, and there is no indication that this will change in the future. Therefore, it is the implication of where the EU is specifically mentioned in company law which is important.

Consideration also has to be given to where the EEA is mentioned. There are three countries which are members of the EEA but are not members of the EU. They are Norway, Lichtenstein, and Iceland. Countries which are within the EEA are part of the single market but are not necessarily members of the EU. The UK will be leaving the EU, and there are indications it will not be part of the single market. On this basis, it has been assumed, that it will not be a member of the EEA either.

1.2 Preparing financial statements under IAS/IFRS

Under s395 UK entities are required to prepare either Companies Act individual accounts or IAS individual accounts. The same applies where group accounts are required to be prepared. SI1606/2002 required all UK listed entities to prepare their consolidated financial statements under EU adopted IAS/IFRS. The Act, as above, only refers to IAS. The same Regulations permitted listed entities to prepare their individual financial statements on the same basis, and other entities could do the same.

From the IP date, the reference to EU adopted will be revised to UK adopted. At that date, there will not be any difference between the two. The FRC will have a process to adopt IAS/IFRS, and therefore there may be some differences over time.

For UK entities preparing accounts under FRS 102, there will not be any changes.

1.3 Exemption from preparing financial statements

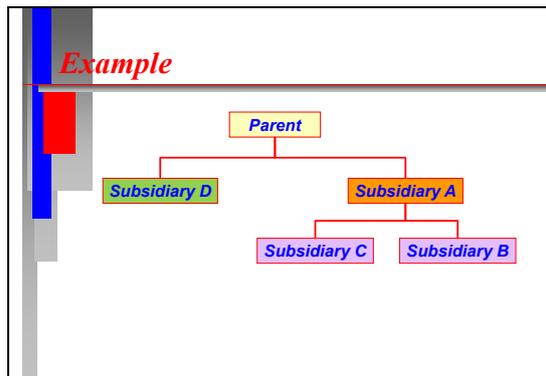
Under s394A, a company is exempt from the requirement to prepare individual accounts if it satisfies all of the following:

- It is a subsidiary undertaking
- It has been dormant throughout the whole of the year
- The parent is established under the law of an EEA State

The last requirement will be amended to UK parents only.

Exemption is conditional on compliance with certain conditions, which are outlined below.

Example



Subsidiary D is dormant, is it entitled to apply s394A?

Exemption is conditional on compliance with several requirements.

- In the above example, for the subsidiary to use the exemption, the parent would have to prepare group accounts. In those consolidated accounts, there must be disclosure that the subsidiary is exempt from the requirement to prepare individual accounts. The subsidiary must also file with the Registrar a copy of the consolidated accounts together with any audit report and annual report.
- The parent is also required to give a guarantee, and a written notice of this is required to be filed. The written notice is form AA06 available from Companies House.
- All the members of the subsidiary must agree to the use of the exemption, and a written notice of this must be filed. There is no form for this and no format available. This could be the written resolution passed by the shareholder(s).

Taking all of the above into consideration, it may be easier to prepare and file the dormant accounts. However, in practice, this exemption is used, and sometimes incorrectly.

For example, if the parent is in India; is the subsidiary entitled to the exemption. India is not in the EEA, and therefore the exemption is not available. If the parent is in Germany is the subsidiary entitled to the exemption? Germany is an EU State, so the answer is yes, but only to 31/12/2020. The Regulations, SI (2019/145), state that the commencement date for this change is accounting periods commencing on or after the IP date. Therefore, if the entity period end was 31 March, the exemption would be available up until 31/03/2021, for the following period the exemption will not be available.

For the entity and the accountant, the issue may be remembering that this change has arisen and that the exemption is no longer available. If no longer available, and accounts are not filed, then a late filing penalty could be incurred.

1.4 Exemption from preparation of group- accounts - Intermediate parent

This arises where an entity is both a subsidiary and parent. Using the same example as above subsidiary A is an intermediate parent.

Is this entity required to prepare group accounts?

There are exemptions from the preparation of group accounts as follows:

Section 399 – parent heading small group

Section 400 – parent in the EEA

Section 401 – parent outside EEA

Section 402 – no subsidiaries to be included

The first consideration would be; does A Ltd head a small group. This group comprises subsidiaries A, B, and C. Applying the criteria turnover, balance sheet total and employees with the “years rule” will establish whether the requirements of s383 have been met. As a reminder, these are as follows:

	<u>Gross</u>	<u>Net</u>
Turnover	£10.2m	£12.2m
Balance sheet total	£5.1m	£6.1m
Employees		50

The common “misunderstandings in applying the above are:

- You only have to satisfy the net or the gross, not both, and not the same for each. Therefore, you could satisfy the gross for turnover and the net for balance sheet total.
- Balance sheet total is total assets, not the value that appears on the balance sheet.
- Employees are as defined in the Act, i.e. the number employed under contracts of service. For example, under the off-payroll working changes arising on 06/04/2021, those contractors who are deemed to have the status of employees and have PAYE and NI deducted from amounts paid are not employees for this purpose. This is because they do not have contracts of service. This conclusion is also supported by the fact that they do not have any other employment rights, e.g. holiday pay, sick pay, termination rights, or pension rights.
- The net is computed as after adjustments to eliminate group transactions, s383(6). This section refers to s404, which states that group accounts must comply with Regulations. Regulation 6 (SI 2008/410) only includes a reference to the elimination of group transactions are debts and claims and income and expenditure relating to transactions between the group members. Regulations 7 to 9 cover the application of acquisition accounting, which presumably should also be adjusted to arrive at the net value. Hence the fixed asset investment would be offset against the acquired capital and pre-acquisition profits in arriving at goodwill. Occasionally, if the group starts as small, and then increases in size, this information may be lost in the mists of time.

A parent qualifies as a small company if the group it heads qualifies as a small group. Some companies are excluded from the small companies regime which would apply to both individual companies and parents, s384. This includes a provision where the company is a member of an ineligible group. An ineligible group would be one which includes a body corporate whose shares are admitted to trading on a regulated market in an EEA state.

Consider the above example, and assume that the group headed by subsidiary A satisfies the criteria above. If the parent is a listed entity in India, then it is not within an EEA state and is not a member of an ineligible group and would be able to use the small companies regime. As a small parent, it would be exempt from the preparation of group accounts and would be able to apply FRS 102 section 1A. If the parent was listed in Germany, then it would not be exempt from the preparation of group accounts unless it applied s400, see below. It would not be able to use section 1A. However, this is another reference to an EEA state which will be amended to a

UK regulated market. The effective date is period commencing on or after the IP completion day.

If the parent was listed in Germany and the period end was 31 March 2020, then s400 would apply if the parent prepared group accounts which included subsidiary A's group. The requirements of s400 include the following:

The parent consolidated accounts must be drawn up to the same date or to an earlier date in the same financial year. Subsidiary A is required to deliver to the Registrar a copy of the group accounts (together with annual report and audit report) within the filing period allowed. If the parent period end is not co-terminus, it is important to ensure that the relevant group accounts are delivered. The requirement is that A must be included in the group accounts for the parent drawn up to the same date, or an earlier date in the same financial year. For example, if the parent period end is 30 June then the group accounts prepared in the period to 31 March 2020 are 30 June 2019. In many instances, this is not an issue as groups tend to have co-terminus period ends, certainly makes consolidation easier.

However, if A is a recent addition to the larger group it may not have been included in those accounts.

If the same scenario was to apply for 31 March 2022, then the subsidiary is no longer a member of an ineligible group and would not have to apply s400. It is important to remember that where exemption under s400 is taken, there is a requirement to disclose this fact. If the entity does not prepare group accounts as it is a small parent, then there is no disclosure requirement.

From IP day section 400 will only be available where the parent is in any part of the UK.

It is also important to be aware that some geographical locations which are popular for parents of UK entities, are not within the EEA. This includes the Isle of Man and the Channel Islands; however, Gibraltar is. If the parent is outside the EEA, then exemption from the preparation of group accounts is available under s401. The requirements are similar to s400, but it is important to refer to s401.

The aspect of listed entities in the group is different for determining small and medium status. For medium then the group must not include a body corporate whose shares are admitted to trading on a regulated market. Hence, in the above example, if subsidiary A ceased to satisfy the small criteria, and the parent was an Indian listed entity, then it would not change to medium, it would be other. If the parent was German then currently it would be other, when the amendment is applicable it would change to small.

In terms of financial reporting, the distinction between medium and other is minimal. There are aspects for other requirements, e.g. strategic report.

1.5 Extending the accounting period

The accounting period is either extended or shortened by changing the accounting reference date (s392). A company can shorten the period as often as it wishes but can only extend once in a 5 year period.

Shortening of the period is commonly used to extend the filing deadline. A recent announcement in respect of possible changes to company law referred to this as one of the most abused sections of the Act. Despite this comment, it is not unusual to find accountants and directors who are not aware of this.

Shortening means that the period ends on the first occasion on which the new accounting reference date falls, and lengthening is the second. The accounting reference date cannot be changed if the period for filing the accounts for the original date has expired.

Example

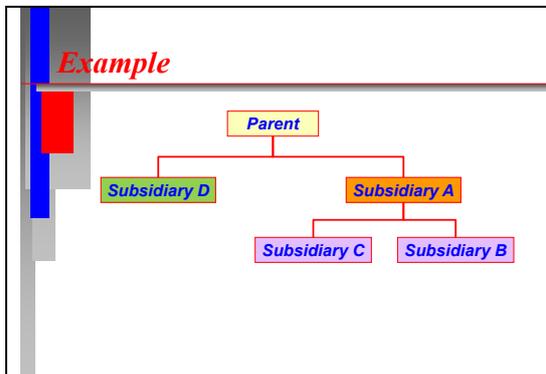
A Ltd has an accounting reference date of 31 May, and the accounts to 31/05/2019 have not been filed. The filing deadline would have been 28/02/2020, so the date cannot be changed.

If the accounting reference date was 30 June, the filing deadline would be 31/03/2020. If, on 25/03/2020 the directors realise they will not meet the deadline they could shorten the period. There is no minimum or maximum period, so the mechanism to avoid the late filing penalty is to shorten by one day, i.e. 29 June. Under s442 the filing deadline is now either the date based on the revised reference date, or three months from the date notice is given to the Registrar whichever is later. In this example the later of 29/03/2020 or 25/06/2020. As above, you can shorten as often as you want so if the directors realise on 20/06/2020 they will not meet the deadline they could shorten again, say to 28 June. This now gives a filing deadline of 28 September. You cannot go any further as you can only give notice for the current period or the previous period. When the 28/06/2020 has been passed, you could only change that period or one in the future, you cannot revise the reference date in 2019.

As commented above, this is often used to avoid a filing penalty. However, the implications are occasionally overlooked. In the above example, the accounting reference date is now 28 June. For future periods the filing deadline is now 28 March, not 31 March. This is because under s443, the deadline is only the end of the corresponding month if the accounting reference date is the end of a month. Otherwise, it is the corresponding date in that month. Subject to requirements, the period could be extended back to 30 June.

An exception to the once every five years is that a subsidiary can align its reference date to a subsidiary or parent undertaking provided that entity is in an EEA State.

Example



Consider that subsidiary A (and B and C) have made the following history.

2017, reference date 31 December, accounts made up to 31/12/2017

2018, extended to 31 March, accounts made up to 31/03/2019

2019, acquired by parent 01/01/2020. Parent has period end 30 September. Next financial statements 30/09/2020. Parent wants A to prepare accounts to the same date as group accounts will be prepared. There are two options, prepare to 31 March 2020 and then shorten the period, or the preference is to extend to 30 September and prepare for 18 month period. Under s392, a period cannot exceed 18 months.

If the parent is in an EEA State, then this will be permitted. Therefore, if the parent is in Germany, the period could be extended, if the parent is in India, it cannot. The

amendment from the IP completion day is to remove the reference to EEA and replace with the UK. This applies to accounting periods commencing on or after IP completion day.

1.6 Dormant companies and filing accounts

Under s448A dormant subsidiaries can take advantage of an exemption not to file their accounts. The requirements are that it must be a subsidiary, it must have been dormant throughout the period, and the parent must be established in an EEA State. The conditions are the same as above for not preparing accounts. The change will be a reference to the UK and not EEA.

1.7 Audit exemption and s479A

There has been some confusion on when the changes to s479A will apply.

SI2019/177		Revised by SI2019/1392.
	s479A	Original revised to add any part of the UK to the reference to EEA. But this was revised in 1392 to remove any reference to EEA. Therefore, exemption will only be available if the parent is in the UK and provides the guarantee, prepares group accounts, etc.
	Commencement	In force on exit day. No reference to financial years commencing on or after. There have been changes to the commencement date.
SI2020/108		In its continuing application in relation to audits of accounts for financial years that begin before IP completion day, section 479A(1)(b) of the Companies Act 2006 (including as modified by regulation 34A of the Limited Liability Partnerships(Accounts and Audit) (Application of Companies Act 2006) Regulations 2008(8)) must be treated as if the reference to a parent undertaking being established under the law of an EEA State included a reference to a parent undertaking being established under the law of any part of the United Kingdom.”
	Explanatory memorandum	7.2 Regulation 4 of this instrument inserts an additional transitional provision into Schedule 4 to the first audit regulations, applying to the amendments those Regulations make to the subsidiaries audit exemption. The exemption is currently available to subsidiaries of UK and EEA parent undertakings as provided for in EU law. The intended effect of the transitional provision is that it will continue to be available to those subsidiaries where their financial years have already begun before commencement of the amendment. The removal of the exemption for subsidiaries of EEA parent undertakings will then only apply for financial years beginning on or after the day after the end of the implementation period. The transitional provision is needed to enable subsidiaries of EEA parent undertakings to file unaudited accounts with Companies House on or after it comes into force for financial years that began before the end of the implementation period.

		On 9 March ICAEW stated that the exemption would continue to be available for periods which commenced before exit day, currently defined as 11pm 31 December 2020.
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Audit exemption

Companies can take advantage of audit exemption under the following provisions:

- Small company (s477)
- Qualifying subsidiary (s479)
- Dormant company (s480)

The exemption under s479 is often seen in groups and is one which is likely to change. To take advantage of the exemption, then the entity must be a subsidiary, and the parent undertaking must be established under the law of an EEA State.

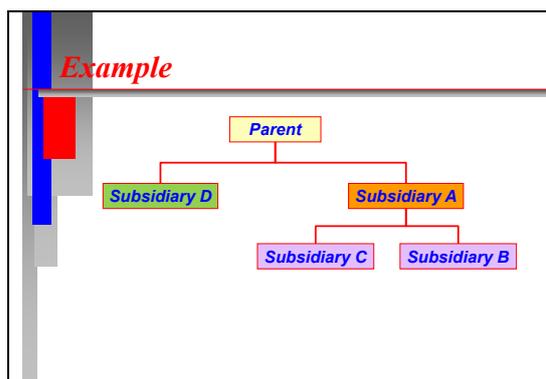
The exemption is conditional on several conditions which include:

- All members must agree
- The parent must give a guarantee
- The entity must be included in consolidated accounts drawn up by the parent
- The parent must disclose that the entity is exempt from the requirements of the Act
- The directors must deliver written notice of the member agreement and the guarantee statement, copy of consolidated accounts together with an annual report and audit report.

Do the parent financial statements need to be audited?

Section 479A does not specifically require that the parent accounts are audited. However, s479A(2)(e) requires that the directors deliver a copy of the audit report on the consolidated accounts. There is no “if prepared” option which would imply that an audit is required.

Example



In consideration of the options available to A, B, and C, the following should be noted.

For these entities to take advantage of audit exemption as a small group, the requirements are different from those applied for accounting. The size of the whole group needs to be considered. Therefore, even if A heads a small group that would not give entitlement to audit exemption on that basis. For the application of the small companies regime and section 1A, and assuming it is not an ineligible group, the

determination is based on the “subgroup” only. Section 479 requires a consideration of the wider group for audit exemption. This is often overlooked, especially where there are members of the group outside the UK.

Therefore, if the group headed by the parent would qualify as small under s477, then the UK entities would be entitled to audit exemption under that section. If not, they are not so entitled.

If the parent is in the EEA, then the requirements for audit should be based on the same framework, and an audit of the group accounts would follow the same requirements the UK. Therefore, addressing the question, the group accounts would be audited. If the parent is outside the EEA, the provision is not available. Hence, if the parent was in Germany, then the exemption would be available if India it is not.

The change from IP completion day will be to only refer to UK parents. This change is in SI 2019/177. Where this exemption is used then the commencement date should be carefully noted.