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TOP 10 TECHNICAL BULLETIN SUBJECTS OF 2016

As 2016 draws to a close, the Editorial Team thought it would be useful to look at the Top 10 subjects that filled the pages of Technical Bulletin throughout the year. No prizes for guessing the top two, which are momentous changes that will affect the profession for many years to come. And no, we are not talking about Brexit, or the election of Donald Trump as the USA's new President!

1. **FRS 102 (Several Issues)**

   FRS102 makes the most appearances in 2016, with February's issue (#136) running an article on Transition Requirements and queries on Revaluing Fixed Assets and Acquisition Costs; issue 137 in April answered queries on Merger Accounting and UK Groups and Foreign Owners; in June, issue 138 looked at Foreign currency exchange movement reserves; Issue 139 in August addressed Directors' Loans; and November's issue 140 covered Exceptional items.

2. **Making Tax Digital (Several Issues)**

   Making Tax Digital came a close second with April's issue 137 giving an overview of the Government's proposals; then in August's issue 139 we looked at some of the detail; and November's issue 140 was full of information about HMRC's consultation documents and ICAS's responses. Together with FRS 102, MTD will undoubtedly be one of the major challenges we will all face in 2017.

3. **Landlords under attack! (Issue 136)**

   With all the buzz in the news about a housing shortage in the UK and the need for more innovative solutions to the problem, it seems strange that the Government seems to be making life as hard as possible for private landlords. In February's issue 136, we looked at a number of changes affecting the taxation of landlords.

4. **Alcohol Wholesale Registration Scheme (Issue 136)**

   The Alcohol Wholesale Registration Scheme covered in Issue 136 was brought in to try and reduce the amount of contraband liquor in the market and, of course, bring in more money to the Exchequer. Whether it makes a jot of a difference remains to be seen.

5. **New Research and Development Claims Scheme (Issue 136)**

   Another first appears in Issue 136 with details of HMRC's Advance Assurance Scheme for Research and Development Claims. This sees HMRC going against its own aversion to giving advance clearance where it can, and gives some welcome assurance to businesses that their expenditure will qualify before it is incurred.

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6. **HMRC direct recovery of debt (Issue 137)**

   Issue 137 looks at the rather controversial move allowing HMRC to take money direct from a taxpayers bank account in settlement of outstanding debts provided certain criteria are met. As usual, there are cross border complications that are not immediately apparent!

7. **Confirmation Statements replace company Annual Returns (Issue 138)**

   The move from Annual Returns to an annual Confirmation Statement, together with the Register of People with Significant Control were two new and fundamental changes to the way Companies House operates. Issue 138 gives more detail.

8. **FRS 105 (Issue 139)**

   Of course, FRS 102 is just part of the rewrite of UK GAAP. Issue 139 looks at FRS 105 – The Financial Reporting Standard Applicable to the Micro-Entities Regime.

9. **New Regime for Taxation of dividends and savings (Issue 139)**

   A new regime for the taxation of dividends and savings came in on 6 April 2016. This article explains the practical implications for clients and for practices doing their tax returns.

10. **ICAS Consumer Credit Regulations (Issue 140)**

   Finally, important changes to how firms deal with Consumer Credit are covered in Issue 140. ICAS firms now need a Consumer Credit Designated Professional Body licence if they engage in certain consumer credit activities, and this article explains when that's the case, and what you need to do.

AUTUMN STATEMENT - A MAN FOR TWO SEASONS

Perhaps one of the most surprising things in Phillip Hammond's first budget was his announcement that, in future, Budget Day will be in the autumn rather than at its usual mid-March slot. There will no longer be an "Autumn Statement" but we will have a "Spring Statement" instead. His intention is that all legislative proposals will be introduced in the new Autumn Budget thereby removing the current situation where, in practical terms, we have two budgets a year.

As well as this welcome move, there were a number of interesting announcements made by the Chancellor, albeit the subsequent press releases made available were, in a number of cases, reminiscent of Groundhog Day where the same announcement keeps reappearing Budget after Autumn statement after Budget.

Income Tax and National Insurance are like a couple who are mutually attracted but are too shy to take the plunge and commit to getting together. Instead, the Chancellor announced further alignment, and from 2017/18 the primary and secondary earnings thresholds will be £157. In addition, National Insurance will be chargeable on termination payments in excess of £30,000, which again brings it into line with the general position for Income Tax.

A long standing relief which will disappear is that in respect of foreign pensions received by UK residents. A 10% deduction has been given with the result that, only 90% of an overseas pension is subject to UK Income Tax. This relief is set to disappear and does represent a simplification. Unfortunately, simplification is happening in all of the wrong places with much impenetrable legislation remaining untouched and, if anything, becoming even more complicated.

The Government has been concerned about salary sacrifice arrangements and the availability of such arrangements is to be severely restricted. In future, salary sacrifice will only be possible in respect of pensions, childcare, cycle to work and ultralow emission cars. The tax system is therefore encouraging us to save for retirement, return to work before our children are truly off our hands, cycle to our work and drive cars which are not major polluters. The question arises again as to whether the tax system should be used as the primary driver in influencing behaviour or whether it might not be more straightforward, for example, to have a system of subsidies or grants to encourage people to purchase electric cars or those with very low emissions.

It was not many years ago that Employee Status Shares (ESS) were introduced whereby employees could give up certain employment rights in exchange for shares worth at least £2,000. At the time, many wondered who in their right mind would give up valued employment rights for very modest shareholdings with very little influence. Such shares, however. found great favour with the likes of employed consultants and non-executive directors who were more than happy to give up some employment rights in exchange for shareholdings which, on a successful sale share or floatation, could yield them vast profits which were not subject to capital gains tax. As you read this, it will no longer be possible for new ESS shares to be issued as the facility is withdrawn in respect of new issues after 30 November 2016.

In a welcome relaxation, the Chancellor has proposed that the "substantial shareholdings exemption" rules for a trading company, or holding company of a trading group which has at least a 10% shareholding in a trading company, are to be relaxed. Hither to, it has been necessary for the disposing company to have been a trading company or the holding company of a trading group after the disposal. If, after the share disposal, the investing company no longer qualified as a trading company, then it was necessary for it to be liquidated soon after the disposal. The chancellor is proposing that the investing company may no longer require to be a trading company or the holding company of a trading group after the disposal. This will enable decisions to be taken on a commercial basis rather than the tax tail perhaps having a greater influence on the dog than it ought.

Finally, the VAT flat rate scheme. This was a well-intentioned simplification idea to assist smaller businesses. Instead of having to account for VAT on the normal basis, they basically did not reclaim input tax and accounted for a flat rate, less than the normal 20% rate of VAT on all of their gross sales. The flat rate percentages varied from trade to trade to reflect the anticipated input tax incurred by the various trades. Some, such as consultancy businesses, incur very little input tax and it is proposed that from 1 April 2017, "limited cost businesses" will be subject to a 16.5% flat rate. Clearly the Government feels that such businesses have been profiting from the scheme. While many businesses have adopted the flat rate scheme, before doing so, most have carried out a calculation to determine whether they are better off accounting for VAT on the normal basis or, alternatively, adopting a flat rate. Initially at least, far from simplifying things, it has been necessary for projections and calculations to be carried out to make a decision as to which way to jump. This carries on, but it will not be quite so advantageous for certain businesses in the future.

Roll on Spring……

A THIRD ALTERNATIVE – EMPLOYEE OWNERSHIP TRUSTS

When a client is thinking of selling his trading company, there are normally two obvious options: either a trade sale; or a management buy-out. In both cases, the client will hope to obtain the benefit of entrepreneurs' relief and the 10% rate of capital gains tax. However, there is a third alternative, which results in no capital gains tax liability at all. This is a sale of a controlling interest in the company to an Employee Ownership Trust.

The Finance Act 2014 included measures to encourage employee ownership of companies including reliefs from income tax and capital gains tax. The capital gains tax relief enables individual vendors of shares to an Employee Ownership Trust ("EOT") to dispose of ordinary shares without giving rise to a capital gain.

A number of conditions must be met for the relief to apply:

- The company must be a trading company or the holding company of a trading group from the time of the disposal to the end of the tax year in which the disposal takes place;
- The EOT must meet the "all employee benefit requirement" from the time of the disposal to the end of the tax year in which the disposal takes place. This is covered in further detail below;
- The EOT must begin to meet the "controlling interest requirement" (discussed later) during the tax year of disposal and continue to meet it up to and including the end of the tax year;
- The "limited participation requirement" must be met. Again, this is discussed later in this article;
- The relief must not apply to any related disposal by the same person or a connected person which occurs in an earlier tax year. The disposal is related if both disposals are of ordinary shares in the same company;

The "**all employee benefit requirement**" means that the EOT deed must not:

- Permit any of the EOT assets to be applied otherwise than for the benefit of all eligible employees on the same terms;
- Permit the trustees to apply any of the EOT property in creating a trust or making a transfer to another settlement other than an authorised transfer. An authorised transfer is basically a transfer to another EOT;
- Permit the trustees to make loans to beneficiaries of the EOT;
- Permit the trustees or any other person at any time to amend the trust such that it would no longer comply with one or more of the above.

Certain employees are not eligible to participate in the EOT. These are basically shareholders of the company in the 10 years prior to the creation of the EOT. However, shareholders who were not beneficially entitled to 5% or more of any class of share and who would not be entitled to 5% or more of the assets of the company on a winding up remain eligible. Individuals connected with a shareholder are also ineligible. Connection includes spouses and children and even extends to include aunts, uncles, nephews and nieces.

The "**controlling interest requirement**" means that the EOT must hold more than half of the ordinary share capital of the company and also hold more than half of the voting powers. The EOT must be entitled to more than half of the profits available for distribution to equity holders and to more than half of the assets available for distribution to equity holders in the event of a winding up.

There must be no provisions in any agreement which would result in any of the above ceasing to be satisfied without the consent of the trustees.

The "**limited participation requirement**" is met provided that, at no time in the 12 months up to the date of disposal, did the "participator fraction" exceed 2/5. The "participator fraction" is defined as "the total number of persons who are both shareholders and employees of the company added to those who are both employees and directors divided by the number of individuals who are employees".

The capital gains tax relief is withdrawn where a disqualifying event occurs in the period to the end of the tax year following the tax year in which the share disposal occurs. Disqualifying events are:

- Where the company ceases to meet the trading requirement
- The EOT fails to meet the all employee benefit requirement
- The EOT ceases to meet the controlling interest requirement
- The participator fraction exceeds 2/5
- The trustees act in a way which the EOT, as required by the all employee benefit requirement, does not permit.

Once the company is owned by the EOT, the company can pay tax free annual cash bonuses of up to £3,600 per employee. This is not a dividend but is a cash bonus and so distributable reserves are not necessary. The bonus is not however exempt from NIC. All employees must be eligible to participate in the bonus scheme and be treated on similar terms. This could be based on relative earnings, length of service, or hours worked. It is possible to exclude employees with less than 12 months' continuous employment. The bonus payments are deductible for corporation tax purposes.

BUSINESS PREMISES RENOVATION ALLOWANCE – THE FINAL CALL

There are only a few months left in which to claim Business Premises Renovation Allowance (BPRA). Could you or your clients benefit? The relief ends for Income Tax on 5 April 2017 and for Corporation Tax on 31 March 2017.

Key points

BPRA is not subject to the £50,000 cap on Income Tax reliefs brought in by FA 2013 Schedule 3. It gives 100% tax relief on qualifying costs of renovation or conversion of unused or derelict former trading/business premises in disadvantaged areas. There is flexibility in the claim - 25% write off is available on the balance of the cost, if less than 100% is claimed in the first year.

The property must have been unused for 12 months and the person incurring the costs must have a relevant interest in the property.

You don't need to be a landlord or property developer to qualify – it would cover conversion by a business for its own use. For example, a business looking for new premises could obtain relief for creating office space from former disused trading premises.

Qualifying costs

The details are set out in Capital Allowances Act 2001 s360B. Capital expenditure on the conversion, or renovation of former business premises including building, design and architectural services, engineering and planning costs and statutory fees, plus general costs of up to 5% of the qualifying expenditure total are allowed. The list of costs is specific – costs of acquiring the premises are not included, only the conversion.

Type of property

Premises formerly used in a trade, profession or vocation or as offices can be included in a claim, but some trades are excluded. For example, buildings formerly used for shipbuilding, in the coal industry or steel industry, as a fishery, in aquaculture and in primary agricultural production, or in energy generation, broadband networks, and synthetic fibres industries are all excluded.

Relief is not given for residential property conversions, so the flat over the shop is excluded. Yet the relief can be wider that it at first seems. The Senex case (**Senex Investments Ltd v Revenue & Customs [2015] UKFTT 0107 (TC) http://www.bailii.org/uk/cases/UKFTT/TC/2015/TC04312.pdf**) showed that a derelict church in Clydebank could qualify as 'redundant business property' for BPRA.

Disadvantaged areas

Significant areas of rural and central Scotland, the Highlands and Islands, Northern Ireland, North East and North West England, Wales, Yorkshire and the Humberside, East and West Midlands, East Anglia and South West England, and selected areas of London and the South East are covered.

Details are set out in Regulation 3 of the Business Premises Renovation Allowances Regulations 2007 (SI 2007/945) and Industrial Development Assisted Areas Order 2014 (SI 2014 / 1508).

How relief is given

BPRA is given against the profits of the person carrying out the renovation/conversion. Only the person carrying out the renovation or conversion can claim.

Where the claim is made by a landlord, relief is against the property rental business. Otherwise the deduction is against trading profits. If neither a trade nor a property business is carried on, relief is against other income, with the expenditure being treated as a loss on a notional property business.

Under EU rules, the maximum financial limit per project is 20 million euros.

Watch out for possible clawback – non-business use or sale within five years can cause a balancing adjustment. Relief is also withdrawn where work paid for in advance is not completed within three years.

Further guidance

The Senex case (above) is also a useful summary of the main rules of the scheme, and includes a useful discussion of the main tests.

The HMRC Capital Allowance Manual at CA 45000 **https://www.gov.uk/hmrc-internal-manuals/capital-allowances-manual/ca45000** gives a useful outline of the rules, but has not been updated for all points – such as the change in the clawback period from 7 years to 5 years following FA 2014. The Gov.uk guidance **https://www.gov.uk/guidance/business-premises-renovation-allowance-bpra** includes a postcode search facility for disadvantaged areas.

Conclusion

Spotting where the relief is due in marginal cases can be challenging. Review cases where clients have converted or renovated business premises to see if the fall within the rules.

REQUIREMENT FOR TAX ADVISERS TO SEND NOTIFICATION LETTERS TO CLIENTS

Background

Changes to the International Tax Compliance Regulations 2015 (SI 2015/878) have created an obligation on financial institutions and relevant persons, including tax advisers, to inform their clients that (a) HM Revenue & Customs (HMRC) will soon be getting data on overseas financial accounts; (b) that there are opportunities to come forward to make disclosures about overseas affairs; and (c) of the possible consequences for those who don't come forward.

Under the Common Reporting Standard, tax authorities around the world will be sharing data on financial accounts and will be using that data to check that taxable income has been properly reported. The reasoning behind the new notification requirement is that HMRC believes financial institutions and advisers know more than HMRC about whether clients have, or are likely to have, assets and income overseas. It therefore wants to ensure that they make clients aware of their obligations to report income in a consistent way.

HMRC held informal consultations about the obligation and the draft guidance and draft notification letters. ICAS took part in the consultations and raised numerous concerns about the obligation **https://www.icas.com/technical-resources/icas-responds-to-the-hmrc-on-draft-regulations-and-guidance-for-the-tax-adviser-notification-requirement**. As a result of feedback on the notification letters the wording was improved.

This article identifies key aspects of the obligations but for the details it is important for advisers to refer to the client notification landing page on GOV.UK **https://www.gov.uk/government/publications/client-notification-income-or-assets-abroad** which includes links to HMRC's detailed guidance in the International Exchange of Information Manual.

Who needs to send notification letters to clients?

The obligation extends to specified financial institutions, such as banks, building societies, insurers and fund managers (not covered further in this article) and 'specified relevant persons' (SRPs). SRPs include tax agents and advisers, solicitors, and financial advisers. There is a limited exclusion for SRPs in certain circumstances where services are provided solely in preparation of a tax return and various conditions are met **https://www.gov.uk/hmrc-internal-manuals/international-exchange-of-information/ieim603040**.

Clients who must be notified

The notification letter only needs to be sent to clients who are UK tax residents in either the 2015/2016 tax year, or the 2016/2017 tax year.

SRPs can choose how to identify the clients they need to notify. They can opt for:

1. The specific approach – identify individual clients they have provided with offshore advice, or referred overseas for this (ie the advice, products or services do not have to have been provided directly to the client); or
2. The general approach – identify all clients they have provided with advice or services for their personal tax affairs (between 1 October 2015 and 30 September 2016).

SRPs only need to use one of these approaches and if they don't find any clients to notify they do not need to do anything else.

How to send notification letters

SRPs must send the notification letter **https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/557296/client-notification-letter.pdf** together with a covering letter (or email). These must be sent to clients by post or email (if this is the way the adviser usually communicates with clients and reasonably believes they will read it).

For SRPs the wording for the covering letter or email reads:

"From 2016, HM Revenue & Customs (HMRC) is getting an unprecedented amount of information about people's overseas accounts, structures, trusts, and investments from more than 100 jurisdictions worldwide, thanks to agreements to increase global tax transparency. This gives HMRC unprecedented levels of information to check that, as in most cases, the right tax has been paid.

If you have already declared all of your past and present income or gains to HMRC, including from overseas, you do not need to worry. But if you are in any doubt, HMRC recommends that you read the factsheet attached to help you decide now what to do next."

The notification letter

The letter **https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/557296/client-notification-letter.pdf** highlights to clients that HMRC will be getting new financial information from over 100 jurisdictions about its 'customers', including details of overseas accounts, structures, trusts and investments.

One of the points ICAS raised with HMRC during the consultation process was that some individuals may not have realised that they needed to disclose offshore income – perhaps because they inherited assets overseas or because they took advice a long time ago but their circumstances or tax legislation have since changed. These inadvertent evaders need to understand that the letter is relevant to them. They would be unlikely to respond to a letter which concentrated solely on offshore tax evasion, as they would not recognise themselves as evaders.

The final version of the notification letter attempts to address this by placing emphasis on checking that tax affairs are up to date and it mentions changes in personal circumstances and inherited assets.

The letter points taxpayers who need to bring their affairs up to date to HMRC's online disclosure facility **https://www.gov.uk/guidance/worldwide-disclosure-facility-make-a-disclosure** and suggests anyone who is unsure should talk to a tax adviser. It also outlines the possible consequences of failing to pay the correct tax on offshore assets.

Timing

The notification letters must be sent to any qualifying clients by 31 August 2017.

Penalties

SRPs who do not identify relevant clients and send them the letter could be charged a one-off penalty of £3,000.

Useful links

Websites relevant to the client notification obligation:

- Client notification landing page: **https://www.gov.uk/government/publications/client-notification-income-or-assets-abroad**
- Guidance for recipients of the client notification: **https://www.gov.uk/guidance/income-or-assets-abroad-letter-about-your-uk-tax-affairs**
- Guide to sending the client notification letter: **https://www.gov.uk/government/publications/client-notification-income-or-assets-abroad/notes-on-how-and-when-to-send-the-client-notification-letter**
- Full guidance on the client notification in the HMRC manual: **https://www.gov.uk/hmrc-internal-manuals/international-exchange-of-information/ieim600000**
- The regulations: **http://www.legislation.gov.uk/uksi/2016/899/contents/made**
- Worldwide Disclosure Facility landing page: **https://www.gov.uk/guidance/worldwide-disclosure-facility-make-a-disclosure**

DIRECTORS' LIABILITY FOR UNPAID PAYE AND NIC

A limited company is under financial stress in challenging trading conditions. The directors declare a bonus which will be used to cover overdrawn directors' loan accounts. The PAYE and NIC due on the bonuses are not paid over to HM Revenue & Customs (HMRC). Can the directors be personally liable for the payroll taxes?

Helpfully, according to two recent cases (**Phillip Marsh and David Price TC05288 [2016] UKFTT 0539 (TC)**) the answer is yes; and no (**Stephen West TC05285 [2016] UKFTT 0536 (TC)**), which shows how close the decision can be. With over £108,000 at stake in the Marsh case, it is as well to be the right side of the line.

HMRC's attitude to unpaid tax is changing. Around 10% of the tax gap is attributed to non-payment. Increasingly, HMRC is using old rules to new effect. One area in which this is happening is unpaid payroll taxes of small companies.

In the **Marsh** case the directors were held personally liable because the Tribunal decided that the directors had 'wilfully procured the company to pay their remuneration without deduction of tax, knowing that tax should have been deducted'.

The rules we need to consider for income tax are regulation 72 Income Tax (PAYE) Regulations 2003 for PAYE, and Reg 86 Social Security (Contributions) Regulations 2001 for National Insurance.

PAYE – " Regulation 72"

Regulation 72 permits HMRC to designate an employee as liable for under deducted PAYE where an employee has 'received relevant payments knowing that the employer wilfully failed to deduct the amount of tax which should have been deducted.' Note that the rules say 'deducted' not 'paid'. This is a subtle but vital distinction, and the employee must have knowledge of the failure to correctly deduct PAYE.

With an owner-managed business, and given their position in the company, the presumption must be that a director knows what 'the employer' is doing! So, the first line of defence, that of 'not knowing', is already likely to be unavailable. Similarly, it is hard for a director to argue that the failure was not wilful if they were aware of all the circumstances.

National Insurance – "Regulation 86"

The National Insurance position is covered by Regulation 86 of the the Social Security (Contributions) Regulations 2001 (SI 2001/1004) which deals with "*Special provisions relating to culpable employed earners*". The wording here is slightly different. Reg 86 (1) (a) (ii) includes knowing … and … wilfully failed to pay; but Reg 86 (1) (a) (i) only refers to an act of default of the earner. Note that the wording here is 'failure to pay', rather than failure to deduct.

Reg 86 (emphasis added) says

(1) As respects any employed earner's employment—

(a) where there has been a failure to pay any primary contribution which a secondary contributor is, or but for the provisions of this regulation would be, liable to pay on behalf of the earner and

(i) <u>the failure was due to an act or default of the earner</u> and not to any negligence on the part of the secondary contributor, or

(ii) it is shown to the satisfaction of an officer of the Board that the earner <u>knows that the secondary contributor has wilfully failed to pay the primary contribution</u> which the secondary contributor was liable to pay on behalf of the earner and has not recovered that primary contribution from the earner;

…

Background to the Marsh case

In **Marsh** the business had expanded rapidly and then ran into cash flow problems. The two directors had maintained a low salary/high dividend remuneration package for a number of years, but changed this to high salary structure (£102,000, each). The decision to change the remuneration structure was said to be due to intended mortgage applications by the directors. The directors said the decision was made at an AGM, but could not produce documentary evidence to support this. Year-end PAYE returns were made, with the P35 for 2010/11 showing a liability of £164,339.60. The company went into administration on 4 April 2011. The directors drew round sum amounts which could not be precisely matched to the P35 details. The Tribunal commented that 'the Appellants drew substantial salaries from the business at a time when the company's profits could not support those salaries. During the tax year in question, no PAYE or National Insurance deductions were made. Their remuneration was disclosed on the Employer's Annual Return Forms P35 and P14, but the deductible amounts were not actually deducted and were not accounted for to HMRC.'

Background to the West case

Mr West was a sole director. Before the company got into financial difficulties he had a remuneration package of low salary and high dividend. In practice, drawings were made against the director's loan account and the balance cleared by dividends voted at the year-end. As the company headed towards insolvency, retained profits were insufficient to cover dividend payments. Salary of £202,967 was voted – a grossed up amount, the net of tax amount earnings being sufficient to cover the overdrawn balance of the director's loan account.

In a split decision, the Tribunal Judge held that the definition of 'payment' for employment income for a director, given by s 686 of the Income Tax (Earnings and Pensions) Act 2003, supported the view that the 'deducted' test of regulation s72 can be satisfied '*when sums on account of the income are credited in the company's accounts or records*' (s686 ITEPA 2003 (1) rule 3).

As regards National Insurance, Regulation 86, as noted above, is worded differently. It requires actual payment of the National Insurance. Here the Tribunal Judge decided that, in his view, the failure to pay was not wilful or deliberate. So the liability could not be transferred to the employee.

In a dissenting judgement, one Tribunal member relied on the fact that remuneration was voted at a time that the company was clearly unable to pay, to maintain that the failure to pay was wilful. By contrast, the Tribunal Judge indicated that it would take a change in law to reach a different conclusion on the facts.

Conclusion

As HMRC tries to recover more tax from failing businesses, the issue of unpaid PAYE and National Insurance is likely to become more significant.

It will become increasingly important to maintain contemporaneous records of decision making on remuneration strategy and how payments to directors have been treated for payroll taxes. Round sum deductions or amounts charged to a director's loan accounts leave open to question whether PAYE has actually been deducted.

The higher hurdle for National Insurance may require evidence that failure has not been wilful or deliberate: this may include evidence of the directors' intentions, and their awareness of the company's circumstances and payroll management.

HMRC'S "ONE TO MANY APPROACH"

HM Revenue & Customs (HMRC) has been a keen advocate of "behavioural insights" since 2000, particularly with regard to the collection of income tax debt. One of the initial successes, which saw tax collection rates rise, involved inserting a single sentence in letters chasing payment along the lines of 'most people pay their tax on time'. Similar tactics are still being used today, and look set to be extended with the "One to Many Approach".

Current tactics

According to the 2015/16 Update Report from The Behavioural Insights Team, a trial focused on people who were due to make a self-assessment payment at the end of July 2015, with the aim of preventing people from incurring tax debts and fines by prompting them before the payment deadline. Ten days before the deadline, people were divided into three groups, with different letters issued to each group.

- Group 1 - 'New' – these letters were issued to people who were new to self-assessment but had missed their first payment due in January 2015. Letters to this group included a sentence noting the previous late payment.
- Group 2 - 'Recurring' – a second type of letter was issued to those people with a poor payment history and a sentence drawing attention to the previous late payments.
- Group 3 - 'Reformed' – the final group, who had previously paid late but made their last payment on time, received a letter including a sentence thanking them for their timely payment.

Receiving a reminder letter had the desired effect. 'New' people increased paying by 34%; 'Recurring' late payers increased by 59%; and 'Reformed' payers went up by 22%.

Promote, Prevent, Respond

Behavioural insights and nudges are not restricted to just written communication, but also feature in policy and service design. HMRC's compliance mantra 'promote, prevent, respond' is embodied in its strategy to tackle non-compliance. The objective is to promote compliance by designing it into systems and processes; prevent non-compliance at or near the time of filing or payment; and respond to non-compliance with a range of interventions.

One to Many

The ingeniously-named "One to Many" (OTM) approach is where HMRC decides to send one standard message to a particular group of taxpayers, to influence their behaviour and to ensure compliance. In other words one message to many taxpayers. The message may be a reminder to pay a tax debt as already discussed, but equally may involve drawing attention to a frequently made mistake.

HMRC considers a number of factors before adopting an OTM approach such as:

- Are there enough common characteristics within the taxpayer group for the OTM approach to be effective?
- How many taxpayers will be involved?
- Are they all behaving like this for the same reason?
- What message, or change to existing communications, could influence this?
- How will these taxpayers react when they receive an OTM communication?
- What will be the operational impact on HMRC eg more telephone calls?

Any such OTM approach also has to be judged alongside existing campaigns and taskforces which may be planned or ongoing. The next consideration is what form the OTM approach should take and the selection of a delivery channel such as letter, email, SMS or digital account message.

Coming soon

Over recent years, we have seen HMRC trial benchmarking within targeted trade sectors and the use of 'effective rates of tax' letters to those individuals earning over £150,000 a year. In both trials HMRC invited the business owner or taxpayer to review their last submitted tax return and to check their accounts or income declarations.

With the rollout of digital services we are likely to see the OTM approach adopted in many guises, such as prompts and nudges but, inevitably, as HMRC learns more about people and businesses via their digital accounts, the OTM approach is likely to become increasingly fine-tuned and personalised in its application.

No doubt HMRC will analyse net profit ratio results by business sector more extensively and begin to risk assess businesses from start up to maturity, prompting and nudging to take particular actions at pertinent points through their lifetime.

AUTUMN STATEMENT: CHANGES TO THE VAT FLAT RATE SCHEME

The Flat Rate Scheme (FRS) was introduced in 2002 in order to simplify VAT accounting for small businesses. The scheme has been generally well received and well used by small traders with low levels of VAT bearing costs. However, an upset is on the horizon for such contented businesses.

From 1 April 2017, HM Revenue & Customs (HMRC) will introduce an additional test that will determine the flat rate percentage used by traders. Traders who use, or wish to use, the FRS and who meet the new definition of a "limited cost trader" will be required to use a new fixed rate of 16.5% which, at an effective rate of 19.8%, is very close to the normal rate of 20%! Currently, the highest flat rate is 14.5%.

A limited cost trader will be defined as one whose VAT inclusive expenditure on goods (and only goods, not services) is either:

- less than 2% of their VAT inclusive turnover in a prescribed accounting period
- greater than 2% of their VAT inclusive turnover but less than £1,000 per annum if the prescribed accounting period is one year (if it is not one year, the figure is the relevant proportion of £1,000, thus £250 per quarter)

The definition of goods here, must only include goods used exclusively for the purpose of the business and must exclude the following items:

- capital expenditure
- food or drink for consumption by the flat rate business or its staff
- vehicles, vehicle parts and fuel (except where the business is one that carries out transport services)

It is very likely that the introduction of this rate will affect many small businesses that use the FRS for the purposes for which it was introduced, that is to save administrative time and costs. Indeed the Government vigorously encouraged its use and not unreasonably so because it saved HMRC having to review many input tax claims of small businesses.

However, businesses using the scheme must now review their position before April 2017 to determine whether they are affected by this change and, if they are, to ensure that there are still advantages to using the scheme. It is likely that many businesses will withdraw from the scheme as it is likely to become uneconomical.

Any business that expects to incur significant VAT bearing expenditure prior to 1 April 2017, ought to consider whether it would be possible to leave the scheme sooner in order to reclaim input tax on such expenditure.

Anti-forestalling legislation has also been announced in order to stop businesses that are affected by the change and decide to withdraw from the scheme from issuing invoices prior to 1 April 2017, where the supply will not be made until 1 April 2017 or thereafter.

PRE-REGISTRATION VAT CLAIMS

This change in HM Rvenue & Customs (HMRC) position on claims for pre-registration VAT incurred was first highlighted in our February 2016 Issue (136), and over the past few months there has been much commentary about HMRC moving the goal posts in terms of what may and may not be claimed. This article will remind readers of the rules and what appears to be HMRC's current attitude towards such claims.

The Law (SI 1995/2518 Reg 111)

VAT incurred prior to registration is not input tax but can be treated as such in certain situations. Claims should be made in the first VAT return after registration but not beyond four years after the date that the first return is due for submission. The rules differ for goods and services:

Pre-registration VAT on the purchase of goods may be reclaimed as long as:

- The goods are for the purposes of the registered business
- They have not been supplied or consumed before the date of registration
- The goods were purchased within four years of the date of registration

All the normal rules allowing input tax to be reclaimed must be met (although see below the issue with respect to partial exemption).

Pre-registration VAT on the purchase of services may be reclaimed as long as:

- The services are for the purposes of the registered business
- They have not been supplied before the date of registration
- The services have not been performed on any goods that have been supplied by the business before the date of registration or more than four years before that date.
- The services were purchased within six months of the date of registration

Again, all the normal rules allowing input tax to be reclaimed must be met (although see below the issue with respect to partial exemption).

With respect to both goods and services, an account/list must be maintained to identify the relevant goods or services showing quantities, purchase dates etc in order to allow HMRC to verify a claim.

Regulation 111 makes no mention of how pre-registration VAT should be treated by a partially exempt business. HMRC have long taken the view that only pre-registration VAT that is incurred in order to make only taxable supplies may be reclaimed. The VAT tribunal has upheld this view in the cases of **T Douros (VTD 12454) and GN Byrd (VTD 12675)**.

HMRC view

HMRC's view relating to pre-registration VAT on goods unexpectedly changed in 2015 when, without warning, HMRC started to restrict claims that were made in respect of goods that might have depreciated since the date of purchase, thus restricting the amount of VAT that could be claimed to the amount of VAT based on the value of the goods at the time of registration. Thus, if a business purchased a van two years prior to registration for £20,000 plus VAT of £4,000 and two years later, the van is only worth £15,000 then the pre-registration claim would be reduced to £3,000. This view is not reflected in either UK law or case law and there was no consultation period or prior warning of the change. This view could arguably be interpreted as reflecting EU law on the subject of pre-registration claims but this is by no means clear, nor would the UK be obliged to follow any such interpretation.

HMRC's manual (VIT32000) reflects this new view. In 2015, a business appealed against a decision by HMRC to restrict a claim for pre-registration VAT but earlier this year, HMRC withdrew from the appeal, allegedly, giving no reason for their withdrawal.

The current position, as far as is known, is that HMRC is taking legal advice on whether its revised policy is correct. Compliance officers have been instructed not to assess for "over claimed" VAT in the meantime. However, seemingly, officers have been told to tell traders that a subsequent assessment would be issued '*if our policy review establishes that apportionment is appropriate*'.

EMPLOYMENT CORNER

In this article we look at what Gender Pay Gap Reporting (GPGR) is and what employers need to do to ensure they are compliant with the regulations, which are due to commence from April 2017.

At the time of writing, The Equality Act 2010 (Gender Pay Gap Information) Regulations 2016 (the Regulations) were due to be published in final on 1 October 2016 but have now been published as The Equality Act 2010 (Gender Pay Gap Information) Regulations 2017, and will not receive Parliamentary approval until early 2017. The information below is based on the draft Regulations which were published in February 2016, although very few changes are expected.

What is GPGR?

The gender pay gap (GPG) is the average difference between men and women's aggregate hourly pay. From April 2017, employers employing 250 or more relevant employees will have up to 12 months to publish information on GPG on their website as well as evidencing its compliance to the Government. This process will then need to be executed annually thereafter. Employers must then retain at least three years' worth of figures on their website on an ongoing basis to enable readers to analyse and compare the figures. The first publication date is 4 April 2018.

Relevant employees are those who ordinarily work in Great Britain under a contract governed by UK legislation.

Employers will be required to report on a sample of "pay" in four monetary quartiles for the month of April each year based on the mean <u>and</u> median values, mean bonuses, and the proportion of men and women who receive bonuses. Clarity is still required as to whether group companies can report as a whole or need to do so separately.

"Pay" will include basic pay, paid leave, maternity pay, sick pay, area allowances, shift premium pay, bonus pay and other pay (including car allowances paid through the payroll, on call and standby allowances, clothing, first aider or fire warden allowances). It will not include overtime pay, expenses, the value of salary sacrifice schemes, benefits in kind, redundancy pay, arrears of pay and tax credits.

Background

Nicky Morgan MP and the Government Equalities Office published a consultation on GPGR in July 2015 called Closing the Gender Pay Gap (**https://www.gov.uk/government/consultations/closing-the-gender-pay-gap**) which asked stakeholders and interested parties how to best increase transparency around gender pay differences. They then published a government response (**https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/500087/Government_response_-_Closing_the_Gender_Pay_Gap.pdf**) that summarised findings.

According to ACAS, the following additional key points should be noted by employers:

- The gender pay gap is not the same as equal pay or pay discrimination as it is concerned with the differences in the average pay between men and women over a period of time no matter what their role is. Equal pay deals with the pay differences between men and women who carry out the same or similar jobs. Organisations who have a higher level of men in senior jobs and women in junior roles are more likely to have a gender pay gap.

- Employers will also need to calculate and publish three other types of figures:
  - gender bonus gap
  - proportion of men and women receiving a bonus
  - proportion of men and women working at each quartile of the organisation's pay distribution.
- Employers may have to collect gender pay gap data from as early as April 2016. This means HR and accounting professionals should be using the interim period to prepare for their reporting obligations.

Who will be affected by this regime?

The Government anticipates the regulations will affect around 7,960 employers and around 11.3 million employees, which equates to 34% of the total workforce in Great Britain.

The Government states that the majority of employers falling within the regulations should be able to calculate and publish the required information using existing HR data (number of male/female employees; hours worked; earnings). All private and voluntary-sector employers with 250 or more employees based in England, Wales and Scotland will be expected to publish stipulated GPGR information. Non-devolved public sector employers are being legislated for separately.

Why are only employers with more than 250 employees affected?

Government has stated that in addition to having to amend the Equality Act 2010 to enable smaller employers to be included, it considers that smaller employers may not be able to report as easily, risking confidentiality and data protection breaches. Section 78 of the Equality Act 2010 currently states that the regulations cannot apply to private and voluntary sector employers in England, Wales and Scotland with fewer than 250 employees (the regulations implementing section 78 only apply to Great Britain).

In Northern Ireland, GPGR is covered by the Employment Act (Northern Ireland) 2016 that received royal assent on 22 April 2016. The Department for Employment and Learning has published some explanatory notes (**http://www.legislation.gov.uk/nia/2016/15/notes/division/4/8**) and employers will be able to see the differences in reporting for Northern Irish employees, timing and qualifying numbers (currently 50 or more employees as opposed to 250 or more in Great Britain). It is likely that these regulations will be streamlined with the Great Britain Regulations over time as an administrative easement for employers operating across both jurisdictions.

Steps employers need to take

Between April 2016 and April 2017: Employers should ensure that they have all the available data to report. Section 83 of the Equality Act 2010 sets out the definition of which employees must be included - note that apprentices and workers who have a contract personally to do work will form part of the calculations. Employers should begin to collect data for the first reporting period, including accrued bonus information from previous periods payable in April 2017.

Conducting a provisional gender pay gap analysis based on data from prior years will enable the organisation to examine historical data and determine concerns and plan how to address these. Publishing this information will demonstrate proactivity and compliance.

Employers should also determine any additional information that may add to the clarity of the reporting being undertaken. What is the gender profile of the organisation, including historical data, perhaps represented in a bar chart? What are bonus trends? It is not compulsory to provide additional information - yet it may help the organisation in terms of public perception to include explanatory notes. It may also assist with attracting new talent if the company is seen to be transparent and proactive in this regard.

6 April 2017: Employers need to carry out calculations to determine gender pay gap results.

4 April 2018: Employers must publish their GPGR results on the organisation's website by 4 April 2018. The results must be publicly accessible, be accompanied by a signed statement that the information is accurate, and must remain on the website for at least three years.

Employers must also upload the GPGR results onto the prescribed Government website (details as yet unpublished).

Is there different treatment for public sector employers, private sector employers and social enterprises/charities?

The reporting requirements will be very similar for public, private and third sector bodies. However, employers from the public sector will not be in scope of the main Regulations as they are governed by separate statute. The Prime Minister announced in November 2015 that larger public sector organisations will be required to publish comparable gender pay gap information under separate regulations.

What's the cost to employers?

In terms of time and training costs, according to the Regulatory Policy Committee (RPC), the one-off familiarisation cost would amount to four hours of an HR or payroll manager's time, resulting in around £1m of cost to employers. We suspect it may be significantly more than that in reality.

Organisations responding to the consultation suggested it would take an average of 68 hours to analyse and publish GPGR information. Two other direct costs have been identified by the RPC. One-off training costs are estimated at around four hours per person to learn about mean and median gender pay gap figures, and a further four hours of training to learn to produce gender bonus gap figures for each salary quartile. This will impose one-off costs to business of nearly £1.4 million. Annual calculation and publication costs are estimated at around 13.75 hours of time to prepare and upload the information for publication, as well as one hour of the CEO's review time. This will impose costs on business of £3.7 million annually.

Any legal and accounting advice and other external or ongoing costs have not been calculated by the RPC.

How will GPGR be enforced?

GPGR is covered by the Equality Acts 2006 and 2010. The Equality and Human Rights Commission (EHRC) is responsible for investigating employers, including failing to undertake GPGR, and assisting employees in bringing cases. Whilst it appears that there are no civil or criminal sanctions in Great Britain for failing to report or publishing incorrect information at present (which calls into question the Government's level of genuine commitment to the process) the obvious sanction is that of reputational damage. The Northern Ireland regulations provide for a process involving fines in respect of every employee.

Is GPGR going to achieve its stated aims?

The government has utilised research by McKinsey (McKinsey and Company (2015), 'Why diversity matters') to support its argument that the most gender diverse companies are 15% more likely to financially outperform less diverse companies and that for every 10 percent increase in gender diversity, EBIT rose by 3.5 percent.

However, the World Economic Forum's 2016 Global Gender Gap Report presents the gloomy picture that at current rates, and bearing in mind there is not a country on earth where gender pay is not unequal, closing the worldwide Gender Pay Gap would take around another 170 years!!

Read into that what you will, but the Government's attempts to align gender pay appear to be a positive first step. However, it should be borne in mind that employers are only required to publish figures from one month of every year. Such results may be capable of manipulation and could simply be paying lip service to GPG issues. In this regard, full time equivalents, short term working and "zero hours contract" environments such as manufacturing, agency working and high turnover businesses such as call centres come to mind.

Are there likely to be any unintended consequences?

With such a new concept for businesses to report, the unintended consequences are difficult to estimate. However, it is clear that the potentially damaging reputational aspects of this reporting measure will be likely to draw unwanted attention to some organisations.

The Government is proposing to produce a league table of organisations, and affected employers should therefore place a high degree of importance in understanding their current GPGR position now so that they can proactively address any major concerns prior to publication. Business and employer brands, as well as workplace recruitment, retention and motivation could be affected. The biggest challenge is likely to be that of equal pay claims.

Other considerations for employers

Organisations may wish to examine and update some of their policies and staff handbooks etc. These could include but not be limited to the following:

- Pay, reward and bonuses
- Equality, Diversity, Discrimination, Bullying and Harassment
- Parental leave
- Training and development
- Flexible working

CHANGES TO SALARY SACRIFICE FROM APRIL 2017

Changes to salary sacrifice will come into effect from April 2017. HM Rvenue & Customs (HMRC) has provided some initial guidance on what employers need to do.

Background

In recent years, salary sacrifice arrangements have become a key component of remuneration policies for a growing number of employers. Due to the associated tax and NIC advantages, this has led to increasing costs to the Exchequer. The government was also concerned that the increase in salary sacrifice arrangements created *"an uneven playing field between employees and employers who use such arrangements and benefit from the tax advantages, and those that don't."*

Following a consultation over the summer, the Government confirmed in its Autumn Statement 2016 that it would legislate in the Finance Bill 2017 to remove the Income Tax and employer NICs advantages of salary sacrifice schemes from 6 April 2017 – although the new rules will not affect pensions saving, and a few other benefits.

ICAS submitted a written response (**https://www.icas.com/__data/assets/pdf_file/0003/267717/20161019-Submission-Salary-Sacrifice-for-the-Provision-of-Benefits-in-Kind.pdf**) to the consultation This flagged some practical problems arising from the start date of 6 April 2017 – when many annual salary schemes would be part-way through their year. Amendments have been made to the proposals to address some of these issues.

Set out below is some initial guidance, provided by HMRC, on what employers need to do.

Which employers and benefits are affected?

Employers who provide benefits to employees in exchange for salary sacrifice, salary exchange, or have a flexible benefits package where an employee can choose between a benefit or cash.

Benefits affected are those which are currently taxable, like cars and white goods, and those currently tax exempt, like mobile phones and workplace parking. There are some exceptions – mentioned below.

The taxable value of the benefit will be the higher of the current value or the cash forgone. This will be the value employers use for calculating Income Tax and Class 1A National Insurance Contributions (NICs).

What do employers need to do?

Employers offering salary sacrifice benefits to their employees need to familiarise themselves with the new rules.

Employers do not need to do anything if their employees are sacrificing salary only for pensions, pensions advice, childcare vouchers, workplace nurseries, directly employer contracted childcare, cycle to work, or cars with emissions of, or under, 75 g CO_2 / km. If employees are sacrificing salary for anything other than these benefits, then employers need to use the new rules.

In many cases employers will report different taxable values on the new P11D (see below 'What changes will employers need to make in payroll and HR software?').

When do the changes come into effect?

The new rules do not start until 6 April 2017. Salary sacrifice contracts entered into on or before 5 April 2017 will be protected up until the contract hits a trigger point.

What is a trigger point?

From 6 April 2017, the normal trigger point is when the salary sacrifice contract renews, auto-renews, starts, ends, or is modified or changed. At this point an employer must use the new rules. This should align with normal 'business as usual' contractual arrangements.

However, if the existing contract is still in place on 6 April 2018, there will automatically be a trigger point on 6 April 2018 (this will be 6 April 2021 for cars with emissions over 75g CO_2/km, accommodation benefits and school fees).

If an employee starts a contract on or after 6 April 2017, then the employer will need to use the new rules immediately for that employee. This will apply to new recruits.

What changes will employers need to make in payroll and HR software?

HMRC will be updating specifications and test services for the 2017/18 P11D and P46 (Car) reporting from April 2018, which will be provided as part of the usual year-on-year changes.

To make the first year easier, HMRC will not be updating the P46 Car for in-year reporting, and employers should continue to use the existing form. Employees who will need to pay more tax can either call HMRC, or wait and the normal P11D process will pick up any corrections after the end of the year.

In April 2018 HMRC will introduce a new version of the P46 (Car) along with a new P11D which will ask for details of any salary sacrificed to allow reporting of the extra information.

Employers who are voluntarily payrolling benefits

For the majority of benefits, most employers will be able to change one taxable value for another. HMRC recognise that for cars this may be more difficult due to software constraints. HMRC will release further technical guidance in late January for payrolling, including what employers should do if they cannot update their systems in time.

Employers need to make sure the right figure is being payrolled after a trigger point is hit. This is especially important for cars.

For 2017/18, HMRC is updating the software requirements for car data for those voluntarily payrolling benefits. These new requirements collect information about the car's details, such as CO_2 emissions and the list price.

Employers using an intermediary, payroll bureau or agent to do their payroll

These employers need to make sure that the intermediary or agent is aware that their employees are using salary sacrifice and that they use the correct taxable values as described above.

ACCOUNTING AND AUDITING QUERIES

Query: *We are a medium sized audit firm. We are currently performing an audit for a medium-sized private limited company under Financial Reporting Standard (FRS) 102. The company is primarily a distribution company but also has several investment properties that are currently held in the accounts at market valuation as per the requirements of Statement of Standard Accounting Practice (SSAP) No. 19 'Accounting for Investment Properties'. The company has a year end of 30 November and the directors will be applying FRS 102 for the first time to the company's accounts for the year ended 30 November 2016. The directors have reviewed what options are available to them under the change to new UK GAAP and have noted the content of paragraphs of 16.7 to 16.9 of FRS 102:*

"Measurement after recognition

16.7 Investment property whose fair value can be measured reliably without undue cost or effort shall be measured at fair value at each reporting date with changes in fair value recognised in profit or loss. If a property interest held under a lease is classified as investment property, the item accounted for at fair value is that interest and not the underlying property. Paragraphs 11.27 to 11.32 provide guidance on determining fair value. An entity shall account for all other investment property as property, plant and

equipment using the cost model in Section 17.

Transfers

16.8 If a reliable measure of fair value is no longer available without undue cost or effort for an item of investment property measured using the fair value model, the entity shall thereafter account for that item as property, plant and equipment in accordance with Section 17 until a reliable measure of fair value becomes available. The carrying amount of the investment property on that date becomes its cost under Section 17. Paragraph 16.10(e)(iii) requires disclosure of this change. It is a change of circumstances and not a change in accounting policy.

16.9 Other than as required by paragraph 16.8, an entity shall transfer a property to, or from, investment property only when the property first meets, or ceases to meet, the definition of investment property."

The directors believe that there has been a change in circumstances as per the content of paragraph 16.8 of FRS 102 above and would like to include the investment properties in the accounts at cost less depreciation as management have concluded that to obtain the fair values would require "undue cost or effort". The directors' rationale is that the company has several such properties, none of which are central to its primary operations; and the only users of the company's accounts are the board of directors, shareholders and the bank. Therefore, to obtain several valuations would be costly and in their opinion would outweigh the benefits.

Do you believe that the directors are justified in their proposed approach? Also, does the directors' choice of accounting treatment have any implications on our audit report?

Answer: The normal required accounting treatment under paragraph 16.7 of FRS 102 is similar to that of SSAP 19 i.e. to include investment properties at fair value – if an entity knows, or can measure, the fair value of an investment property without undue cost or effort. The company had previously complied with the requirements of SSAP 19 in relation to its investment properties which required them to be held at open market value. In practice the fair value (FRS 102) and open market value (SSAP 19) of such assets should result in similar valuations. Therefore, it may be difficult to argue on the grounds of a "change in circumstances" that this accounting treatment should not be continued with. The bank is also an interested stakeholder so there is an external stakeholder with an interest in the entity. However, ultimately, it is up to the directors to determine the company's accounting policy in this regard and materiality would also need to be considered.

If you believe that the company's proposed accounting treatment is acceptable ie to include investment properties at depreciated cost due to undue cost and effort, then there would be no need to qualify your audit report as this accounting policy is permitted by FRS 102 in rare circumstances. If you go along with the view of the directors, based on the information contained in International Standard on Auditing (ISA) 706, you would then need to decide whether an emphasis of matter paragraph was required.

If you do not believe that the circumstances justify the use by the directors of the "undue cost or effort" cost provision, then you would need to consider whether you need to qualify your audit opinion.

Query: *I am a partner in a small firm of chartered accountants. I have a client which is a small manufacturing private company with a financial year end of 31 December. The directors historically prepared accounts under former full UK GAAP ie not the Financial Reporting Standard for Smaller Entities (FRSSE). The company, although small, did not take the small company exemption from Financial Reporting Standard (FRS) 1 and consequently prepared a cash flow statement. For the year ended 31 December 2015, the directors decided to delay the introduction of new UK GAAP by preparing the company's accounts under the FRSSE for the first time.*

However, they opted to include a cash flow statement in those accounts.

For their next set of accounts ie the year ending 31 December 2016, they will qualify for preparation of accounts under Section 1A of FRS 102 and in all likelihood, given their past history, they will want to prepare a statement of cash flows. I have reviewed Section 1A of FRS 102 and I have not found anything to state that they could not prepare a statement of cash flows.

My question is therefore: "Are you aware of any technical guidance that would prevent a company preparing accounts under Section 1A of FRS 102 and including a voluntary statement of cash flows?"

Answer: Section 1A of FRS 102 was added to FRS 102 to take account of the reduced mandated disclosure requirements for smaller companies following the introduction of the EU Accounting Directive which takes effect for accounting periods commencing on or after 1 January 2016.

Paragraphs 1A.7 and 1A.8 of FRS 102 state

"1A.7 A small entity is not required to comply with the requirements of paragraphs 3.3, PBE3.3A, 3.9, 3.17, 3.18, 3.19 and 3.24(b) which relate to presentation and disclosure requirements that are not required of small companies in company law, Section 4 Statement of Financial Position, Section 5 Statement of Comprehensive Income and Income Statement, Section 6 Statement of Changes in Equity and Statement of Income and Retained Earnings and Section 7 Statement of Cash Flows.

1A.8 Instead a complete set of financial statements of a small entity shall include all of the following:

(a) a statement of financial position as at the reporting date in accordance with paragraph 1A.12;

(b) an income statement for the reporting period in accordance with paragraph 1A.14; and

(c) notes in accordance with paragraphs 1A.16 to 1A.20."

Therefore, a small entity is not required to prepare a statement of cash flows. However, it does not say "shall not" prepare a cash flow statement. Therefore, it would appear that a small entity can include a cash flow statement whilst applying Section 1A if it so desires. This would also appear to be in line with the overall spirit of FRS 102. Additionally, and logically, if a statement of cash flows is prepared then the relevant cash flow notes should also be included.

FRS 102 - ROUNDUP OF ISSUES

The ICAS Technical team recently held two innovative and informative surgery sessions with various firms to consider some of the practical issues emerging in relation to the implementation of new UK GAAP. These events also helped to inform the ICAS response to the Financial Reporting Council (FRC) to its recent request seeking feedback on the implementation of Financial Reporting Standard (FRS) 102. The key points emerging from the surgeries and also from other feedback received from ICAS Committees are as follows:

Accounting treatment of investment properties

The differences in the accounting treatment of investment properties under the former UK GAAP (Statement of Standard Accounting Practice 19/ Financial Reporting Standard for Smaller Entities (FRSSE)) and FRS 102 were highlighted – with the key change being that revaluation changes are now recognised in the profit and loss account as opposed to previously being recognised in the Statement of Total Recognised Gains and Losses (STRGL).

Particular focus was given to the different treatment under new UK GAAP when properties are leased to other group companies: the prohibition on such properties being treated as investment properties under old UK GAAP has not been carried forward into FRS 102. This means that where a parent company leases a property to a subsidiary, it is treated as an investment property in the parent balance sheet, but as property, plant and equipment in the group balance sheet. This issue has been raised by a number of our members involved in the preparation of accounts under FRS 102 who believe this treatment creates unnecessary complexity and does not accurately reflect the underlying economics, as such properties are not being held for rental income or capital appreciation.

Disclosures under FRS 102

The FRC's mandatory and encouraged disclosures under FRS 102 'Section 1A: Small entities' were noted. The new regime requires greater judgement as to the nature and extent of information that should be disclosed in the financial statements, as there are now fewer mandatory disclosures than were previously required under the FRSSE, but the accounts must still provide a true and fair view. The withdrawal of the option to file abbreviated accounts also means that a greater volume of disclosure may now be required to be filed at Companies House. Therefore, it has been recommended to the FRC that it should consider the structure and drafting of Appendix D to section 1A of FRS 102 to make it more user-friendly - a re-ordering and potential re-wording of Appendix D would assist in developing a more consistent approach to small entity disclosures.

Many of the requirements introduced in FRS 102 Section 1A were necessitated by the adoption into UK law of the requirements of the EU Accounting Directive. Now that the decision has been taken for the UK to leave the EU, there is an opportunity to consider whether any of these requirements should be amended in UK company law and therefore in FRS 102. For example, the restriction imposed by the Accounting Directive on the number of disclosures that can be specified for small companies is unhelpful, and could be reviewed in the future.

New filing options

The new filing requirements for small companies, including the withdrawal of abbreviated accounts, effective for accounting periods commencing on or after 1 January 2016, were highlighted. Entities now have various filing options, and these are covered in the separate filing guidance for small companies included in this issue (page 17).

The transition to FRS 102

The need for the disclosure of reconciliations between the previous reporting framework and FRS 102 was emphasised. It was also stressed that an entity was required to include an explanation of how the transition to FRS 102 had impacted upon its financial performance. Reference was made to the Financial Reporting Council's (FRC) Staff Education Note (SEN) which can be viewed at: **https://frc.org.uk/Our-Work/Corporate-Governance-Reporting/Accounting-and-Reporting-Policy/New-UK-GAAP/Staff-Education-Notes.aspx** which provides illustrative examples of the reconciliations required.

Audit considerations

Some of the specific considerations for auditors of entities preparing accounts under FRS 102 for the first time were also discussed, and the need for the auditor to document the rationale behind all their judgements and conclusions was stressed.

Financial Instruments (Including Directors Loans/Inter-Group Loans)

The requirements for accounting for financial instruments under FRS 102 are one of the major changes for the many UK entities which did not previously apply FRS 26. ICAS is generally supportive of the general approach taken in FRS 102, which allows more financial instruments to be measured at amortised cost than under International Financial Reporting Standards (IFRS). However, the requirements of paragraph 11.9 on the measurement of debt instruments at amortised cost are currently highly rules-based. Ideally, a principles-based approach would be desirable and therefore it may be appropriate for the FRC to consider whether such an approach is feasible. Ultimately, this should result in a more clearly articulated and understandable model for financial instruments. The FRC should consider whether the principles of IFRS 9 could form the basis of accounting for financial instruments under FRS 102 in the future.

A significant area of concern on implementation of FRS 102 is the requirements for accounting for loans to and from directors and other group companies that are considered financing transactions under section 11 of the standard. ICAS continues to receive numerous queries from our members on how to account for such loans. We note that SEN 16 addresses this area. However there are outstanding issues which we believe require further investigation.

Loans repayable on demand/without stated terms

SEN 16 deals clearly with the accounting for loans with a fixed repayment period. However, it is our understanding that many loans to or from directors or other group companies do not have a set repayment period, and are either repayable on demand or are treated as such because they have no written contractual terms. This could result in two alternative accounting treatments as follows:

1. Treat as a creditor due within one year and recognise at the transaction price (no discounting). However, in many cases there is no intention to require repayment within the short-term, therefore this treatment may not provide a fair representation of the nature of the arrangement.
2. If there is no practical ability to repay immediately, estimate the period over which repayment could be made, and discount over this period. This therefore requires determination of the repayment period and discount rate.

There are two key concerns here that we believe the FRC should consider further:

1. The view that the above accounting is excessively complex, particularly for small companies, and may not provide a fair representation of the underlying arrangement.
2. The result of this complexity is that companies may seek to renegotiate loan arrangements in order to achieve a more straightforward accounting outcome.

Therefore, it has been recommended that the FRC should investigate how these loans are being accounted for under FRS 102 and consider whether further guidance or amendment to the standard is necessary.

Determination of the appropriate discount rate

In cases where, for example, a director has provided a loan to a company with no interest, problems can be encountered in practice in determining a market rate of interest for a similar loan. This is particularly difficult if the company would be unlikely to be able to secure financing from a third party eg the company is a start-up or is experiencing financial difficulties. There is a lack of clarity as to how the discount rate should be identified.

Related Party Transactions

It has been highlighted to the FRC that there are difficulties in practice with the definition of 'under normal market conditions' in the context of related party disclosures under section 1A of FRS 102. Whilst it is recognised that the wording derives from the EU Accounting Directive and cannot currently be altered, the FRC could provide some additional guidance in this matter. For small companies, it is difficult to define 'normal market conditions' in terms of remuneration and dividends paid to directors, therefore there is a lack of clarity around what disclosures should be made. This is a particularly sensitive topic for many small companies which up until now will have filed abbreviated accounts which may only contain very limited related party disclosures.

Accounts production software

Problems with accounting software packages were highlighted as one of the barriers to the smooth implementation of FRS 102, with a lack of consistency in the accounts formats and disclosure checklists produced. Whilst the engagement the FRC has previously undertaken with the software providers to highlight the requirements of the new standards was appreciated, it is important this process continues to assist in ensuring that software packages are of appropriate quality.

Guidance

It has been recommended that the FRC should consider other options for addressing issues and problems of application, as well as issuing amendments to the main standards. For example, the SENs are a useful source of implementation guidance, and could be updated and added to in order to address certain issues. In addition, it is vital that the FRC has an 'urgent issues' mechanism to address interpretation issues where there is no need to amend the standards.

Some additional guidance in the following areas, perhaps in the form of a SEN, would be useful, particularly for small entities:

- how the 'undue cost and effort exemption' in relation to 'investment properties' should be applied in practice.
- discounting – guidance on selection and mechanics of discount rates, as well as determining when the impact of discounting is not material.

Definitions

Two instances that definitions should be added or amended were highlighted to the FRC:

1. Financing transactions – the term is used in section 11 of FRS 102 but is not formally defined. A fuller definition would assist users in identifying such transactions.
2. Group reconstruction – the list of arrangements considered to be group reconstructions should be amended to include a hive-up/hive-across, as these are fairly commonly used mechanisms.

Need for Ongoing Feedback

Given that the new standards have been in use for only a short period of time, most entities will currently only have one year's experience of applying FRS 101 or FRS 102, whilst most small entities have yet to produce their first set of accounts under the new requirements. It is early in the process and some issues and concerns may not yet have come to light, therefore it is welcomed that the FRC has stated it will continue to consider feedback received at any stage of the triennial review process. It is important that the FRC remains alert to emerging issues, particularly in relation to the implementation of FRS 102 by small entities.

GUIDE TO THE NEW SMALL COMPANY ACCOUNTS FILING REQUIREMENTS

This article relates to the accounts filing requirements of small companies at Companies House (not including micro-entities).

For accounting periods commencing on or after 1 January 2016, small companies no longer have the option of filing abbreviated accounts at Companies House – for periods commencing after that date abbreviated accounts have been abolished.

The filing obligations of small companies are contained in Section 444 of the Companies Act 2006. This allows companies to file the accounts which they prepared for shareholders (full or abridged) or to take advantage of the exemptions available which allow the profit and loss account and/or director's report to be excluded from the accounts being filed. **Please note: abridged accounts are not the same as abbreviated accounts.** Abridged accounts allow a company to include only certain line items in the abridged profit and loss account and abridged balance sheet and require pre-consent from shareholders. Abbreviated accounts were based on the principle that full accounts were prepared for the members but an abbreviated version of the full accounts was allowed to be prepared and submitted to Companies House.

Section 444 of the Companies Act 2006 applies regardless of the reporting framework that the company has applied i.e. UK Generally Accepted Accounting Practice (GAAP) or International Financial Reporting Standards (IFRS), and whether or not it has prepared abridged accounts.

As noted above, a small company can file the same set of accounts that it prepared for its shareholders regardless of the framework applied and regardless of whether these were abridged. This guidance sets out what options are available for a company looking to reduce the amount of information put on to the public record under the following different scenarios:

1. Small company filing **unaudited** and **unabridged** accounts in accordance with Section 444 of the Companies Act 2006.
2. Small company filing **audited** and **unabridged** accounts in accordance with Section 444 of the Companies Act 2006.
3. Small company filing **unaudited** and **abridged** accounts in accordance with Section 444 of the Companies Act 2006.
4. Small company filing **audited** and **abridged** accounts in accordance with Section 444 of the Companies Act 2006.

1. Small company files unaudited and unabridged accounts in accordance with Section 444 of the Companies Act 2006

Key points for filing

a) The directors of the company **must file its balance sheet** (the Companies Act definition of 'Balance Sheet' includes **related notes**). In practical terms this means that most notes to the accounts will need to be filed.

b) The directors of the company **do not need to file either its profit and loss account** (nor the related notes) **or the director's report** (They of course also have the options to file either or both).

c) Where directors of the company **do not file the profit and loss account or the director's report** then they must make the following **statement** in a prominent place on the balance sheet filed:
"*The company's annual accounts and reports have been delivered in accordance with the provisions applicable to companies subject to the small companies regime.*"

d) Additionally, in relation to the **non filing of the profit and loss account** only, the filed **balance sheet** must include the following statement:
"*As permitted by Section 444 of the Companies Act 2006, the directors have not delivered to the Registrar a copy of the company's profit and loss account for the year ended xxxx.*"

e) The **filed balance sheet** and t**he directors' report** (if delivered), must **state** the **name** of the person who signed it on behalf of the board of directors.

Please note that where t**he profit and loss account** is delivered, **the related notes** should also be included in the notes to the accounts.

2. Small company files audited and unabridged accounts in accordance with Section 444 of the Companies Act 2006

Key points for filing

a) The directors of the company **must file its balance sheet** (the Companies Act definition of 'Balance Sheet' includes r**elated notes**). In practical terms this means that most notes to the accounts will need to be filed.

b) Where the directors **choose to file the profit and loss account** they **must also file** a copy of the auditor's report on the accounts (and any directors' report) that they deliver.

c) The directors of the company **do not need to file either its profit and loss account** (nor the related notes) **or the directors report** (They of course also have the options to file either or both).

d) Where directors of the company **do not file its profit and loss account or director's report** then they must make the following statement in a prominent place on the balance sheet filed:
"*The company's annual accounts and reports have been delivered in accordance with the provisions applicable to companies subject to the small companies regime.*"

e) Additionally, in relation to the non filing of the profit and loss account only:
   (i) the filed **balance sheet** must **disclose** that fact as per point 1(d) above; and
   (ii) the **notes to the balance sheet** must:
   - State whether the auditor's report was qualified or unqualified;
   - Where qualified, the basis of the qualification must be disclosed (reproducing any statement under section 498(2)(a) or (b) or section 498(3), if applicable;
   - Where report was unqualified, include reference to any matters which the auditor drew attention by way of emphasis;
   - State name of auditor and (where the auditor is a firm) the name of the person who signed the auditor's report as senior statutory auditor, or in the very rare circumstances that section 506

(circumstances in which names may be omitted) are met, that a resolution has been passed and notified to the Secretary of State in accordance with that section.

f) The **filed balance sheet** and the **directors' report** (if delivered), must state the name of the person who signed it on behalf of the board of directors.

g) Where the **auditors' report** is filed it must:

(i) State the name of the auditor and (where the auditor is a firm) the name of the person who signed it as senior statutory auditor, or

(ii) If the conditions in section 506 (circumstances in which names may be omitted) are met, state that a resolution has been passed and notified to the Secretary of State in accordance with that section.

Please note that where the **profit and loss account** is delivered the **related notes** should also be included in the notes to the accounts.

3. Small company files unaudited and abridged accounts in accordance with Section 444 of the Companies Act 2006

Key points for filing

a) The directors of the company must file its **balance sheet** (the Companies Act definition of 'Balance Sheet' includes related notes). In practical terms this means that most notes to the accounts will need to be filed.

b) The directors of the company do not need to file either its **profit and loss account** (nor the related notes) or the **director's report** (They of course have the options to file either or both).

c) Where the **balance sheet** or **profit and loss account** is abridged (Section 1A of Schedule 1 to the Small Companies and Groups (Accounts and Directors' Report) Regulations (SI 2008/409), the directors must also deliver to the registrar a statement by the company that all members of the company have consented to the abridgement as below:
"*All the members of the company have consented to the preparation of an abridged profit and loss account and balance sheet for the year ended xxxxx in accordance with Section 444 (2A) of the Companies Act 2006.*"

The above statement should be included within the accounts therefore we would suggest that it is disclosed at the foot of the balance sheet filed.

d) Where directors of the company do not file its **profit and loss account** or **director's report** then they must make the following statement in a prominent place on the **balance sheet** filed:
"*The company's annual accounts and reports have been delivered in accordance with the provisions applicable to companies subject to the small companies regime.*"

e) Additionally, in relation to the non filing of the **profit and loss account only**, the filed **balance sheet** must include the following statement:
"*As permitted by Section 444 of the Companies Act 2006, the directors have not delivered to the Registrar a copy of the company's profit and loss account for the year ended*"

f) The filed **balance sheet** and the **directors' report** (if delivered), must state the name of the person who signed it on behalf of the board of directors.

Please note that where the profit and loss account is delivered the related notes should also be included in the notes to the accounts.

4. Small company files audited and abridged accounts in accordance with Section 444 of the Companies Act 2006

Key points for filing

a) The directors of the company must file its **balance sheet** (the Companies Act definition of 'Balance Sheet' includes related notes). In practical terms this means that most notes to the accounts will need to be filed.

b) The directors of the company do not need to file either its **profit and loss account** (nor the related notes) or the **directors report** (They of course also have the options to file either or both).

c) Where the **balance sheet** or **profit and loss account** is abridged (Section 1A of Schedule 1 to the Small Companies and Groups (Accounts and Directors' Report) Regulations (SI 2008/409), the directors must also deliver to the registrar a statement by the company that all members of the company have consented to the abridgement. (See example 3c above).

d) Where the directors choose to file the **profit and loss account** they must also file a copy of the auditor's report on the accounts (and any directors' report) that they deliver.

e) Where directors of the company do not file its **profit and loss account** or **director's report** then they must make the following statement in a prominent place on the **balance sheet** filed:
"*The company's annual accounts and reports have been delivered in accordance with the provisions applicable to companies subject to the small companies regime.*"

f) Additionally, in relation to the non filing of the **profit and loss account only**:

(i) the filed **balance sheet** must disclose that fact as per 3e) above ; and

(ii) the n**otes to the balance sheet** must:

- State whether the auditor's report was qualified or unqualified;
- Where qualified, the basis of the qualification must be disclosed (reproducing any statement under section 498(2)(a) or (b) or section 498(3), if applicable;
- Where report was unqualified, include reference to any matters which the auditor drew attention by way of emphasis;
- State name of auditor and (where the auditor is a firm) the name of the person who signed the auditor's report as senior statutory auditor, or in the very rare circumstances that section 506 (circumstances in which names may be omitted) are met, that a resolution has been passed and notified to the Secretary of State in accordance with that section.

g) The filed **balance sheet** and the **directors' report** (if delivered), must state the name of the person who signed it on behalf of the board of directors.

h) Where the **auditors' report** is filed it must:

i) State the name of the auditor and (where the auditor is a firm) the name of the person who signed it as senior statutory auditor, or

(ii) If the conditions in section 506 (circumstances in which names may be omitted) are met, state that a resolution has been passed and notified to the Secretary of State in accordance with that section.

Please note that where the profit and loss account is delivered, the related notes should also be included in the notes to the accounts.

AUDIT EXEMPTION: A PRACTICAL GUIDE FOR CHARITIES IN ENGLAND AND WALES

Most charities in England and Wales in terms of size will be below the audit threshold. Some charities which are below the audit threshold will receive an audit because their constitution requires one or due to trustee or donor preference. ICAS members acting for charities in this position should encourage the trustees to review on a regular basis whether an audit is the required or is the most appropriate form of scrutiny for the charity. Where donor preference is the only reason for undertaking an audit, charity trustees should be encouraged to engage with donors to establish whether an audit is really necessary to meet their needs.

Only accountancy firms which are registered to undertake audit work can audit a charity.

This article does not specifically address the audit arrangements which apply to exempt charities. Exempt charities are those exempt from registration with the Charity Commission for England and Wales (CCEW). Most exempt charities have their own 'principal' regulator. Therefore, the legal requirements which apply to the audit of an exempt charity depend on how the charity is constituted and the regulatory regime under which it operates.

This article is part of a series of articles for Technical Bulletin on audit thresholds relevant to periods commencing on, or after, 1 January 2016.

Audit threshold: charities receiving an audit under the Charities Act 2011

For periods ending on, or after, 31 March 2015, the external scrutiny requirements for charities registered with the Charity Commission for England and Wales (CCEW) and subject to the audit requirements of the Charities Act 2011 were amended to:

- Increase the audit threshold for individual charities from gross annual income of £500,000 to gross income of £1 million.
- Increase the audit threshold for parent charities to the level of the revised group accounts preparation threshold.

The group accounts preparation threshold for parent charities increased at the same time from gross annual income of £500,000 to gross annual income of £1 million. Gross income for this threshold is based on income after consolidation adjustments.

There has been no change to the requirement that a charity with gross assets of more than £3.26 million which also has gross annual income of more than £250,000 must receive an audit.

For an individual charitable company above the audit threshold in the Companies Act 2006, the Charities Act 2011 audit requirements do not apply. For information on the revised Companies Act audit threshold, for periods commencing on, or after, 1 January 2016, refer to the article in issue 140 of Technical Bulletin entitled 'Audit exemption practical guide'.

Charity audit threshold for periods ending on, or after, 31 March 2015

For charities registered with the CCEW and receiving an audit under the Charities Act 2011:

- Gross annual income greater than £1million; or
- Gross assets of more than £3.26 million and a gross annual income of more than £250,000

In addition, a charity will need an audit if:

- its constitution requires one; or
- in the case of a charity with a pre-1993 constitution, that constitution contains a requirement for an audit or examination by a professional auditor

Audit threshold for charitable groups for periods ending on, or after, 31 March 2015

For parent charities registered with the CCEW complying with the Charities Act 2011:

- Gross income greater than £1 million after consolidation adjustments

Interpretation of the term audit for constitutions approved before the 1993 Charities Act

If a charity's constitution was approved before the 1993 Charities Act, then 'audit' means 'the appropriate external scrutiny required by the current legislation'. In this case a charity can have an independent examination if its gross annual income is below the current audit threshold even if its constitution refers to an 'audit' being required. In other words, if the constitution only refers to a requirement of an audit, without stipulating that the 'audit' has to be performed by a professional auditor, then an independent examination will meet the requirement.

However, if the constitution clearly states or stipulates that a professional auditor must carry out an examination or audit, such a charity will need to have an audit, or amend its constitution. Unless the trustees have the power to amend the constitution, the trustees will need CCEW approval to make the change.

Receipts and payments accounts: non-company charities only

Charities eligible to prepare receipts and payments accounts may need an audit if the constitution of the charity, another enactment, or the trustees or donors require. Receipts and payments accounts are not required to give a true and fair view therefore the auditor will be required to give an opinion on whether the accounts properly present the receipts and payments of the charity for the financial year and the assets and liabilities of the charity reported in the statement of balances.

Cross-border charities registered with OSCR

A cross-border charity is a charity registered with the CCEW or the Charity Commission for Northern Ireland which is also registered with OSCR under the Charities and Trustee Investment (Scotland) Act 2005.

Cross-border charities registered with the Office of the Scottish Charity Regulator (OSCR) should continue to apply the audit and accounts preparation thresholds of the Charities Accounts (Scotland) Regulations 2006 (as amended) in addition to the requirements which apply in their jurisdiction of origin.

Charity audit threshold for cross-border charities

For charities registered with OSCR complying with the Charities and Trustee Investment (Scotland) Act 2005:

- gross annual income of £500,000 or more;
- gross assets of more than £3.26 million at the balance sheet date

Audit threshold for cross-border charitable groups

For parent charities registered with OSCR complying with the Charities and Trustee Investment (Scotland) Act 2005

- Gross annual income of £500,000 or more after consolidation adjustments.

ICAS guidance on the audit of charitable companies

The Financial Reporting Council and the CCEW take the view that a charitable company (either standalone or a parent not required to prepare group accounts), which is below the company law audit threshold but above the charity law audit threshold, can receive an audit solely under charity law and elect for audit exemption under company law.

ICAS, however, takes the view that it is good practice where any piece of legislation requires a charity to be audited that the charity is audited under all applicable legislation. Therefore, our guidance to members on the legislative basis for the audit of charitable companies is as follows:

- For individual charitable companies below the company audit threshold but above the Charities Act 2011 audit threshold, an audit should be undertaken under both the Charities Act 2011 and the Companies Act 2006.
- For individual charitable companies above the company law audit threshold, an audit should be undertaken under the Companies Act 2006.
- For individual charities below the Charities Act 2011 audit threshold, an audit should be undertaken under the Companies Act 2006.
- For a parent charitable company preparing group accounts, an audit should be undertaken under both the Charities Act 2011 and the Companies Act 2006, unless the charitable parent heads a group which exceeds the Companies Act threshold for preparing group accounts in which case the audit should be undertaken solely under the Companies Act 2006.

The rationale for ICAS guidance in respect of the legislative bases of audit is that:

- A charitable company receiving an audit should always be audited under the Companies Act 2006.
- A charitable company should not receive an audit under the Charities Act 2011 unless specifically required to do so under that Act.

If a decision is taken to audit a charitable company solely under charity law, the audit firm should check with its professional indemnity insurance provider to discuss any implications for its insurance cover.

As referred to above, charitable companies which are cross-border must also comply with the requirements of Scottish charity law.

CAPS TECHNICAL BULLETIN

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