The EU Accounting Directive and Changes to Company Law

The EU Accounting Directive has been brought into force in the UK through amendments to the Companies Act 2006 ("the Act"), enacted via Statutory Instrument 2015/980 "The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015".

There are a number of changes brought about by these amendments, outlined below, which all have effect for accounting periods commencing on or after 1 January 2016. Please note that there is an option to early adopt the new rules set out below for accounting periods commencing on or after 1 January 2015. If the early adoption provision is used, FRS 102 Section 1A must be used for the financial statements:

Small Entity Thresholds

The size criteria to qualify as small are amended as follows:

	Old	New
Turnover	Not more than £6.5m	Not more than £10.2m
Gross assets (fixed + current)	Not more than £3.26m	Not more than £5.1m
Average number of employees	Not more than 50	Not more than 50

The same "2 out of 3" and "two year" rules will apply. In assessing company size, the new thresholds will be applied to the first year of adoption and the comparative period to determine whether the two year rule applies.

Audit Exemption

The criteria to be exempt from audit is set out in section 477 of the Act, which refers to the size of a company as defined in sections 382-384. The table above shows the amendment to the size criteria of section 382, therefore audit exemption limits have also been raised (please note, there is a possibility that further changes will be made in this area prior to 1 January 2016).

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However, although an entity can early can adopt the new size criteria to qualify as small a year early (as the new size criteria can be applied for periods commencing on or after 1 January 2015) there is no similar option to bring forward the new criteria for audit exemption. Please remember that if an entity early adopts the new size criteria, they must early adopt the new financial reporting standard (i.e. section 1A of FRS 102).

Disclosures and the Requirement to Show a "True and Fair view"

The required disclosures in a set of small entity financial statements have been significantly reduced due to the EU Accounting Directive and the introduction of FRS 102 Section 1A. An entity will still be required to produce a Directors' Report, a Profit and Loss account, a Balance Sheet and some notes. However, a lot of the notes that are familiar under current UK GAAP will no longer be required under the new standards. It could be the case, for instance, that the financial statements for a straight-forward small company may have, say, just five or six notes. However, the over-arching principle remains that directors must present accounts which show a true and fair view. Guidance and best practice will develop here to determine what can be considered true and fair, and whether additional disclosures are required over and above the minimum required.

Filing Options

Small companies will be able to take advantage of section 444 of the Act to avoid filing the Directors' Report and profit and loss account.

However, a small company will no longer be able to file a set of abbreviated accounts with Companies House. Instead a small company will file the versions of the Balance Sheet and Profit and Loss account (if the Profit and Loss account is filed), along with the notes, which are prepared and sent to shareholders. This means that what is filed at Companies House will change, and in some circumstances more information will be on public record.

Additionally, where all members of a company (which is not a charitable company) consent, small companies will be permitted to prepare an "abridged" Balance Sheet and Profit and Loss account to send to shareholders. Abridged accounts will still require the same notes, but would present a simplified profit and loss account and balance sheet (for example, the first item presented in an abridged Profit and Loss account will be "Gross Profit"). It should be noted that such consent needs to be obtained on an annual basis.

Practical Considerations

There are a number of areas that directors and preparers of financial statements need to consider in respect of the new accounting landscape;

- The financial statements are going to look different - the Profit and Loss account will become an "Income Statement", which may be combined with other recognised gains or losses (as the STRGL is also being replaced) to become a "Statement of Comprehensive Income";
- There will be more volatility in the "P&L" account;
- The need to (re-)construct a balance sheet at the transition date, and to undertake a potentially substantial restatement of the comparative figures;
- The impact on the entity's tax affairs;
- Whether there is any merit in adopting these changes early, or deferring them as long as possible (this will depend on your individual circumstances)
- Whether profit-related pay schemes or earn-out agreements need to be amended;
- Whether bank covenants are breached;
- Timing of acquisitions (the date of which may impact how they are accounted for);
- Whether revaluations are necessary (either before or at the transition date);
- Current and future dividend policies.

As a result of all these changes, you may be thinking "What is the way out of this?" – Unfortunately, there isn't one. However, for the smallest of entities, there is a new micro-entity regime.

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