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CONSOLIDATION OF MEDIUM SIZED GROUPS

Lecture A278 (11.44 Minutes)

Need to Consolidate Medium Sized Groups

One of the changes brought in by the Companies Act 2006 is a requirement for parent companies of medium sized groups to prepare consolidated accounts. Such groups were previously exempt under s248(1) of the Companies Act 1985 but the new regime applies for periods commencing on or after 6 April 2008.

There are a number of implications arising from the removal of this exemption beyond the obvious change in the content of the financial statements.

Mechanics of consolidation

Assuming an April year-end, it will not be just the April 2009 results that have to be consolidated. It will be necessary to consolidate the results for 2008 (to provide comparatives) and for 2007 (to provide opening figures and to prepare the cash flow statement).

In the past many practices have not had to worry about group accounts, as none of the groups they deal with are large groups. How confident are you that your staff know how to prepare a set of consolidated accounts? Similarly, does the accounting software used by your firm handle consolidated accounts?

Ethical issues

Unless all of the subsidiaries in the group have been wholly-owned from incorporation it will be necessary to revisit the acquisition of each subsidiary to consider issues such as the fair value of assets acquired, goodwill, pre-acquisition profits, minority interests etc. This point raises a number of questions:

- Who will do this work? In many cases the client will not have the resources and will expect you as the auditor to do it for them.

- Does the client have the necessary information available (essentially a set of accounts for the subsidiary at the date of acquisition)?

- If the client has the information available and the group structure is straightforward then it should not be a problem implementing appropriate safeguards for the accounting services provided. However, if complete information is not available or if the group structure is complicated it may be that significant judgements will be necessary in arriving at some of the numbers in the consolidated accounts. In such circumstances would the effectiveness of the available safeguards be sufficient to reduce the self-review threat to an acceptable level?

Other matters

- A new engagement letter will be required that addresses the audit of consolidated accounts.
- There will be fee implications and the client should be warned in advance that costs will increase.
- Will there be an impact on the timetable for the preparation of the accounts?
- Does the firm audit the entire group?

Action Points

1. Planning is key: don't wait for problems to arise before you take action!
2. Identify the clients that will be affected now so that you can start to address the issues.
3. Involve the client in as much of the information gathering as possible. This will help to reduce costs and also help to mitigate any self-review threat.
4. Where judgements are required, involve the client as much as possible in determining the numbers and obtain their agreement to the approach taken. This will help to demonstrate informed management in these areas.

DEFERRED TAX

Lecture A277 (8.12 Minutes)

Changes to the Capital Allowances regime could have a significant impact on accounting for deferred tax for smaller entities. The introduction of the 100% annual investment allowance (£50,000) and the availability of 100% first year allowances for green cars and certain other environmentally friendly assets might mean that previously immaterial deferred tax liabilities grow to become material. Therefore, this is an ideal opportunity to revisit FRS 19.

Case studies

Situation 1

The directors of R Ltd have a depreciation policy which is to charge on a straight line basis at 20% per annum. On this basis, they have never bothered to include deferred tax in their accounts since, they claim, the amount must be trivial. They provide the following as supporting evidence for their view:

Suppose an asset is purchased for £20,000 at the start of year 1. Capital allowances are calculated on the basis of a 20% per annum writing down allowance. The appropriate tax rate is 22%.

Year	NBV of asset	Tax WDV	Difference	Deferred tax (Liability)/asset
1	16,000	16,000	0	0
2	12,000	12,800	800	176
3	8,000	10,240	2,240	493
4	4,000	8,192	4,192	922
5	0	6,554	6,554	1,442

The directors argue that there is never a liability; the asset is immaterial and, anyway, it would not be prudent to recognise a deferred tax asset.

Is the directors' view acceptable?

Situation 2

How would the situation change if the tax regime was altered so that there was a first year allowance of 40% which replaced the writing down allowance in that year?

Situation 3

How would the situation change if the tax regime was altered so that all fixed asset purchases qualified for a first year allowance of 100%.

Situation 4

A new business purchases £50,000 of fixed assets each year. In year two, it buys a low emissions vehicle for £20,000 which it then replaces every 3 years. All assets are depreciated over 5 years.

Turnover	£750,000
Profit	£100,000
Balance Sheet	£400,000

Is deferred tax material?

Comments on case studies

Situation 1

We often talk about accelerated capital allowances as being the usual source of a deferred tax balance. However, if a company depreciates its assets fairly quickly then there is more likely to be a deferred tax asset. In the profitable company, there is no reason why this asset should not be recoverable.

The directors have only looked at one asset. Consider the situation that arises if the company undertakes regular capital expenditure.

Suppose that a new company spends £20,000 per annum on fixed assets which qualify for capital allowances. Assets are disposed of at the end of their expected useful life – there are no disposal proceeds. All other assumptions are as before.

Here is the calculation of the fixed assets net book value:

Year	1	2	3	4	5	6	7
Fixed assets							
Brought forward	0	20000	40000	60000	80000	100000	100000
Additions	20000	20000	20000	20000	20000	20000	20000
Disposals						20000	20000
Carried forward	20000	40000	60000	80000	100000	100000	100000
Depreciation							
Brought forward	0	4000	12000	24000	40000	60000	60000
Charge for year	4000	8000	12000	16000	20000	20000	20000
Disposals						20000	20000
Carried forward	4000	12000	24000	40000	60000	60000	60000
Net book value	16000	28000	36000	40000	40000	40000	40000

The net book value will now remain stable at £40,000

This is the calculation of tax written down value and deferred tax for the same period:

Year	1	2	3	4	5	6	7
Tax written down value							
Brought forward	0	16000	28800	39040	47232	53786	59028
Additions	20000	20000	20000	20000	20000	20000	20000
Total	20000	36000	48800	59040	67232	73786	79028
WDA	4000	7200	9760	11808	13446	14757	15806
Carried forward	16000	28800	39040	47232	53786	59028	63223
Tax WDV - NBV	0	800	3040	7232	13786	19028	23223
Deferred tax asset	0	176	669	1591	3033	4186	5109

Note that the deferred tax asset will go on increasing until year 47 when it reaches its stable balance of £8,800.

Situation 2

The introduction of a first year allowance of 40% will initially give rise to a deferred tax liability. This, however, will be rapidly overtaken by reversing timing differences. Using the same example as before, we obtain the following calculation of tax written down value and deferred tax:

Year	1	2	3	4	5	6	7
Tax written down value							
Brought forward	0	12000	21600	29280	35424	40339	44271
Additions	20000	20000	20000	20000	20000	20000	20000
First year allowance	8000	8000	8000	8000	8000	8000	8000
WDA	0	2400	4320	5856	7085	8068	8854
Carried forward	12000	21600	29280	35424	40339	44271	47417
Tax WDV - NBV	-4000	-6400	-6720	-4576	339	4271	7417
Deferred tax	-880	-1408	-1478	-1007	75	940	1632

The deferred tax asset will increase until year 46 when it reaches its stable balance of £4,400

Situation 3

This is the simplest situation. We do now have a liability arising from the accelerated capital allowances:

Year	1	2	3	4	5
Tax written down value					
Brought forward	0	0	0	0	0
Additions	20000	20000	20000	20000	20000
Annual investment allowance	20000	20000	20000	20000	20000
Carried forward	0	0	0	0	0
NBV - Tax WDV	16000	28000	36000	40000	40000
Deferred tax liability	3520	6160	7920	8800	8800

By the end of year 4, the deferred tax liability reaches its stable position which can be calculated as (net book value x tax rate).

Situation 4

Year	1	2	3	4	5	6	7
Fixed assets							
Brought forward	0	50,000	120,000	170,000	220,000	270,000	270,000
Additions	50,000	70,000	50,000	50,000	70,000	50,000	50,000
Disposals					20,000	50,000	50,000
Carried forward	50,000	120,000	170,000	220,000	270,000	270,000	270,000
Depreciation							
Brought forward	0	10,000	34,000	68,000	112,000	154,000	158,000
Charge for year	10,000	24,000	34,000	44,000	54,000	54,000	54,000
Disposals					12,000	50,000	50,000
Carried forward	10,000	34,000	68,000	112,000	154,000	158,000	162,000
Net book value	40,000	86,000	102,000	108,000	116,000	112,000	108,000
Tax written down value							
Brought forward	0	0	0	0	0	0	0
Additions	50,000	70,000	50,000	50,000	70,000	50,000	50,000
Capital allowance	50,000	70,000	50,000	50,000	70,000	50,000	50,000
Carried forward	0	0	0	0	0	0	0
NBV - Tax WDV	40,000	86,000	102,000	108,000	116,000	112,000	108,000
Deferred tax liability	8,800	18,920	22,440	23,760	25,520	24,640	23,760

Given the performance of the company, materiality is in the region of £10,000. In a number of the previous situations, deferred tax would not have been material but it becomes so in this example.

FREQUENTLY ASKED QUESTIONS

Lecture A274 (13.57 Minutes)

These questions arise from a variety of sources. Most are questions asked during courses but some are adapted from the pages of the accountancy magazines.

LLPs – date of application of FRSSE 2008

A LLP is a small LLP and is preparing its accounts for the year ended 30 June 2009. Which Companies Act will be referred to in the statement in the balance sheet? Which FRSSE will be referred to in the accounting policies?

The application of the Companies Act 2006 to LLPs is covered by the following Regulations:

- SI 2008/1911 – applies the accounting and auditing aspects of the CA 06 to LLPs, effectively Parts 15 and 16 of the Act
- SI 2008/1912 – the regulations applying to small limited liability partnerships for the preparation of accounts. These are the equivalent of the small company regulations.
- SI 2008/1913 – as 1912 but for large and medium sized LLPs.

The regulations apply to financial years commencing on or after 1 October 2008.

Therefore, the LLP will still apply the requirements of CA 1985 for the year ended June 2009.

FRSSE 2008 is effective for periods commencing on or after 6 April 2008. Therefore, if the LLP adopts the FRSSE it would be logical to expect it to adopt the applicable version of the FRSSE – namely FRSSE 2008.

This answer runs contrary to general opinion which is that FRSSE 2008 should not apply to LLPs until periods commencing on or after 1 October 2008. This view is based on an article in Inside Track No 57 published in October 2008. This article also stated that a footnote would be added to this effect in the legal derivations section of the FRSSE on the APB website – and, checking the website in August 2009, this footnote is not apparent. Is this because the APB have changed their mind?

In my view, it would be acceptable to refer to FRSSE 2008 because the extracts from the Companies Act included in the FRSSE are there as a convenience not as a statement of the law. Accordingly, it is possible for an entity to adopt FRSSE 2008 without needing to follow the requirements of CA 2006. However, readers of these notes should be aware of this potential problem area.

Impairment of goodwill

B Ltd acquired a subsidiary three years ago. The goodwill arising from the acquisition is being written off over 10 years. In view of the general downturn in the economy, the directors decided to perform an impairment test. The discounted cash flow forecast prepared at the balance sheet date (31 December 2008) showed that goodwill was not impaired. It is now eight months after the year-end and the auditors, being conscious of the deepening economic gloom, have asked the directors to reconsider the figures used in the original forecast. The reforecast predicts lower future cash flows and, based on the reforecast, goodwill would be impaired. Should the goodwill be written down in the accounts prepared for the year-ended 31 December 2008?

According to the Accounting Solutions page of Accountancy magazine (April 2009) the answer to this question is no. The downturn which has occurred since the year-end is not evidence of a condition which existed at the balance sheet date. Therefore the continuing deterioration is a non-adjusting event. Provided the original impairment review performed at 31 December 2008 was based on reasonable and supportable assumptions and estimates at that date, no impairment should be recorded in the accounts for 2008. It may, however, be appropriate to disclose the non-adjusting event.

Investment losses

During 2007, C Ltd invested £1 million in a fund which was promising outstanding returns. Indeed, dividends of £100K were received on both 31 December 2007 and 31 December 2008. At the balance sheet date (31 March 2009), the units were valued at £1.2 million. During August 2009, while the audit was in progress, it became clear that the investment fund had been fraudulently reporting assets that did not exist. The units are now worthless. Is the discovery of third-party fraud an adjusting post- balance sheet event?

According to the Accounting Solutions page of Accountancy magazine (July 2009) the answer to this question is - it depends. If the value stated was determined by reference to market activity, then the units could have been sold at the balance sheet date without loss. Accordingly, the new information would be a non-adjusting event.

On the other hand, if the units were never publicly tradable, then the loss already existed at the balance sheet date and the discovery of the fraud after the year-end is an adjusting event.

Comment: The two questions above might be thought to be irrelevant to many users of these notes. The two questions that follow bring the concepts into the realm of the typical SME.

Fixed asset impairment

D Ltd is preparing accounts for the year ended 31 December 2008. A property in the balance sheet at £250,000 was put up for sale in January 2009 and sold in April for £100,000. Should the asset be written down in the 2008 accounts?

This is a non-adjusting event. However, the loss on sale is an indication of possible impairment under FRS 11 and therefore an impairment test should be performed. Unless the fall in value was due to events arising after the year end, this would probably result in the need to write the asset down at 31 December 2008.

Bad debts

E Ltd is preparing accounts for the year ended 31 December 2008. A debtor owing £75,000 went into liquidation in March 2009. Is this an adjusting event?

It depends. The judgement to be made here is whether the debt was already bad at 31 December or whether some event occurred after the year end which led to the insolvency of the customer.

CA 2006: DISCLOSURE OF DIRECTORS' TRANSACTIONS

Lecture A275 (15.44 Minutes)

Introduction

Disclosure of transactions involving directors may be required by:

- Company law provisions
- Accounting standards

These notes refer to company law provisions with some references to accounting standards requirements.

Company law provisions

CA 2006 includes two sections concerning disclosure of director transactions: 412 and 413. Section 412 covers the disclosure of director's remuneration and has associated Regulations. Section 413 covers advances and credits and does not have any associated Regulations.

Section 413

413 Information about directors' benefits: advances, credit and guarantees

(1) In the case of a company that does not prepare group accounts, details of-

(a) advances and credits granted by the company to its directors, and

(b) guarantees of any kind entered into by the company on behalf of its directors,

must be shown in the notes to its individual accounts.

(2) In the case of a parent company that prepares group accounts, details of-

(a) advances and credits granted to the directors of the parent company, by that company or by any of its subsidiary undertakings, and

(b) guarantees of any kind entered into on behalf of the directors of the parent company, by that company or by any of its subsidiary undertakings,

must be shown in the notes to the group accounts.

(3) The details required of an advance or credit are-

(a) its amount,

(b) an indication of the interest rate,

(c) its main conditions, and

(d) any amounts repaid.

(4) The details required of a guarantee are-

(a) its main terms,

(b) the amount of the maximum liability that may be incurred by the company (or its subsidiary), and

(c) any amount paid and any liability incurred by the company (or its subsidiary) for the purpose of fulfilling the guarantee (including any loss incurred by reason of enforcement of the guarantee).

(5) There must also be stated in the notes to the accounts the totals-

(a) of amounts stated under subsection (3)(a),

(b) of amounts stated under subsection (3)(d),

(c) of amounts stated under subsection (4)(b), and

(d) of amounts stated under subsection (4)(c).

(6) References in this section to the directors of a company are to the persons who were a director at any time in the financial year to which the accounts relate.

(7) The requirements of this section apply in relation to every advance, credit or guarantee subsisting at any time in the financial year to which the accounts relate-

(a) whenever it was entered into,

(b) whether or not the person concerned was a director of the company in question at the time it was entered into, and

(c) in the case of an advance, credit or guarantee involving a subsidiary undertaking of that company, whether or not that undertaking was such a subsidiary undertaking at the time it was entered into.

(8) Banking companies and the holding companies of credit institutions need only state the details required by subsections (3)(a) and (4)(b).

Are the disclosures required in the abbreviated accounts of a small company?

This is open to interpretation.

Section 413(1) requires the information to be disclosed in the individual accounts. The term individual accounts is defined in section 396:

396 Companies Act individual accounts

(1) Companies Act individual accounts must comprise-

(a) a balance sheet as at the last day of the financial year, and

(b) a profit and loss account.

(3) The accounts must comply with provision made by the Secretary of State by regulations as to-

(a) the form and content of the balance sheet and profit and loss account, and

(b) additional information to be provided by way of notes to the accounts.

The term abbreviated accounts is included in section 444

444 Filing obligations of companies subject to small companies regime

(1) The directors of a company subject to the small companies regime-

(a) must deliver to the registrar for each financial year a copy of a balance sheet drawn up as at the last day of that year, and

(b) may also deliver to the registrar-

(i) a copy of the company's profit and loss account for that year, and

(ii) a copy of the directors' report for that year.

(3) The copies of accounts and reports delivered to the registrar must be copies of the company's annual accounts and reports, except that where the company prepares Companies Act accounts-

(a) the directors may deliver to the registrar a copy of a balance sheet drawn up in accordance with regulations made by the Secretary of State, and

(b) there may be omitted from the copy profit and loss account delivered to the registrar such items as may be specified by the regulations.

These are referred to in this Part as "abbreviated accounts".

Where a company does not deliver the profit and loss account these have been referred to in the past by Companies House as filleted accounts. It is important to remember that companies subject to the small regime have two filing options. This is clear from the guidance that appears on Companies House website under Companies Act 2006 FAQs.

Audit exempt small companies

Audit exempt small companies with accounting periods starting on or after 06/04/2008 must include the following statements on the balance sheet:

For the year ending ……………… the company was entitled to exemption from audit under section 477 of the Companies Act 2006 relating to small companies.

Director's responsibilities:

The members have not required the company to obtain an audit of its accounts for the year in question in accordance with section 476,

The directors acknowledge their responsibilities for complying with the requirements of the Act with respect to accounting records and the preparation of accounts

These accounts have been prepared in accordance with the provisions applicable to companies subject to the small companies regime.

Note: Small companies that do not deliver abbreviated accounts may also choose not to include a copy of the Directors report and/or a copy of the profit and loss. In this case the balance sheet must also contain the following statement:

'The accounts have been delivered in accordance with the provisions applicable to companies subject to the small companies regime.'

The regulations refer to this as follows:

Accounts for delivery to registrar of companies (Companies Act individual accounts)

6

(1) The directors of a company for which they are preparing Companies Act individual accounts may deliver to the registrar of companies under section 444 of the 2006 Act (filing obligations of companies subject to small companies regime) a copy of a balance sheet which complies with Schedule 4 to these Regulations rather than Schedule 1.

(2) Companies Act individual accounts delivered to the registrar need not give the information required by -

(a) paragraph 4 of Schedule 2 to these Regulations (shares of company held by subsidiary undertakings), or

(b) Schedule 3 to these Regulations (directors' benefits).

This includes no reference to the term abbreviated accounts, which is referred to in s444(3). It does refer to the individual accounts. If you recall, s444 referred to two

options for filing accounts. Are both being referred to in regulation 6 or is it just the option based on the individual accounts?

Unlike schedule 8A of the 1985 Act there is no clear description of abbreviated accounts. In addition s246 of the 1985 Act was clear as to which parts of schedule 6 were not included in accounts filed with the Registrar and hence, by default, what was. The small company regulations schedule 4 states the following:

1

(1) A company may deliver to the registrar a copy of the balance sheet showing the items listed in either of the balance sheet formats set out below, in the order and under the headings and sub-headings given in the format adopted, but in other respects corresponding to the full balance sheet.

The above could be interpreted as saying that Schedule 4 is giving a complete list of all that needs to be included in abbreviated accounts. If this interpretation is correct, and since there is no reference to s413 in schedule 4, those disclosures would not be required in the abbreviated accounts.

Without a clear indication in the current legislation this will be open to interpretation.

The ICAEW has stated the following in its Technical Enquires Service FAQ April 2009

Should the disclosures required by section 413 Companies Act 2006 (Information about directors' benefits: advances, credit and guarantees) be included in small company abbreviated accounts?

It appears the legislation could be open to interpretation. Sec 444 of the CA 2006 and Reg 6 of SI 2008/409 indicate a requirement only to deliver a balance sheet and notes and the balance sheet and notes delivered can comply with Sch 4 of SI 2008/409. Therefore, by implication, there is no need for the sec 413 directors' loans disclosures.

However, as far as we are aware, there was no intention to change the law in this respect through Companies Act 2006. S444(3) says that the copy filed with the Registrar needs to be the same as the full accounts, except that the balance sheet can be prepared in accordance with regulations (which is Sch 4 to the small co regs), and s444(1) exempts you from filing the P&L and directors' report (or rather, makes filing optional).

In conclusion it is not clear that disclosure of directors' loan and other related transactions have to be made in small company abbreviated accounts, but as there was no known intention of changing this requirement, our recommendation would be to continue to make disclosure

What is an advance, credit and guarantee?

None of these terms appear in schedule 8, index of defined expressions.

Guarantee

There is a clear reference to guarantees in Part 10 of the Act and one could assume that s413 is referring to these transactions. Section 197 states:

> (1) A company may not-
>
> (a) make a loan to a director of the company or of its holding company, or
>
> (b) give a guarantee or provide security in connection with a loan made by any person to such a director, unless the transaction has been approved by a resolution of the members of the company.

If it is assumed that it is these transactions which are included in section 413 then this would follow the general approach to what were section 330 transactions in the 1985 Act and were covered by the disclosure requirements of schedule 6 parts 2 and 3 - although it should be noted that such transactions were not permitted under the 1985 Act. If therefore the intention was not to change the legislation this would appear to be a valid interpretation.

Credit

As with guarantees the term credit may refer to Part 10 transactions. Section 202 defines a credit transaction as:

> (1) A "credit transaction" is a transaction under which one party ("the creditor")-
>
> (a) supplies any goods or sells any land under a hire-purchase agreement or a conditional sale agreement,
>
> (b) leases or hires any land or goods in return for periodical payments, or
>
> (c) otherwise disposes of land or supplies goods or services on the understanding that payment (whether in a lump sum or instalments or by way of periodical payments or otherwise) is to be deferred.

As with guarantees this would follow the approach taken under the 1985 Act.

Advances

There is no reference to the term advances anywhere in the Act. The 1985 Act did not include this term either. Therefore what is included in this disclosure requirement is open to interpretation. It could be assumed that, as the terms “guarantee” and “credit” were apparently related to Part 10 transactions then the term “advance” could also be related to Part 10 as well. In this case, there are only two other types of transactions that could be covered namely loans and quasi loans.

It is also important to distinguish the requirements of s204 in respect of expenditure on company business. This may be referred to in every day speech as an “advance” but this term does not appear in either the 1985 or 2006 Act. Section 204 states that an amount given to a director to meet expenditure to be incurred will not require approval as a loan provided the amount is less than £50,000. The amount is in aggregate with all other similar transactions. This does not exempt these transactions from disclosure as loans but merely does not require members’ approval.

Therefore in considering advances there may be three types of transactions to be considered:

- Loans to directors
- Quasi loans to directors
- Advances for expenditure

So which ones are included?

There is likely to be a significant effect on OMBs simply due to the nature of the relationship between the company and the directors. Many OMBs have director current accounts which may fluctuate between debit and credit. If the current account remains in credit throughout the entire period then s413 will have no effect. The section is clear that it is advances "to its directors" and not from.

Directors receiving an advance for expenditure to be incurred on the company's behalf will be a common transaction in many companies. In respect of this we could go back to the requirements of schedule 6 of the 1985 Act. Schedule 6 was amended on 1 October 2007 to include Part 10 transactions of the 2006 Act.

> **15**
>
> The group accounts of a holding company, or if it is not required to prepare group accounts its individual accounts, shall contain the particulars required by this Schedule of -
>
> (a) any transaction or arrangement of a kind described in section 197, 198, 200, 201 or 203 of the Companies Act 2006 entered into by the company or by a subsidiary of the company for a person who at any time during the financial year was a director of the company or its holding company, *or was connected with such a director*;

Note the reference in italics was repealed for accounting periods ending on or after 6 April 2008. (SI2008/948)

Sections 197 and 198 cover loans and quasi loans (respectively) to directors and the requirement for members' approval. Therefore it could be argued that if section 204 (re business expenditure) states approval is not required then the transaction falls outside of section 197 and hence would not be required to be disclosed. However, section 207 gives exceptions to 197 and 198 for minor and business transactions. If the value of the loan, quasi loan and guarantee does not exceed £10,000 then approval is not required. Using the same basis as just applied to s204, this would imply these would also avoid disclosure. This would indicate a clear change from the requirements in place before 1 October 2007.

Therefore if one is trying to use consistency with what was required in the past as a means to interpret current law, then it has to be said that there have been too many changes to draw a conclusion.

Is a loan or quasi loan an advance? Is an advance of business expenditure an advance?

This will be a matter of interpretation.

What level of disclosure is required?

Section 413(3), (4), and (5) indicate the disclosure requirements.

Section 413(3) uses the words “of an” which implies a single transaction. It would therefore appear to envisage a specific transaction where an advance or credit is provided to the director. For this reason there is no requirement to indicate the balance due at the balance sheet date. Using a combination of the amounts disclosed in (a) to (d) would allow the reader to calculate the amount.

This disclosure requirement is different from that in schedule 6. This required the value at the beginning and end of the year to be disclosed together with the maximum amount outstanding during the period. There was no reference to “an” and hence the disclosure of director current accounts was straight forward.

Applying these requirements to the OMB may lead to extensive disclosure. It may also be difficult to establish each of the “an”s. As stated above if the current account remains in credit then there will be no disclosure required by the Act. If however it regularly moves from credit to debit and there are a number of transactions the requirements of s413 will require some consideration. It should also be noted that s413(5) requires disclosure of aggregate figures.

The ICAEW has stated the following in its Technical Enquires Service FAQ April 2009

It appears from the legislation that every single loan transaction with a director has to be disclosed. Is this interpretation correct since it would be impractical to give such disclosure where there are numerous transactions with a director during the year in the form of a director’s current account?

Agreed, the legislation (s413 Companies Act 2006) does seem to make this a requirement. There is no further guidance on this subject at present except to suggest that the disclosures do have to be made for each loan payment to a director.

What about transactions in which the director has a material interest?

These are not included in the requirements of s413 nor within the regulations. Therefore the disclosure of these transactions on a statutory basis is no longer required.

What about accounting standards?

There will be duplication in some disclosure requirements. In other cases, there will be a transaction which is not disclosed on a statutory basis but may need to be disclosed to comply with accounting standards. As far as the individual accounts are concerned, it doesn’t matter whether disclosure is required to comply with the Companies Act or to comply with accounting standards. However, for small companies filing abbreviated accounts there is an impact. The APB has indicated in the past that the abbreviated accounts of a small company do not show a true and

fair view. On this basis any disclosures required only by accounting standards do not have to be included in abbreviated accounts. Therefore distinguishing between those which are disclosed on a statutory basis, and those on the basis of FRS8 or FRSSE could be important. However, as noted above, whether the disclosures of s413 are required in the abbreviated accounts of a small company is open to interpretation.

It may also be worth considering, if the company is filing filleted individual accounts, the requirements of s396.

396 Companies Act individual accounts

(2) The accounts must-

(a) in the case of the balance sheet, give a true and fair view of the state of affairs of the company as at the end of the financial year, and

(b) in the case of the profit and loss account, give a true and fair view of the profit or loss of the company for the financial year.

What about dividends paid to directors, are these related party transactions?

This is a matter of current debate.

The ICAEW has stated the following in its Technical Enquires Service FAQ April 2009

Are dividends to directors disclosable as related party transactions?

Yes, dividends to directors do meet the definition of related party transactions and are disclosable as such. Prior to 06/04/07, directors' interests were disclosed in directors' reports and it was generally accepted that a reader could determine dividends to directors on the basis of their shareholdings disclosed, and therefore there was a consensus of opinion that this was sufficient to meet the related party transaction disclosure requirements. However, subsequent to 06/04/07, as a result of changes in Companies Act 2006, directors' interest disclosures are no longer required, hence the requirement to disclose dividends

Note, in passing, that the rationale given above for non-disclosure is not satisfactory since the directors' report is not part of the financial statements. Therefore any disclosures made in the directors' report do not satisfy the disclosure requirements of accounting standards.

Whilst on this subject, presumably, disclosure is also required of dividends paid to the close family of a director.

DISCLOSURE OF AUDITOR'S REMUNERATION

Small and medium-sized companies

In line with the requirements of both CA 1985 (SI 2005/2417) and CA 2006 (SI 2008/489), small and medium-sized companies must disclose the following in a note to the annual accounts:

(a) the amount of any remuneration receivable by the company's auditor for the auditing of the accounts

(b) the nature and estimated monetary value of any benefits in kind

(c) where more than one person has been appointed as a company's auditor during the period, separate disclosure in respect of the remuneration for each such person.

Medium-sized companies

Under SI 2008/489, there are new requirements concerning auditor's remuneration. The new requirements apply in respect of accounting periods commencing on or after 6 April 2008 and are relevant to medium-sized companies only. In order to meet the new requirements, the notes to the accounts should also disclose total remuneration receivable by the auditor under the following headings:

(a) Assurance services other than auditing of the company's accounts.

(b) Tax advisory services.

(c) Other services.

Companies which are not small or medium-sized companies

For completeness, these notes also include the disclosures required for companies that are not small or medium-sized. Again these disclosures are unchanged from those required previously.

A company that is not small or medium-sized should disclose the following in respect of remuneration of the auditor(s) in a note to the annual accounts:

(a) any remuneration receivable by the company's auditor for the auditing of those accounts;

(b) any remuneration receivable for the supply of other services to the company or any associate of the company by:

  (i) the company's auditor; or

  (ii) any person who was, at any time during the period to which the accounts relate, an associate of the company's auditor;

(c) the nature and estimated money-value of any benefits in kind included in the remuneration above;

Separate disclosure is required in respect of the auditing of the accounts in question and of each type of service in the following list:

(a) The auditing of accounts of associates of the company pursuant to legislation (including that of countries and territories outside the UK).

(b) Other services supplied pursuant to such legislation.

(c) Other services relating to taxation.

(d) Services relating to information technology.

(e) Internal audit services.

(f) Valuation and actuarial services.

(g) Services relating to litigation.

(h) Services relating to recruitment and remuneration.

(i) Services relating to corporate finance transactions entered into or proposed to be entered into by or on behalf of the company or any of its associates.

(j) All other services.

Separate disclosure is required in respect of services supplied to the company and its subsidiaries on the one hand and to associated pension schemes on the other.

Where more than one person has been appointed as a company's auditor in respect of the period to which the accounts relate, separate disclosure is required in respect of the remuneration of each such person and his associates.

IFRS FOR SMES

Lecture A279 (11.45 Minutes)

Introduction

The international Accounting Standards Board (IASB) has published the International financial reporting standard for small and medium-sized entities (IFRS for SMEs). This is of interest to us in the UK because the UK Accounting Standards Board (ASB) has tentatively proposed that the IFRS for SMEs should replace UK GAAP. To this end, it is expected that the ASB will issue a consultation document within the next few months.

In these notes we will consider extracts from the IFRS for SMEs factsheet issued by the IASB to coincide with the publication of the IFRS for SMEs.

Five types of simplifications

The IFRS for SMEs contains five types of simplifications of full IFRSs:

1. some topics in IFRSs are omitted because they are not relevant to typical SMEs
2. some accounting policy options in full IFRSs are not allowed because a more simplified method is available to SMEs
3. simplification of many of the recognition and measurement principles that are in full IFRSs
4. substantially fewer disclosures
5. simplified redrafting

Omitted topics

The IFRS for SMEs does not address the following topics that are covered in full IFRSs:

- earnings per share
- interim financial reporting
- segment reporting
- special accounting for assets held for sale

Examples of options in full IFRSs NOT included in the IFRS for SMEs

- financial instrument options, including available-for-sale, held-to-maturity and fair value options

- the revaluation model for property, plant and equipment, and for intangible assets
- proportionate consolidation for investments in jointly-controlled entities
- for investment property, measurement is driven by circumstances rather than allowing an accounting policy choice between the cost and fair value models
- various options for government grants.

Recognition and measurement simplifications

Some of the main simplifications to the recognition and measurement principles in full IFRSs include:

- Research and development costs - must be recognised as expenses.
- Borrowing costs - must be recognised as expenses.
- Property, plant and equipment and intangible assets - Residual value, useful life and depreciation method for items of property, plant and equipment, and amortisation period/method for intangible assets, need to be reviewed only if there is an indication they may have changed since the most recent annual reporting date (full IFRSs require an annual review).
- Income tax - Requirements follow the approach set out in the Board's ED Income Tax, published in March 2009, which proposes a simplified replacement for IAS 12 Income Taxes.
- No separate held-for-sale classification - Instead, holding an asset (or group of assets) for sale is an impairment indicator.

Main changes from the ED

Some of the main changes that resulted from the Board's redeliberations of the recognition, measurement and presentation principles proposed in the ED have already been mentioned in the previous section of these notes. Others include:

- Making the IFRS a stand-alone document (eliminating all but one of the 23 cross-references to full IFRSs that had been proposed in the ED)
- Omitting topics that typical SMEs are not likely to encounter (thereby removing the cross-references to full IFRSs proposed in the ED).
- Eliminating references to the pronouncements of other standard-setting bodies as a source of guidance when the IFRS for SMEs does not address an accounting issue directly.
- Not permitting a revaluation option for intangibles.
- Amortising all indefinite-life intangibles, including goodwill.

- Requiring all government grants to be accounted for using a single, simplified model: recognition in income when the performance conditions are met (or earlier if there are no performance conditions) and measurement at the fair value of the asset received or receivable.
- Adding further simplifications for share-based payments, including directors' valuations, rather than the intrinsic value method.

COMPANIES ACT 2006: EXTRACTS FROM PART 17: CAPITAL

Nominal value of shares and allotment

Section 542(1) continues the requirement for shares in a limited company to have a fixed nominal value.

Section 542(3) states that shares may be denominated in any currency, and different classes of shares may be denominated in different currencies. Note that section 765 requires the initial authorised minimum share capital requirement for a public company to be met by reference to share capital denominated in sterling or euros.

Section 550 permits directors of a private company with only one class of shares to allot shares without the need for approval of the members.

Coupled with the fact that companies formed under CA 2006 will not have authorised share capital, Section 550 makes it easier for directors of private companies to allot shares.

Section 550 applies to an existing company only if the members of the company pass a resolution that the directors should have the powers given by that section. Such a resolution may be an ordinary resolution (even if it takes the form of an alteration of the company's articles) and if any such resolution is passed before 1st October 2009, it is treated as if passed on that date.

The company must, within one month of making an allotment of shares, deliver to the registrar for registration a return of the allotment. The return must contain the prescribed information, and be accompanied by a statement of capital.

Section 561continues the existing shareholders' right of pre-emption.

Share premiums

Section 610 states that, if a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount or value of the premiums on those shares must be transferred to an account called "the share premium account".

Where, on issuing shares, a company has transferred a sum to the share premium account, it may use that sum to write off:

(a) the expenses of the issue of those shares;

(b) any commission paid on the issue of those shares.

The company may use the share premium account to pay up new shares to be allotted to members as fully paid bonus shares.

Contrast the above with the following extract from Section 130 under CA 1985:

The share premium account may be applied by the company in paying up unissued shares to be allotted to members as fully paid bonus shares, or in writing off:

(a) the company's preliminary expenses; or

(b) the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company,

or in providing for the premium payable on redemption of debentures of the company.

Section 610 has effect subject to section 611 (group reconstruction relief) and section 612 (merger relief). These sections do not change the existing provisions of CA 1985.

Section 617 states that a limited company having a share capital may not alter its share capital except by increasing its share capital by allotting new shares in accordance with this Part of the Act, or by reducing its share capital in accordance with Chapter 10.

Chapter 10 which dealt with reduction of share capital came into force from 1 October 2008 and was dealt with in a previous set of quarterly notes.

CA 2006: ACQUISITION BY LIMITED COMPANY OF ITS OWN SHARES

Lecture A272(14.57 Minutes)

Section 658 states that a limited company must not acquire its own shares, whether by purchase, subscription or otherwise, except in accordance with the provisions of Part 18.

Section 658 does not prohibit the acquisition of shares in a reduction of capital duly made or the purchase of shares in pursuance of an order of the court.

Financial assistance

Section 678 states that where a person is acquiring or proposing to acquire shares in a public company, it is not lawful for that company, or a company that is a subsidiary

of that company, to give financial assistance directly or indirectly for the purpose of the acquisition before or at the same time as the acquisition takes place.

Note that Section 678 does not apply to private companies. The requirement applying to private companies under CA 1985 was repealed at 1 October 2008.

Redeemable shares

A limited company having a share capital may issue shares that are to be redeemed or are liable to be redeemed at the option of the company or the shareholder ("redeemable shares"), subject to the following provisions:

- The articles of a private limited company may exclude or restrict the issue of redeemable shares.
- A public limited company may only issue redeemable shares if it is authorised to do so by its articles.
- No redeemable shares may be issued at a time when there are no issued shares of the company that are not redeemable.

The directors of a limited company may determine the terms, conditions and manner of redemption of shares if they are authorised to do so by the company's articles, or by a resolution of the company.

Where the directors are authorised to determine the terms, conditions and manner of redemption of shares they must do so before the shares are allotted. Where the directors are not so authorised, the terms, conditions and manner of redemption of any redeemable shares must be stated in the company's articles.

Redeemable shares in a limited company may not be redeemed unless they are fully paid.

For shares issued on or after 1 October 2009, the terms of redemption of shares in a limited company may provide that the amount payable on redemption may, by agreement between the company and the holder of the shares, be paid on a date later than the redemption date. Where shares were issued before 1 October 2009, the terms of redemption may be amended on or after that date to allow for payment on a date later than the redemption date.

A private limited company may redeem redeemable shares out of capital in accordance with Chapter 5 (see below). Otherwise redeemable shares in a limited company may only be redeemed out of distributable profits of the company, or the proceeds of a fresh issue of shares made for the purposes of the redemption.

Any premium payable on redemption of shares in a limited company must be paid out of distributable profits of the company, subject to the following provision.

If the redeemable shares were issued at a premium, any premium payable on their redemption may be paid out of the proceeds of a fresh issue of shares made for the purposes of the redemption, up to an amount equal to-

(a) the aggregate of the premiums received by the company on the issue of the shares redeemed, or

(b) the current amount of the company's share premium account (including any sum transferred to that account in respect of premiums on the new shares), whichever is the less.

The amount of the company's share premium account is reduced by a sum corresponding (or by sums in the aggregate corresponding) to the amount of any payment made under the above subsection.

Where shares in a limited company are redeemed, the shares are treated as cancelled, and the amount of the company's issued share capital is diminished accordingly by the nominal value of the shares redeemed.

Purchase of own shares

The following table compares the requirements concerning **private** companies under CA 1985 with the new requirements of CA 2006 when purchase of own shares is out of distributable profits or the proceeds of a fresh issue of shares.

Procedures under CA 1985	**Procedures under CA 2006**
The company must have the relevant power in its Articles. S162(1)	The company may purchase its own shares subject to any restriction or prohibition in its Articles. S690(1)
There must be some shares still in issue after the purchase (excluding redeemable shares and treasury shares). S162(3)	There must be some shares still in issue after the purchase (excluding redeemable shares and treasury shares). S 690(2)
The shares must be fully paid-up. S159(3)	The shares must be fully paid S691(1)
The terms of redemption must provide for payment on redemption. S159(3)	The shares must be paid for on purchase. S691(2). However, see note above concerning payment on a date later than redemption date.
The shares must be cancelled on redemption. S160(4); Note that only listed companies are permitted to hold treasury shares. The amount of the authorised share capital is not reduced.	The shares must be cancelled on purchase. S706(b); Note that only listed companies are permitted to hold treasury shares under CA 2006 – although there is a suggestion that this right might be extended at some future date. The concept of authorised share capital does not exist in the CA 2006.

The contract to purchase shares must be authorised in advance by a special resolution. S164(2) Members holding shares which are to be redeemed are not permitted to exercise the voting rights of those shares. S164(5) A copy of the special resolution must be filed with the Registrar of Companies within 15 days. S380.	The contract to purchase shares must be authorised in advance by a special resolution. S694(2a) However, note that a contract can be entered into before approval is obtained as long as the contract provides that no shares can be purchased until the contract has been authorised by special resolution. S694(2b) If a meeting is to be held, members holding shares which are to be redeemed are not permitted to exercise the voting rights of those shares. S695(3) If the resolution is to be proposed as a written resolution then a member holding shares to which the resolution relates is not an eligible member. S695(2) A copy of the special resolution must be filed with the Registrar of Companies within 15 days. S30
A copy of the contract to purchase shares (if written) or a memorandum of the contract terms (if the contract is not in writing) must be available for inspection for at least 15 days before the meeting at which the resolution is to be passed and at the meeting itself. S164(6)	A copy of the contract to purchase shares (if written) or a memorandum of the contract terms (if the contract is not in writing) must be available to members. S696(2) If the resolution is to be proposed as a written resolution then the details must be sent at or before the time that the written resolution is sent to the member If the resolution is to be passed at a meeting then the details must be available for inspection for at least 15 days before the meeting at which the resolution is to be passed and at the meeting itself.
A copy of the contract to purchase shares (if written) or a memorandum of the contract terms (if the contract is not in writing) must be available for inspection at the company's registered office by members for a period of ten years after the completion of the purchase of shares. S169(4)	A copy of the contract to purchase shares (if written) or a memorandum of the contract terms (if the contract is not in writing) must be available for inspection by members for a period of ten years after the completion of the purchase of shares. If this is not at the company's registered office then the registrar must be informed of the place at which the

	information is kept. S702
The company must make a return to the registrar within 28 days of the shares being delivered to it. S169(1)	The company must make a return to the registrar within 28 days of the shares being delivered to it. S707
Where the nominal value of shares purchased is greater than the proceeds of a fresh issue of shares made for the purpose of the redemption then the capital of the company must be maintained by a transfer from P&L reserves to the capital redemption reserve. S170	Where the nominal value of shares purchased is greater than the proceeds of a fresh issue of shares made for the purpose of the redemption then the capital of the company must be maintained by a transfer from P&L reserves to the capital redemption reserve. S733 A premium payable on redemption is dealt with in the same way as shown above for redemption of shares. S692

You will see from the above that there is, in fact, very little difference between the two regimes when the redemption is out of profits or from the proceeds of a new issue. One benefit however is that, under CA 2006, the purchase can proceed subject to approval by the shareholders rather than approval being required in advance.

Accounting treatment for purchase of own shares at a premium

Extracts from the balance sheet of X Ltd show the following:

Ordinary £1 shares	£50,000
Share premium account	£25,000
Total capital and undistributable reserves	£75,000
Profit and loss account	£120,000

The share premium arose equally on the issue of all of the ordinary shares.

Having fulfilled the necessary conditions shown above, the company has purchased 40% of the ordinary shares in issue for an amount of £120,000. To help finance this purchase, the company has issued 2,500 Ordinary £1 shares at £6 per share.

The required journal entries are as follows:

Dr Cash	£15,000	
Cr Share capital		£2,500
Cr Share premium account		£12,500

Being the proceeds of the new issue.

Dr Share capital	£20,000	
Dr Share premium account	£10,000	
Dr Profit and loss account	£90,000	
Cr Cash		£120,000

Being the purchase of the shares.

Note that the amount of the premium on redemption that can be debited to the share premium account is the lower of the premium on the issue of shares that are now being redeemed (£10,000) and the balance on the share premium account including the premium received on the new issue (£25,000 + £12,500).

Dr Profit and loss account	£15,000	
Cr Capital redemption reserve		£15,000

Being the transfer necessary to make good the capital.

Extracts from the final balance sheet:

Ordinary £1 shares	£50,000 + £2,500 - £20,000 =	£32,500
Share premium account	£25,000 + £12,500 - £10,000 =	£27,500
Capital redemption reserve		£15,000
Total capital and undistributable reserves		£75,000
Profit and loss account	£120,000 - £90,000 - £15,000 =	£15,000

Power of private limited company to redeem or purchase own shares out of capital

Procedures under CA 1985	Procedures under CA 2006
All of the requirements shown in the previous table apply also to this situation.	All of the requirements shown in the previous table apply also to this situation.
The company must have the relevant power in its Articles. S171(1)	The company may purchase its own shares subject to any restriction or prohibition in its Articles. S709(1)
The directors must make a statutory declaration concerning the solvency of the company. S173(3) Amongst other things this will specify the amount of the permissible capital payment (PCP). The PCP is computed as follows: Redemption price less any available profits less the proceeds of any fresh issue of shares made for the purpose of the redemption. S171(3) Accounts are required (need not be audited but must be reliable for the purpose) as at any date within 3 months up to the date of the declaration. S172	The directors must make a statement concerning the solvency of the company. S714 Amongst other things this will specify the amount of the permissible capital payment (PCP). The PCP is computed as follows: Redemption price less any available profits less the proceeds of any fresh issue of shares made for the purpose of the redemption. S710 Accounts are required (need not be audited but must be reliable for the purpose) as at any date within 3 months up to the date of the declaration. S712
The auditors must provide a report on the statutory declaration stating that, inter alia, it is not unreasonable in all the circumstances. The auditors will also state that the amount specified in the declaration as the PCP is in their view properly determined. S173(5) (See Bulletin 2007/1 for guidance and the wording required.)	The auditors must provide a report on the directors' statement stating that, inter alia, it is not unreasonable in all the circumstances. The auditors will also state that the amount specified in the declaration as the PCP is in their view properly determined. S714(6) (See Bulletin 2008/9 for guidance and the wording required.)
The proposed payment out of capital must be authorised in advance by a special resolution. S173(2) The resolution must be passed within a week of the date of the directors'	The proposed payment out of capital must be authorised in advance by a special resolution. S716(1) The resolution must be passed within a week of the date of the directors'

declaration. S174(1) Members holding shares which are to be redeemed are not permitted to exercise the voting rights of those shares. S174(2) The statutory declaration and the auditors' report must be available for inspection at the meeting. S174(4) A copy of the resolution must be filed with the Registrar of Companies within 15 days. S380	declaration. S716(2) Members holding shares which are to be redeemed are not permitted to exercise the voting rights of those shares at a meeting. S717(3) The statutory declaration and the auditors' report must be available for inspection at the meeting. S718(2) Where the resolution is to be passed as a written resolution, a member holding shares to which a resolution relates is not an eligible member. S717(2) The statutory declaration and the auditors' report must be made available to every eligible member at or before the time the resolution is sent to him. S718(2) A copy of the resolution must be filed with the Registrar of Companies within 15 days. S30
Within the week following the date of resolution, the purchase must be publicised in the Gazette and other press. S175	Within the week following the date of resolution, the purchase must be publicised in the Gazette and other press. S719
Copies of the declaration and auditors' report must be filed at Companies House by the date of the first notice in the press. S175(5) Copies of the declaration and auditors' report must be open for inspection by members and creditors at the company's registered office throughout the period from the date of the first notice in the press until five weeks after the date of the resolution. S175(6)	Copies of the declaration and auditors' report must be filed at Companies House by the date of the first notice in the press. S719(4) Copies of the declaration and auditors' report must be open for inspection by members and creditors throughout the period from the date of the first notice in the press until five weeks after the date of the resolution. If this is not at the company's registered office then the registrar must be informed of the place at which the information is kept S720
The payment must be made no earlier than 5 weeks nor later than 7 weeks from the date of the declaration. S174(1)	The payment must be made no earlier than 5 weeks nor later than 7 weeks from the date of the declaration. S723(1)
If the aggregate of the PCP and the	If the aggregate of the PCP and the

proceeds of any fresh issues is less than the nominal amount of the shares redeemed then the amount of the difference is transferred from P&L reserves to the capital redemption reserve. S171(4) If the aggregate of the PCP and the proceeds of any fresh issues is greater than the nominal amount of the shares redeemed then the amount of the difference is applied to reduce the capital or non-distributable reserves of the company. S171(5)	proceeds of any fresh issues is less than the nominal amount of the shares redeemed then the amount of the difference is transferred from P&L reserves to the capital redemption reserve. S734(2) If the aggregate of the PCP and the proceeds of any fresh issues is greater than the nominal amount of the shares redeemed then the amount of the difference is applied to reduce the capital or non-distributable reserves of the company. S734(3)

You may have heard that the procedures required to redeem shares out of capital were to be simplified considerably under CA 2006 but, in fact, the simplifications are limited. The only significant change is in the requirement for a directors' statement of solvency rather than the previous statutory declaration.

Accounting treatment for redemption of own shares out of capital

Extracts from the balance sheet of Y Ltd show the following:

Ordinary £1 shares	£60,000
Redeemable preference £1shares	£20,000
Share premium account	£5,000
Total capital and undistributable reserves	£85,000
Profit and loss account	£12,000

The directors wish to redeem all of the preference shares at par. Since the distributable profits of the company are insufficient to achieve this, the directors will need to follow the requirements of the Act as shown above

Having fulfilled the necessary steps, the required journal entries are as follows:

Dr Redeemable preference shares	£20,000	
Cr Cash		£20,000

Being the purchase of the shares.

	Dr	Cr
Dr Profit and loss account	£12,000	
Cr Capital redemption reserve		£12,000

Being the transfer to make good the capital as far as it can be achieved from distributable profits.

Extracts from the final balance sheet of Y Ltd:

Ordinary £1 shares	£60,000
Redeemable preference £1shares	-
Share premium account	£5,000
Capital redemption reserve	£12,000
Total capital and undistributable reserves	£77,000
Profit and loss account	-

The total of the share capital and undistributable reserves is not the same as before the redemption. The difference of £8,000 is the permitted capital payment (PCP).

Treasury shares

Chapter 6 covers the situation where the company purchases its own shares and holds them as treasury shares. As before, this situation can only arise where the shares concerned are “qualifying shares” that is the shares are listed in an EEA state or traded on a regulated market.

ISSUES ARISING FROM COMPANIES HOUSE

Lecture A276 (22.31 Minutes)

Companies House Insider

The Institute of Chartered Accounts in England & Wales (ICAEW) is running a roadshow on the Companies Act 2006 implementation in conjunction with Companies House. The Companies House representative has said some very interesting things during his presentation and these are summarised below.

Accounts late filing penalties

Last year Companies House took approximately £73m in accounts late filing penalties but virtually all of these monies have to be passed on to government and Companies House keeps only enough to cover the costs of collection. Companies House has a target to collect accounts late filing penalties of zero! Their priority is to receive the accounts on time.

Accounts late filing – a tougher stance

Companies House have come under pressure from users of the accounts to ensure that accounts are received on time. This means that they are chasing unfiled accounts much harder than before. They have found that threatening directors with prosecution for unfiled accounts is often ineffective. Threatening directors to strike off companies has been much more successful so generally a letter will be sent to this effect about 6 weeks after the filing deadline if the accounts have not been filed. If it is a busy year end like March or December it might take longer for Companies House to act.

14 days grace

Previously Companies House had been giving companies 14 days grace on the filing deadline if the accounts were filed before the deadline but were rejected because they contained errors.

Apparently this concession was “subject to abuse” and that is why the grace period will no longer be given.

e-filing

Currently small company abbreviated accounts that are not subject to audit can be filed electronically, as can the majority of company forms. There are currently no plans for mandatory e-filing but there are a number of countries in the world where the relevant registrar demands e-filing and paper forms don’t exist. So read between the lines.

Company names

From 1 October 2008, the issue of "opportunistic incorporation" is being tackled by Companies House for the first time. Where a company is formed with a name that another individual or organisation has some right over, the Arbitrator can act. The Arbitrator has the rather charismatic name of Raul Columbo and he has already settled a number of cases such as "Coke Cola Ltd" and "Newton & Ridley Ltd". No prizes for guessing the objectors.

It costs £400 to put the case to the arbitrator but there is somewhat of a backlog and some companies have decided to settle the matter out of court rather than wait, by paying the opportunistic incorporator some money for the name.

Natural directors

From 1 October 2008 every company (subject to transitional rules) must have at least one natural director, yet there are over 100,000 companies on the register with no natural directors.

This is too many for Companies House to tackle and they plan to wait until the number reduces before addressing the companies individually.

Sole directors

Under Companies Act 2006 the company does not need a company secretary and a company now only requires by law, to have one director. Many lawyers might think this to be a bad idea but Companies House has received numerous incorporations for sole director companies. It is suspected that these are sole traders incorporating now that the rules have changed.

Company secretaries

The requirement to have a company secretary being dropped from 6 April 2008 has started to be noticed when looking at the statistics on new incorporations. Currently 57% of new incorporations do not have a company secretary.

Directors' service addresses

From 1 October 2009 directors will not have to make their ordinary residential address public. All directors will have the option of supplying a service address as well as their residential address. Only certain government agencies will have access to the residential address. The public record will only contain the service address. Different service addresses can be maintained for different companies by a common director.

Companies House will offer a service to remove details on documents previously submitted that contain the residential address.

Underage directors

From 1 October 2008 directors have to be at least 16 years old. There were hundreds of company directors that were under sixteen. Apparently some received directorships as birthday presents! Imagine getting a form 288 when all you really wanted was a bike!

On a related topic there are 8,000 disqualified company directors on the Companies House database.

New forms

New Companies House forms are available in draft on the website. They are in draft because there are still some typos and BERR has only recently changed its name to BIS! (Interestingly BERR was DBERR for a few days. This was changed when someone noticed the possible confusion with a popular middle of the road singer)

The new forms should not be used until 1 October 2009 otherwise they will be rejected. The old Companies House forms will be valid until then but will be rejected if used afterwards.

Anyway Companies House prefer e-filing to people using the forms.

Company accounts – power to remove

For the first time Companies House now have the power to remove information from the accounts before putting them on to the public record. Previously if a tax computation was included with the accounts, the accounts would either have gone on record with the computation attached or be rejected. Now it can be removed.

Trading disclosures

Who cares about trading disclosure on company letterheads etc? Companies House do look to see whether the correct trading disclosures are made on letterheads, e-mails and websites, such as the company number, name, place of incorporation and registered office address. When non-compliant communications are received they are sometimes referred to the technical offences team. This can happen if a letter of complaint is not compliant!

CHANGES FOR CHARITIES

There have been a number of changes recently concerning charitable companies and charities under the Charities Act 1993.

Changes in accounting

This will only affect charities under the Charities Act 1993; there is no change for charitable companies. For financial years ending on or after 1 April 2009 the accounts threshold has been increased from £100,000 to £250,000. The accounts threshold is the point at which the charity is required to prepare its accounts on the basis of a true and fair view. If the income for the charity is below this threshold then the trustees have the option to prepare receipts and payments based accounts under s42(3).

It is important to remember that when the accounts threshold is exceeded then accruals based accounts must be prepared. That requirement would also apply to the corresponding amounts.

One question that often arises is that 1 April is very close to 31 March. So what happens if the financial year ends on 31 March 2009, the charity has prepared receipts and payments based accounts in the past, and the income exceeds £100,000? The 2008 regulations require a charity to make up its accounts to a date 12 months from the end of the previous financial year. Unlike companies there is no registered accounting reference date but one is determined from the regulations. The regulations require the accounts to be made up to a date not more than 7 days from the accounting reference date. Therefore a charity with an accounting reference date of 31 March 2009 would be able to make up its accounts to 1 April 2009 and this would not constitute a change in accounting reference date.

If a charity wants a shorter or longer period then it would need to comply with the requirements of regulation 3. These restrict the ability of a charity to change its accounting reference date to once every three years, unless consent is obtained from the Commission.

Guidance on the preparation of receipt and payments based accounts can be found on the Commission website.

Determining gross income

Gross income is defined in the SORP. It does not include gains from investments, asset revaluation gains, or amounts received in endowment funds. It does include any funds released from endowment funds to income funds.

Changes to external scrutiny

These changes can be considered in the following time frames:

- Financial years commencing on or after 27 February 2007. This affected charities under the Charities Act 1993 and charitable companies
- Financial year commencing on or after 1 April 2008. This affected charitable companies only
- Financial years ending on or after 1 April 2009. This affected charities under the Charities Act 1993 and charitable companies

Charitable companies

For accounting periods commencing on or after 27 February 2007 the thresholds under the Companies Act 1985 were:

- An audit was required if the gross income of the charitable company exceeded £500,000 or balance sheet total exceeded £2.8m.
- If the income did not exceed £90,000 and the balance sheet total did not exceed £2.8m then the company was not required to have any form of external scrutiny.
- For other charitable companies an audit exemption report/reporting accountant's report was required.

For accounting periods commencing on or after 1 April 2008 these provisions were repealed. Therefore under the Companies Act provisions there was no distinction between charitable companies and other companies in respect of audit exemption. This change came in on 1 April and Part 7 of the Companies Act was repealed for accounting periods commencing on or after 6 April being replaced by provisions in the Companies Act 2006.

With the repeal of the "special provisions" for charitable companies, referred to above, the requirement for a reporting accountant's report is removed. Charitable companies which are below the audit threshold of s43 Charities Act will be required to have an independent examination. Therefore those who were reporting accountants in the past will not be in the future. Engagement terms should be revised accordingly to refer to this new role. Those requiring guidance on independent examinations, the work required, and the report, should consult CC32 on the Commission website.

The other important change that was made at this date was that charitable companies were not excluded from s43 Charities Act 1993. Prior to this date charitable companies were not required to comply with the external scrutiny requirements of charities legislation.

The Charities Act 1993 s43 was amended as follows:

> (9) Nothing in this section applies in relation to the accounts of a charity for a financial year if those accounts are required to be audited in accordance with Part 7 of the Companies Act 1985.

In respect of timing it is important to remember that Part 7 was repealed for accounting periods commencing on or after 6 April 2008, i.e. 5 days after this amendment was made. This raised the question as to whether one should insert Part 16 Companies Act 2006 in place of the 1985 reference. The explanatory notes to this amendment (SI2008/527) contained the following:

> Section 1175 and Schedule 9 to the Companies Act 2006 remove from company law special rules about the audit of companies that are charities. The purpose of those changes to company law is to change the treatment of small charitable companies, so that, as far as

their accounts scrutiny is concerned, they will be required to comply with the requirements of charity law, rather than those of company law. That in turn also requires amendments to charity law so as to bring small charitable companies within the accounts scrutiny provisions relating to charities. Those amendments to charity law are made by means of Articles 2 to 7 of this Order.

Article 2(6) substitutes a new section 43(9) in the 1993 Act. Section 43 provides for the annual audit or examination of the accounts of a charity and section 43(9), as originally enacted, dis-applied the whole section in the case of a charity that is a company. The new section 43(9) provides that the audit and examination requirements in section 43 do not apply to a charity that is a company if the accounts are required to be audited in accordance with company law.

The APB has issued two Bulletins concerning audit reports on charities. Bulletin 2009/1 applied to 31 March 2009 year ends and Bulletin 2009/3 to accounting periods commencing on or after 6 April 2008. Bulletin 2009/3 clarifies the aspect of s43(9) referred to above. It states:

4. In respect of periods beginning on or after 6 April 2008 charitable companies which meet the Companies Act 2006 definition of a small company and do not exceed the Companies Act 2006 audit threshold may elect to take advantage of the audit exemption conferred by section 477 of the Companies Act 2006. However, charitable companies which are eligible for audit exemption under the Companies Act 2006 but are above the lower threshold for audit contained within charity law must receive an audit under charity law if they elect not be audited under the Companies Act 2006.

The audit threshold under the Charities Act, for accounting periods commencing on or after 27 February 2007 and ending before 1 April 2009 has two measures:

- Gross income exceeds £500,000, or
- Gross income exceeds £100,000 and balance sheet total exceeds £2.8m

For accounting periods ending on or after 1 April 2009 the second measure is amended to (SI2009/508):

- Gross income exceeds £250,000 (accounts threshold) and balance sheet total exceeds £3.26m

Therefore charitable companies can be segregated as follows:

- Those above the audit threshold under the Companies Acts. These will need an audit under the Companies Acts and Bulletins 2009/1 and 2009/3 should be consulted as required. It is important to note that charitable companies do not use ISA700 revised for accounting periods ending on or after 5 April 2009. Therefore the format of their audit report will be different from other companies which are required to comply with the revised ISA. There is no change in the engagement terms but auditors should ensure any engagement letters refer to the correct companies legislation. For accounting periods commencing on or after 6 April 2008 the report must be signed by the senior statutory auditor.

- Those below the audit threshold of the Companies Act but above the threshold of the Charities Act. These will require an audit under either legislation. It would be for the directors/trustees to decide which route to take. For the auditor it would be necessary to establish this at the planning stage in order to ensure the engagement terms are appropriate. A charitable company which takes advantage of audit exemption under the Companies Act but has the audit completed under the Charities Act will need to have an engagement letter that refers to this fact. If the charitable company follows this route it will need to have a statement on the balance sheet to reflect this fact. A failure to include the balance sheet statement means the company is not entitled to take advantage of audit exemption under Companies legislation. This statement may appear to be misleading as it states the company has taken advantage of audit exemption, but an audit report (Charities Act) will be attached. This could be reflected by adding a reference to this fact in the balance sheet statement. A possible wording could be “but is required to be audited under Charities Act 1993”. It could be argued that there is little to be gained by these companies in taking advantage of audit exemption under Companies legislation. There would be little difference in the audit approach under either Companies or Charities requirements. The reports are different and examples of these can be found in the Bulletins referred to above.

- Those below the audit threshold under the Charities Act. These could take advantage of audit exemption and would need to comply with the requirements of Companies legislation, i.e. would need to include the required balance sheet statement. If the charity is above the independent examination threshold then an independent examination under the Charities Act would need to be completed. The threshold is income above £10,000 for accounting periods ending prior to 1 April 2009. For accounting periods ending on or after this date the threshold is £25,000. Attention is drawn to financial years noted above and to the requirement to consider the engagement terms, and guidance issued by the Commission in CC32. It should be noted that the “directions” have been amended by the Commission for accounting periods commencing on or after 1 April 2008. Those who have completed independent examinations in the past should ensure work programmes reflect the requirements laid down by the Commission.

Charities – Charities Act 1993

There are no changes to the requirements except as indicated above in the new threshold for accounting periods ending on or after 1 April 2009.

Bulletin 2009/3 includes an example audit report. This is identical to Bulletin 2009/1 with the exception of the signature box. 2009/1 referred to registered auditor, 2009/3 to statutory auditor.

Groups

It is a requirement that where the charity is a parent undertaking group accounts must be prepared if the threshold is exceeded. The threshold is £500,000 (2008 Regulations 29). These requirements also apply to charitable companies. It should

be noted that, as originally passed, Schedule 6 Charities Act 2006 which adds the new Schedule 5A to the Charities Act 1993 indicates the provisions do not apply to companies. However, this was amended in SI2008/527 to remove this. Therefore charitable companies which are parent undertakings are obliged to prepare group accounts if the threshold is exceeded. The threshold is referred to as the “aggregate gross income” and is defined in regulation 9 of the 2008 regulations. This is the gross income of the group but excluding any group transactions.

Schedule 5A requires that all group accounts prepared under the Charities Act must be audited. This is irrespective of whether an audit was required under Companies legislation.

Therefore parent charitable companies can be divided into two groups:

- Those which would not be entitled to audit exemption under Companies legislation. These will require an audit report which refers to both Companies legislation and the Charities Act. Bulletin 2009/3 provides an example of such a report.
- Charitable companies that could take advantage of audit exemption under companies legislation. If they take advantage of it then the audit will need to be completed under the Charities Act, if not then the requirements above would apply.

It should be noted that the obligation under the Charities Act only applies to the parent and not the subsidiary undertakings. Therefore it is likely that the group accounts will be subject to audit but the accounts of the subsidiary undertakings would not be.

Issues in using the Bulletins

The following should be noted:

- The example audit reports do not include any reference to, or examples of, “Bannerman” disclaimer. This would need to be considered in accordance with guidance from the professional bodies on this matter. It should be noted that the disclaimer will be different for Charities Act, Companies Act 1985, and Companies Act 2006. Guidance is available from the ICAEW website.
- There is no reference to the use of the FRSSE. This should be included as required and opinions should reflect this fact if the FRSSE has been used.
- There are no examples of modifications to the audit report. Guidance issued in Bulletin 2006/6 should be consulted.

SIGNING AUDIT REPORTS

Lecture A273 (17.45 Minutes)

The changes resulting from the commencement of the Companies Act 2006 have raised a number of questions concerning the signing of audit reports. The requirements are included in legislation and Audit regulation.

The requirements in respect of legislation vary. Some legal requirements are precise as to who should sign the audit report and the information that needs to be included in the 'signature box'. Other legislation does not provide any indication at all. Two examples of this would be the Companies Act 2006 for the former and the Pension regulations for the latter. Prior to the Companies Act 2006 the format for the signature box was standard across most, if not all, audit reports. The requirement in the Companies Act for the report to be signed by the senior statutory auditor in their own name is different from the requirements in other legislation.

The following points should be noted:

- The term senior statutory auditor only appears in the Companies Act 2006. Other legislation makes no reference to this but also would not prohibit the use of such a term.
- Some legislation is specific as regards the signing of audit reports and therefore must be complied with. This therefore requires a detailed knowledge of the legal requirements. For example the 2008 charity regulations require "is signed by him, or where the office of auditor is held by a body corporate or partnership, in its name by a person authorised to sign on its behalf". This seems to indicate that the signature must be in the name of the firm not the individual who is authorised to sign on its behalf. Therefore an audit report on a charity prepared under the Charities Act would have to be signed in the name of the firm; an audit report on a charitable company prepared under the Companies Act 2006 would have to be signed by the senior statutory auditor.
- Some legislation, e.g. pension scheme regulations appears to be silent on how the report should be signed.

The issue has also been confused by two articles that have appeared in ICAEW Audit news. Issue 45 April 2009 stated "For audit reports on accounting periods starting after 6 April 2008, the name of the responsible individual in charge of the audit must be given and the report has to be signed in his or her own name, not in the name of the firm." There is no reference to the nature of the entity on which the report is being signed. Issue 44 October 2008 covered retrospective changes to audit regulation. These changes were effective from 6 April 2008, being applied retrospectively. A commentary on the changes stated the following:

"The original version of this regulation required the name of the responsible individual in charge of an audit (known for this purpose as the 'senior statutory auditor') to be disclosed on the audit report."

"In addition, the report had to be signed by the individual in his or her own name. However, this is only a requirement of company law and, although the law extends this requirement to some other entities, the scope is more limited than the definition of audit used in the audit regulations. Consequently, the scope of this regulation has been reduced to be the same as the law as far as disclosure of the name is concerned. The implementation dates have now been finalised and these are also noted."

Audit regulation 3.16 states:

"3.16 An audit report must:

a state the name of the firm as it appears in the Register;

b include the words 'Statutory Auditor' or 'Statutory Auditors' after the name of the firm; and

c if required by law, state the name of the responsible individual who was in charge of the audit, be signed by this person in his own name and include the words 'Senior Statutory Auditor' after the name of the responsible individual.

An audit report has to be signed by the firm with the added description 'Statutory Auditor'. There is nothing to prevent a firm adding any other appropriate description, such as 'chartered accountants'.

In certain cases the law requires that the responsible individual in charge of the audit (known as the senior statutory auditor) should sign the audit report. The individual's name must also be given. This is only required if the audit report is a report on the annual accounts for a financial year of a 'section 1210' entity (see below), a special report on abbreviated accounts or when accounts are voluntarily revised by the directors. The individual's name need not be given in the case of other reports required under the Act (for example a report under section 714 – redemption of shares out of capital) or reports on other entities included in the definition of an audit.

The APB has published guidance (Bulletin 2008/6) on how firms should decide which responsible individual is the senior statutory auditor in relation to a particular audit.

The Act allows, where there is a serious risk of violence or intimidation to the registered auditor or responsible individual, for their names not to be given in published copies of the audit report or the copy filed at Companies House etc. If these provisions, which only apply to the 'section 1210' entities listed below, are to be invoked, it may be advisable for the entity and the firm to seek legal advice.

Other legislation that is not included in the definition of audit, or the constitution of an entity, may call for a report from an auditor. A firm may choose to sign these reports as a statutory auditor. For example, a client may require a report about it to be given to a trade association. That trade association may require the report to be given and signed by a statutory auditor. There is nothing to prevent a firm doing this and the work would not come under these regulations. However, if the Institute receives a complaint about this work, enquiries may be made into the general standard of the firm's audit work. If necessary, enquiries may be made into other work which the firm is signing as a registered auditor or conducting in accordance with auditing standards. Regulation 6.07 gives the Registration Committee the power to enquire into other work undertaken by the firm.

The requirements of this regulation apply to audit reports for financial years beginning on or after 6 April 2008. For entities listed in Section 1210 of the 2006 Act the requirement applies as follows:

• companies, banks, insurers, certain partnerships (see definition of an audit) – audit reports for financial years beginning on or after 6 April 2008.

• building societies – audit reports for financial years beginning on or after 29 June 2008

• friendly and industrial and provident societies that are insurers – audit reports for financial years beginning on or after 29 June 2008.

• Limited liability partnerships– audit reports for financial years beginning on or after 1 October 2008.

• Lloyd's syndicates – audit reports for financial years beginning on or after 1 January 2009.

There is nothing to stop firms adding the name of the responsible individual who was in charge of the audit and having the audit report signed by this person in his own name where this is not required by law. However, the statutory protection against any additional civil liability (if such a liability exists) is not extended in these situations. If a firm intends to do this, the engagement letter should make it clear that if any claim arises it would be against the audit firm and that the individual, by reason of being named and by signing the auditor's report, is not subject to any civil liability to which he would not otherwise be subject.

Audit reports for financial periods starting before 6 April 2008, or the implementation date given above, should be signed in accordance with regulation 3.10 of the Audit Regulations (December 1995 edition, as amended)."

The following points should be noted:

- The term Registered Auditor should not be used for periods commencing on or after 6 April 2008. This should be changed to Statutory Auditor. This applies to all audit reports, irrespective of the nature of the entity.

- If the entity falls within section 1210, as noted above, then the report must be signed in the name of the individual in order to comply with legal requirements. This change is effective at the dates shown above and is not applied to periods before that date. The implication of the last paragraph is that periods before the implementation date should continue to be signed in accordance with Regulation 3.10. This required the report to be signed in the name of the firm with the added description "Registered Auditor(s). Therefore the auditor of a LLP will continue to use the term Registered Auditor for periods commencing before 1 October 2008.

- If legalisation requires the report to be signed in the name of the firm this should be complied with but using the term Statutory Auditor. This applies for all periods commencing on or after 6 April 2008.

- If the legislation includes no such requirements then the report can be signed in the name of the individual, as senior statutory auditor, but the engagement letter should refer to this to avoid civil liability. Given that many engagement letters will not refer to this it may be advisable to use the signature of the firm.

- Where it is necessary to show the name of the Senior Statutory Auditor, this should be in the same format as is used in the Audit Register – that is First name, Surname.

MODIFIED AUDIT REPORTS

Lecture A273 (17.45 Minutes)

Following the publication of ISA 700 (Revised) back in March 2009, the structure of company audit reports has changed substantially. As a result, it is not now obvious how to prepare a modified audit report. Fortunately, APB Bulletin 2009/2 contains numerous examples of modified audit reports in the new style.

These notes look at how such reports should be laid out. Firstly, however, we reproduce below an unmodified, "clean" audit report as a reminder of the new format and layout.

Unmodified report

Example 2 - UK non-publicly traded company under UK GAAP

This report is to be used for the audits of accounting periods commencing on or after 6 April 2008 and ending on or after 5 April 2009. Note that the Bannerman paragraph is excluded as this is recommended for inclusion by the ICAEW (and not by the ACCA for its members), not the APB.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF XYZ LIMITED

We have audited the financial statements of XYZ Limited for the year ended ... which comprise [specify the titles of the primary financial statements, such as the Profit and Loss Account, the Balance Sheet, the Cash Flow Statement, the Statement of Total Recognised Gains and Losses, the Reconciliation of Movements in Shareholders' Funds] and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement [set out [on page ...]], the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is [provided on the APB's web- site at www.frc.org.uk/apb/scope/UKNP] / [set out [on page x] of the Annual Report].

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the company's affairs as at ... and of its profit [loss] for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

[Signature] Address

John Smith (Senior statutory auditor) Date

for and on behalf of ABC LLP, Statutory Auditor

Emphasis of matter

One of the most common modifications to the audit report is the inclusion of an emphasis of matter paragraph, often in connection with doubts about going concern. This is addressed in APB Bulletin 2009/2 in Example 11.

The wording of the emphasis of matter paragraph itself is identical to that in the equivalent example in APB Bulletin 2006/6. However, its location within the report has changed due to the new layout of having three separate opinion sections. The emphasis of matter paragraph should be inserted directly after the “Opinion on the financial statements” section, as shown below:

Example 11 – Emphasis of matter: Material uncertainty that may cast significant doubt about the company's ability to continue as a going concern

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF XYZ LIMITED

...

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the company's affairs as at 31 December 20X1 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Emphasis of matter – Going concern

In forming our opinion on the financial statements, which is not qualified, we have considered the adequacy of the disclosure made in note [x] to the financial statements concerning the company's ability to continue as a going concern. The company incurred a net loss of £X during the year ended 31 December 20X1 and, at that date, the company's current liabilities exceeded its total assets by £Y. These conditions, along with the other matters explained in note [x] to the financial statements, indicate the existence of a material uncertainty which may cast significant doubt about the company's ability to continue as a going concern. The financial statements do not include the adjustments that would result if the company was unable to continue as a going concern.

Opinion on other matter prescribed by the Companies Act 2006

...

Qualified opinion – disagreement

This type of modification is used when the auditor disagrees with the directors about the accounting treatment of a material item, or the disclosure (or lack thereof) of a material issue in the accounts where, in either case, the issue is not of sufficient magnitude or is pervasive so as to require an adverse opinion. In such circumstances an “except for” disagreement opinion is appropriate.

These situations are covered by Examples 13 and 14 in APB Bulletin 2009/2, the former of which is reproduced below. Note that although the opinion section on reporting by exception matters has been left unmodified, in such the auditor may often need to report under one or more of these headings.

Example 13 – Qualified opinion: Disagreement – Inappropriate accounting treatment of debtors

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF XYZ LIMITED

...

Qualified opinion on financial statements arising from disagreement about accounting treatment

Included in the debtors shown on the balance sheet is an amount of £Y due from a company which has ceased trading. XYZ Limited has no security for this debt. In our opinion the company is unlikely to receive any payment and full provision of £Y should have been made. Accordingly, debtors should be reduced by £Y, the deferred tax liability should be reduced by £X and profit for the year and retained earnings should be reduced by £Z.

Except for the financial effect of not making the provision referred to in the preceding paragraph, in our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at ... and of its profit [loss] for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or

- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

...

Qualified opinion – limitation on scope

This type of modification is used when the scope of the auditor's work has been limited in some way such that they have insufficient audit evidence to be able to issue a complete opinion, but where the issue is not of sufficient magnitude or is pervasive so as to require a full disclaimer of opinion. In such circumstances an "except for" limitation on scope opinion is appropriate.

These situations are covered by Examples 15 and 16 in APB Bulletin 2009/2. One of the most common examples of when this arises is where the stock take is not attended for some reason, often because the directors do not realise that the company will exceed the audit threshold for the first time. Example 15, which is reproduced below, covers this specific situation.

Here, the qualification is inserted into the "Opinion on the financial statements" section as before, but this time the auditor also needs to modify the "Matters on which we are required to report by exception" section.

Example 15 – Qualified opinion: Limitation on scope – Auditor not appointed at the time of the stocktake

...

Qualified opinion on financial statements arising from limitation in audit scope

With respect to stock having a carrying amount of £X the audit evidence available to us was limited because we did not observe the counting of the physical stock as at 31 December 20X1, since that date was prior to our appointment as auditor of the company. Owing to the nature of the company's records, we were unable to obtain sufficient appropriate audit evidence regarding the stock quantities by using other audit procedures.

Except for the financial effects of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to physical stock quantities, in our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 20X1 and of its profit [loss]for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and

- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

In respect solely of the limitation on our work relating to stock, described above:

- we have not obtained all the information and explanations that we considered necessary for the purpose of our audit; and
- we were unable to determine whether adequate accounting records had been kept.

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made.

Adverse opinion and disclaimer of opinion

These are dealt with by Examples 17 to 20 in the Bulletin.

COMMON WEAKNESSES REPORTED BY QAD

Audit News Issue 45 contains a report from the QAD reporting common weaknesses observed during their visits to audit firms. The notes which follow contain extracts from the report with additional comments.

Auditing standards

ISA 210 - Terms of audit engagements

Common issues with letters of engagement were:

- reference to incorrect legislation (including lack of tailoring for specialist/regulated clients);

- reference to SASs instead of ISAs; and
- reference to NCIS instead of SOCA and reference not being made to the latest Money Laundering Regulations 2007.

Comment: It is very difficult for any individual firm to identify promptly all of the changes which should be reflected in an engagement letter. It is recommended that firms should subscribe to an appropriate updating service.

ISA 230 - Audit documentation

ISA 230 requires that the audit files should be sufficiently documented to allow an experienced auditor, with no previous connection with the audit, to understand the nature, timing and extent of the audit procedures performed; the results of those procedures and the audit evidence obtained; and significant matters arising and the conclusions reached. A practical test for this is to ask yourself whether an experienced auditor could, from the information supplied, understand the above points.

Comment: Try reviewing files of colleagues. Not necessarily as part of the annual cold file review process but just to gain a picture of how well your firm complies with this standard.

ISA 240 - Auditor's responsibility to consider fraud in an audit

This issue is consistent with the ISA 260 findings as not all firms are communicating appropriately with their clients at the planning stage and fraud risks are not specifically discussed. In addition, team discussions are often not conducted, or not recorded. Finally, some firms do not seem to appreciate that income recognition is presumed to be high risk, and therefore the audit approach needs to reflect this, unless the audit team can justify, in writing, a different approach.

Comment: The above criticism is straightforward. For many firms, a change of attitude is required.

ISA 250A - Consideration of laws and regulations

Problems arise in the following areas:

- identification of the key legal and regulatory requirements affecting the client at the planning stage of the audit;
- follow-up at the fieldwork stage of the client's compliance with the laws and regulations identified at planning; and
- lack of evidence of discussion with the client, review of regulatory reports and correspondence, and a lack of review of correspondence or direct confirmation with legal advisers.

Comment: Recall that the additional procedures are only required where the laws and regulations are “central” to the business.

ISA 260 - Communicating audit matters to those charged with governance

Not all firms have the required discussions at either the planning or completion stage or, if they do, there is no record. This is a vital requirement in all audits.

Comment: Probably the easiest way to achieve and demonstrate compliance with this ISA (re. planning) is through the use of a tailored planning letter.

ISA 315 - Obtaining an understanding of the entity and its environment and assessing the risks of material misstatement

The issues arising include:

- insufficient recording of the understanding of the entity - mainly noted on specialist audits;
- no confirmation of the design and implementation of the controls used by the client (eg, via observation, walk-through testing or some other test);
- risk assessments not always performed on an assertion basis; and
- often, no significant risks identified.

Comment: These criticisms are familiar. This remains the weakest area of compliance with the new standards.

ISAs 500-505 - Audit evidence

Lack of sufficient audit work still ranks as a common finding, particularly in the following areas:

- bank and cash - lack of bank confirmations
- expenditure - occurrence
- creditors completeness
- turnover completeness
- other debtors - existence and/or value
- stock valuation.

The underlying cause is often a failure to identify the key audit areas and to tailor the audit approach at the planning stage.

Also, firms are not using their audit procedures or manuals effectively (in some cases not at all!) or not using specialist audit procedures or tailoring standard procedures sufficiently for specialist or regulated clients.

Comment: These are straightforward issues of basic auditing. The QAD criticism is clear and no further comment is required.

ISA 520 - Analytical procedures

The main issue is with the preliminary and final analytical review; not documenting sufficient narrative to explain key variances and their impact on the audit.

Comment: Recall the purpose of preliminary analytical review – it is a risk assessment procedure. By contrast, final analytical review is corroborative in nature.

ISA 560 - Subsequent events

As with going concern, a lack of recorded evidence to support the conclusions reached.

Comment: And don't forget the gap.

ISA 570 - Going concern

Given the current economic climate, it is perhaps not surprising that going concern is a common issue. Not all firms are considering or recording sufficient evidence to support their going concern conclusions. The current recession makes this all the more important and it is vital that audit firms consider and record the full scope of evidence available in making their going concern conclusions, eg, review of forecasts, order books, post-year-end management accounts, discussions with those charged with governance, review of banking and lending facilities, review of minutes and legal correspondence, review of gearing, interest cover, liquidity and so on. ISA 570 provides examples to assist in compliance. The other common issue that firms sometimes forget is that going concern considerations should extend to one year after approval of the financial statements and audit files should be able to demonstrate that this full period has been considered.

Valuable additional guidance is also available in APB Bulletins 2008/10, Going concern issues during the current economic conditions, and 2008/01, Audit issues when financial market conditions are difficult and credit facilities may be restricted. There is also an article on going concern in edition 45 of Audit News.

Comment: We have given considerable attention to this subject in recent update notes.

ISA 580 - Management representations

Some audit matters can only be dealt with in a letter of representation but many firms do not:

- obtain written representations where these are needed;
- obtain a representation letter before the audit report is signed;

- cover the areas of going concern, laws and regulations, fraud, unadjusted errors; or
- tailor the letter for specialist clients.

Comment: Whilst standard letters can be dangerous, it is a good idea to start with a standard document which covers all of the compulsory requirements including those mentioned in the third bullet point above.

ISA 700 - The auditor's report

The most common issues are:

- failure to adopt the wording of the APB Bulletin (at the time of writing: 2006/6 for standard audit reports in the UK);
- errors in the wording and nature of audit report qualification/modifications; and
- reference to UK auditing standards instead of ISAs.

It is vital that what is, after all, the end product of the audit, is accurate. Firms should:

- ensure that their audit report templates reflect the current APB Bulletin;
- apply appropriate quality control procedures prior to signing the audit report; and
- for audit reports with qualifications or modifications:
    - refer to ISA 700 prior to finalising the audit report; in particular, to the decision tree to help determine the correct qualification or modification and also to the appropriate illustrative examples for appropriate wording; and
    - the firm should consider either a second review by a responsible individual or additional consultation procedures - both documented of course!

Comment: Again, the QAD criticism is clear and thorough. Recall the cut-off date for the new form of report under ISA 700 – that is periods ending on or after 5 April 2009.

Financial statements

Reviewers identified the following matters, which seem to feature regularly.

Directors' reports

- no risks and uncertainties;
- no fair review of business activities;
- no statement regarding the disclosure to auditors; and
- no disclosure in relation to future developments.

Comment: Bullet points 1, 2 and 4 do not apply to small companies. Bullet point 3 will apply to a small company if its accounts are audited.

Accounting policies

- turnover and income recognition;
- fixed asset policies: depreciation or non-depreciation; investment properties (including true and fair view override); intangible fixed assets, including goodwill; revaluation of properties;
- pension scheme;
- going concern where there were apparent issues.

Comment: There is a tendency to accept the policies produced by the firm’s standard software without a critical read.

Profit and loss account

- auditor's remuneration, including analysis of non-audit services;
- taxation: mainly omitting reconciliation of current year tax charge;
- directors' remuneration: directors' pension contributions; the numbers accruing pension benefits; directors' emoluments.

Balance sheet

- fixed assets: hire purchase/finance lease disclosures; the details regarding revaluations;
- bank loans: terms, interest, maturity analysis;
- operating leases: no commitment note.

- Related parties: no controlling party note; directors' loans omitted; and other missing RPT disclosures.

Many of these issues can be avoided by using a disclosure checklist.

Comment: At the time of preparing this report, the QAD had not yet identified directors' dividends as an RPT requiring disclosure.

Audit compliance review (ACR)

This requirement should be second nature but some firms are misunderstanding the requirements and are not realising that the ACR process has two parts: an annual whole-firm (or firm-wide) review and an annual cold file review of a sample of audit engagements. So not all firms are conducting a full ACR.

Some firms are not conducting sufficiently challenging cold file reviews. In other words, the reviews had identified few or no findings compared with the findings of the QAD.

Some firms are not following up sufficiently the matters found in order to rectify the ACR findings for the future.

Sole practitioners or other smaller firms may find it difficult to conduct effective internal ACRs, given the inevitable limitations of self-review. So, with the extent of regulatory changes and the changes to come with the clarified ISAs, such firms may wish to consider implementing the discipline of periodic external cold file reviews, (that does not necessarily mean annual). As long as you take action to review the findings, this should allow you to keep up to speed with the constant changes and should mean that you are less likely to achieve a poor monitoring outcome.

The worst mistake firms can make is, having been required to submit external hot or cold file reviews to the ARC as a result of a monitoring visit, to revert to just internal reviews or no annual reviews once the visit has been concluded to the ARC's satisfaction. Many firms have fallen into the trap of improving in the short-term after a monitoring visit, only to go back to old habits again. Repeated non-compliance and repeated poor visits are taken very seriously by the ARC and this situation is best avoided.

CPD

Since the change to the CPD arrangements in 2005, there is no longer a requirement to achieve a minimum amount of CPD or to attend courses. What you have to do is identify the training needs of audit staff and then identify the CPD activities that will best meet those needs.

If the findings of the visit show that CPD has not been effective or sufficiently far-reaching, this will usually result in the firm requiring follow-up action, including submission of CPD records to the ARC. There is a significant link between ineffective CPD and poor audit files and this emphasises the importance of CPD. This is especially the case given the imminent arrival of the clarified ISAs.

Comment: Whilst the firm has its responsibility for achieving satisfactory CPD, remember that the individual must also submit an annual return confirming their compliance with the rules.

Ethics

Three matters frequently arise.

- Long Association (Ethical Standard (ES) 3) - mainly responsible individuals acting for non-listed audit clients for more than 10 years without either implementing appropriate safeguards or informing those charged with governance in writing, obtaining their approval and documenting this.
- Provision of accounting services - under ES5, accounting services that involve initiating or authorising transactions or creating journals for a client without management input are prohibited unless the small company PASE exemption can be applied (which must be disclosed in the audit report). Other accounting services can be conducted provided they are not of a management nature and appropriate safeguards are applied.
- Fee dependency (ES4) - a lack of safeguards for non-listed audits with total fees regularly between 10-15%. Remember that if fees for non-listed audit clients regularly exceed 15%, there is a prohibition from accepting the audit appointment.

The above is the position for non-listed audit clients. Listed audit clients have more stringent requirements, as set out in the relevant standards.

SUMMARY OF DEVELOPMENTS

This section of the notes is designed to give you an overview of all recent developments announced by the various bodies under the control of the Financial Reporting Council (FRC). The bodies concerned are:

Accounting Standards Board (ASB)

Urgent Issues Task Force (UITF)

Financial Reporting Review Panel (FRRP)

Auditing Practices Board (APB)

For more details of any topic go to www.frc.org.uk and then click through to the appropriate body. Click on the press release in which you are interested and that will give you a link to further information.

ASB issues Amendment to FRS 29 - Improving Financial Instrument Disclosures

The Accounting Standards Board (ASB) has today issued 'Amendments to FRS 29 – Improving Disclosures about Financial Instruments'. The amendments are based on those issued by the International Accounting Standards Board (IASB) in March 2009. This package of amendments is part of the standard setting response to the credit crisis by improving the quality of information disclosed in financial statements about financial instruments.

The amendments to FRS 29 require enhanced disclosures about fair value measurements and liquidity risk. The ASB also took this opportunity to incorporate credit risk disclosures for loans and receivables as this requirement in IFRS 7 had not previously been adopted into UK GAAP.

Entities are required to apply the amendments to annual periods beginning on or after 1 January 2009.

21 May 2009

FRC Publishes Exposure Draft updating Going Concern Guidance for Directors

The Financial Reporting Council (FRC), the UK's independent regulator responsible for promoting confidence in corporate reporting and governance, has published an Exposure Draft of updated guidance for directors of UK companies to assist them with their assessment of going concern and in evaluating the nature and extent of disclosures.

The Draft will replace the existing guidance for directors of listed companies that was published in 1994. It is designed to be relevant to the directors of all sizes of UK companies including those that adopt the Financial Reporting Standard for Smaller Entities. The Draft incorporates the going concern material published in recent months in the FRC's "Update for directors" and "Guidance for directors of smaller companies". However, it will not replace that guidance until published in final form, taking account of the comments received.

Commenting on the Draft, Paul Boyle, Chief Executive of the FRC, said:

"The guidance that the FRC has issued over the last year has been well received and the Exposure Draft gives us the opportunity to bring together all of the latest thinking in a single place to help directors all of sizes of UK companies. We hope that the four principles will be particularly helpful. "

The comment deadline is 28 August 2009 and the FRC is consulting on whether the final guidance can reasonably be implemented in time for 31 December 2009 year ends.

29 May 2009

FRC publishes Discussion Paper on Reducing Complexity in Corporate Reporting

The Financial Reporting Council (FRC), the UK's independent regulator responsible for promoting confidence in corporate reporting and governance, has published a discussion paper arising from its project on reducing complexity in corporate reporting.

The paper's title - Louder than Words: Principles and actions for making corporate reports less complex and more relevant – is intended to remind all of those involved in corporate reporting that it is what we all do in practice that affects the quality and readability of corporate reports.

The paper seeks to address growing concerns about the complexity of corporate reporting. Many people point to the increasing length and detail of annual reports – and the regulations that govern them – as evidence that we have a problem.

The paper recommends a commonsense approach to reducing complexity based on eight guiding principles – four for better communication in reports and four for improving the quality and effectiveness of regulations. It also recognises that there is no easy solution and that change will only happen if all of those involved in corporate reporting make a concerted effort.

Ian Wright, the FRC's Director of Corporate Reporting said:

'The FRC and many others agree that regulations themselves should be principles or outcomes based. So shouldn't those setting the regulations and standards also do so within a principles-based framework? We set out four simple principles that we believe should govern the way regulators create and communicate the standards that govern the content of annual reports. Regulations should be targeted, proportionate, coordinated and clear.'

The paper also makes five calls for action where the FRC believes further investigation may lead to opportunities for reducing complexity. These are:

- Cash flow and net debt reporting: could this be better aligned with user needs such as by including a net debt reconciliation?

- Wholly owned subsidiaries reporting requirements: could we find ways to reduce the reporting burden such as by reducing the filing or disclosure requirements?

- Cut clutter: could preparers reduce immaterial information (with the support of regulators) that may be undermining the quality of reports?

- Disclosures: could we overhaul the process for creating disclosures and provide guidance about when they can be deleted as not relevant?

- IFRS: could we improve usability through logical organisation and clearer articulation of the desired outcomes for each standard?

Paul Boyle, Chief Executive of the FRC said:

"Complexity in corporate reporting is a multi-faceted problem that will require changes in behaviour from all members of the corporate reporting community, including standard-setters, company directors, auditors and regulators. We hope that this paper will stimulate change."

The FRC is hoping that the discussion paper will lead to debate within the UK and global financial reporting communities. We hope that respondents will help us identify priorities and offer to take on projects to help reduce complexity in the future. The FRC welcomes comments on its paper from a wide range of constituents by 30 October 2009.

04 June 2009

ASB issues proposals for Improvements to Financial Reporting Standards

The Accounting Standards Board (ASB) has today issued a Financial Reporting Exposure Draft (FRED) of Improvements to Financial Reporting Standards so as to maintain the existing levels of convergence between UK and International Financial Reporting Standards.

The ASB conducts an annual review of its standards. The proposals set out in the FRED arise as a consequence of the International Accounting Standards Board's (IASB) annual improvements process. Proposals are also developed to respond to specific issues raised by the ASB's constituents. In particular, the FRED includes a proposal to strengthen the disclosure requirements for asset impairments.

The ASB has also decided to simplify the improvement process by not including minor editorial corrections in the FRED but to list these on its website. This is consistent with the practice the IASB follows.

The comment period for the FRED closes on 30 September 2009.

11 June 2009

ASB issues Amendments to Financial Reporting Standard for Companies Act Changes

The Accounting Standards Board (ASB) has today published an amended FRS 2 'Accounting for Subsidiary Undertakings'; and amendments to FRS 6 'Acquisitions and Mergers' and FRS 28 'Corresponding Amounts'. The amendments update the references in these Financial Reporting Standards to refer to the 'Companies Act 2006' and the 'The Large and Medium-sized Companies and Reports Regulations 2008.

The FRS does not amend existing requirements of these FRSs but updates them such that the references contained in the FRSs correspond with current legal requirements.

The amendments take effect for accounting periods beginning on or after 6 April 2008 or when the provisions of the Act/and or the Regulations are applied to other entities (eg limited liability partnerships), if later.

18 June 2009

ASB Requires New Disclosures for Heritage Assets

The Accounting Standards Board has today issued a new Financial Reporting Standard that will improve the reporting of assets held by museums and art galleries. FRS 30 'Heritage Assets' introduces significant new disclosure requirements for reporting the content and value of collections.

The standard covers heritage assets that are kept principally for their contribution to knowledge and culture, regardless of whether these assets are reported in the balance sheet. New disclosures will provide information about an entity's total holding of heritage assets and its stewardship of these assets. Illustrative examples of the disclosures are provided to help with implementation.

FRS 30 retains the recognition and measurement requirements in FRS 15 'Tangible fixed assets', which require heritage assets to be reported in the balance sheet where information is available on cost or value. The ASB remains of the view that heritage assets are assets and that the best financial reporting is secured when they are reported as such in the balance sheet. To encourage a valuation approach, the FRS allows entities to use internal valuations without the need for a full valuation every five years.

Announcing the issue of FRS 30 'Heritage Assets', Ian Mackintosh, Chairman of the ASB, said:

"There can be little doubt that a museum's collections and exhibits are its greatest assets. Yet, under the current accounting practice, many museums and galleries publish accounts that do not adequately reflect the collections that they exist to safeguard and preserve. We expect the new disclosures being introduced in FRS 30 to significantly improve the financial reporting of heritage assets and thereby contribute to better financial management in this important sector."

The new FRS should be applied in respect of accounting periods beginning on or after 1 April 2010. Earlier application is encouraged.

This marks the culmination of the ASB's project on heritage assets, which was launched in January 2006 with publication of the Discussion Paper 'Heritage assets: Can accounting do better?'

In developing the FRS, the ASB considered comments on the DP and on the exposure drafts, FRED 40 and 42. Despite the more radical approaches proposed in these consultations, the ASB is not persuaded there is a better accounting solution for heritage assets than the current approach, which is based on FRS 15 and results in entities capitalising those heritage assets that have been acquired since 2001.

19 June 2009

ASB proposes Amendments to UITF Abstract 42 and FRS 26

The Accounting Standards Board (ASB) has today issued a Financial Reporting Exposure Draft (FRED) on Embedded Derivatives proposing amendments to UITF Abstract 42 (IFRIC 9) 'Reassessment of Embedded Derivatives' and FRS 26 (IAS 39) 'Financial Instruments: Recognition and Measurement'. The proposed amendments clarify the treatment of embedded derivatives when an entity reclassifies a financial asset out of the fair value through profit or loss category.

The proposed amendments are a consequence of the International Accounting Standards Board (IASB) issuing 'Embedded Derivatives – Amendments to IFRIC 9 and IAS 39' on 12 March 2009. The amendments to IFRIC 9 and IAS 39 require an entity to assess whether an embedded derivative is required to be separated from a host contract when an entity reclassifies a hybrid (combined) financial asset out of the fair value through profit or loss category. The assessment is made on the basis of the circumstances that existed on the later date of (i) when the entity first became a party to the contract; and (ii) a change in the terms of the contract that significantly modified the cash flows that otherwise would have been required under the contract. If the fair value of the embedded derivative that is to be separated cannot be reliably measured then the entire financial instrument must remain in the fair value through profit or loss category.

The FRED proposes parallel amendments to UITF Abstract 42 (IFRIC 9) and FRS 26 (IAS 39) with the objective of ensuring that UK GAAP remains fully converged with IFRS in this area.

The comment period for the FRED closes on 31 July 2009.

29 June 2009

The Financial Reporting Review Panel welcomes improvements in Impairment Disclosures

In December 2008 the Financial Reporting Review Panel wrote to 30 large companies advising them that the impairment disclosures in their next set of financial statements would be subject to review for compliance with IAS 36 "Impairment of assets". The aim of the project was to stimulate improvements in disclosures about impairment and to test assumptions, given the high importance of this information to investors in current market conditions.

The Panel has now completed its initial review of the impairment disclosures and is pleased to report that 22 companies out of the 30 improved the overall quality of their impairment information compared with the previous year, 13 significantly so. There was also a noticeable increase in the level of compliance with the requirements of IAS 36 generally - particularly relating to disclosures of reasonably possible changes in assumptions that could trigger an impairment charge.

The Panel will be writing to 26 of the companies to thank them and to inform them that no further enquiry will be made into their annual accounts at this point. The Panel will conduct a more detailed review of the impairment information disclosed by the remaining four companies and will write to them when that exercise has been

completed. The fact that the Panel has selected four sets of company accounts for further review does not mean that the Panel has concluded that their accounts failed to comply with the requirements of IAS 36.

Bill Knight, Chairman of the Panel said:

“We appreciate the work undertaken by the companies involved in this review. It is clear from a comparison of their 2007 and 2008 disclosures that many thought carefully about what information they needed to communicate and the majority made improvements.

A number of the companies found ways to make their disclosures easier to read and understand. In particular, some provided key data and assumptions in tabular form which improved ease of understanding when compared to long notes of closely written text in small print. “

Ian Wright, Head of Corporate Reporting at the Financial Reporting Council, said:

“We hope that many companies will be looking at their peer group disclosures and will be seeking to improve their goodwill and intangible asset disclosures which are so relevant at present.”

02 July 2009

APB issues a Consultation Paper and Exposure Draft of a Revision to Practice Note 26 'Guidance on Smaller Entity Audit Documentation'

The Auditing Practices Board (APB) has today issued for consultation an Exposure Draft of Practice Note 26 (Revised). Comments are requested by 30th September 2009.

APB first issued Practice Note 26 in September 2007 to provide guidance and illustrative examples on how the documentation requirements contained within ISAs (UK and Ireland) can be applied to smaller entity audits. In April 2009 APB exposed proposed revisions to the ISAs (UK and Ireland) that will apply to audits for accounting periods ending on, or after, 15 December 2010. The APB is planning to finalise the update to Practice Note 26 at about the same time as it finalises the changes to the revised ISAs (UK and Ireland) so that the guidance will be available on a timely basis to assist audit firms with their implementation of the new standards.

In addition to updating the existing material for changes to the proposed standards, new examples have been added to illustrate the impact on audit documentation of some of the changes in the proposed ISAs (UK and Ireland).

Richard Fleck, Chairman of APB commented:

“We received strong support from practitioners, training providers and standard setters in other countries for Practice Note 26 when it was first issued in 2007. While much of that guidance will still apply to audits undertaken under the new ISAs (UK

and Ireland) APB hopes that this update will assist firms with their implementation of the new standards in 2010."

30 July 2009

ASB seeks views on proposals for the future reporting requirements for UK and Irish entities

The Accounting Standards Board has today issued a consultation paper 'Policy Proposal: the future of UK GAAP', which sets out its proposals for the future reporting requirements for UK and Irish entities.

The issue of the proposals has been deferred awaiting publication by the International Accounting Standards Board (IASB) of its International Financial Reporting Standard (IFRS) for Small and Medium-sized Entities (SMEs), which the Board believes can play a significant role for future UK GAAP. The IASB published the standard on 9 July 2009.

The Board's proposals envisage a differential reporting regime based on public accountability, broadly in line with the IASB's definition in the IFRS for SMEs, which states that entities do have public accountability if they (a) trade their debt or equity instruments in a public market or (b) hold assets in a fiduciary capacity for a broad group of outsiders as one of their primary businesses.

The Board is proposing a three-tier approach to developing UK GAAP converged with IFRS as follows:

- Tier 1 – publicly accountable entities would apply IFRS as adopted by the EU ('EU-adopted' IFRS).
- Tier 2 – all other UK entities other than those who can apply the Financial Reporting Standard for Smaller Entities (FRSSE) could apply the IFRS for SMEs.
- Tier 3 – small entities could choose to continue to apply the FRSSE.

Entities within Tier 2 and Tier 3 would have the option of using EU-adopted IFRS if they wished, and those in Tier 3 would have the option of using the IFRS for SMEs.

The Board has been working with the UK Department for Business Innovation and Skills (BIS) in developing these proposals.

The consultation paper explores whether constituents would prefer to retain the current legal definition of public accountability. This would imply, for example, that all large entities are publicly accountable, and so should be required to follow EU adopted IFRS. Views on this issue are requested in the consultation paper.

The consultation paper also sets out what the Board sees as the impact of its proposals for public-benefit entities.

Announcing the issue of the consultation paper, Ian Mackintosh, Chairman of the ASB, said:

“For a number of years, the Board has stated that, in the medium term, there is no case for the use of two different accounting frameworks in the UK. The recent publication by the IASB of its IFRS for SMEs provides the Board with the opportunity to consult on what we see as the future framework for financial reporting by UK and Irish entities. I would urge all interested parties to consider the proposals and let us have their views”.

The Board is seeking comments on the proposals by 1 February 2010. In the light of the responses to this document, the Board, working with BIS, will explore more fully the mechanism needed to implement a differential reporting regime based on public accountability.

11 August 2009