

THE COMPANY LAW REVIEW

DEVELOPING THE FRAMEWORK - SMALL COMPANIES

**SUBMISSION TO THE DEPARTMENT OF TRADE & INDUSTRY
IN JUNE 2000**

BY

SMALL PRACTITIONERS ASSOCIATION

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INTRODUCTION AND BACKGROUND

SPA is a wholly independent association of small practitioners within the Institute of Chartered Accountants in England and Wales. It was formed in early 1996 because of concerns with the perceived effectiveness, or not, of our Institute's support for such members.

The Association's stated policy is to promote and improve the relationship between members and our Institute by providing constructive criticism together with practical proposals for improvements. Further to provide commentary and proposals to other authorities influencing our practising environment.

SPA's membership work at the coal face of our profession, alongside the very many thousands of the small companies the Government seeks to assist. Our members have many years' experience and a deep understanding of how such companies manage their affairs and whether statutory regulation is a benefit or burden to them.

SPA has previously made submissions on small limited company activities to both the DTI on Audit Exemption levels and to the Accountancy Standards Board on Financial Reporting Standards for Small Entities (FRSSE). SPA's commentary to *Developing the Framework* is consistent with our previous reports.

In respect of small private owned/managed limited companies where no material public interest arises, our view is that statutory audit should not apply as there is in the vast majority of instances no distinction between directors and shareholders on which audit is focused; secondly, that accounting standards should be based on a flexible bottom up structure reflecting the individual simplicities of widely varying small companies rather than a reduced Plc mode which requires the whole of that code to be understood.

SPA is accordingly greatly encouraged by the approach 'think small first' adopted within *Developing the Framework*.

Our response is supportive of changes set out with one principal exception - the Independent Professional Review.

SPA also wishes to congratulate the authors and editing staff responsible for the discussion draft for their very clear presentation and excellent use of English; despite its length, it proved to be a very readable document.

PROPOSED INDEPENDENT PROFESSIONAL REVIEW

With the exception of the introduction of an Independent Professional Review (IPR), SPA supports the simplification proposed for small and private companies for those limited companies whose size criteria falls between current audit exemption limits and the EU maximum.

Either a company is subject to statutory audit or it is not; in SPA's opinion, no middle ground quasi audit is desirable or appropriate. It is worth remembering that a similar halfway house report known as the Compilation Report was soon abandoned for limited companies falling between the original audit exemption limit criteria and the current small company limits.

In SPA's view such a report, which includes references to Auditing Standards, would leave the reporting accountant vulnerable on two fronts which SPA feels the Law Review would not intend, namely:

- Statutory audit is a reserved area of work subject to special registration and regulation. To be able to provide an Independent Professional Review, would require awareness of current audit regulations and, unless such an area were policed as now by the Joint Monitoring Unit, the competence of the reviewing accountant could not be determined.
- The provision of such an opinion and its cost to the company would pre-suppose the reporting accountant had taken the necessary steps to satisfy himself that such a report could be provided. It follows that it would be reasonable for third parties to place reliance on the report which, if it contained an erroneous or deliberate misstatement, might leave the reporting accountant open to legal action. As such, it appears that all accountants providing an IPR would need to be covered by Professional Indemnity Insurance.

SPA believes, and has previously stated, there is value added in terms of credibility and acceptability to government agencies and other external users of a small company's accounts if they are overviewed by a professionally qualified accountant, who most probably would be an independent practising accountant, as the nature and size of the company would in the vast majority of cases not permit an in-house professional qualified accountant.

SPA sees such a report as a statement (not an opinion) of compliance with Accounting Standards, Inland Revenue Rules and Companies Acts, and such a report might state: the Company's statement of accounts to xx/xx/xx have been prepared on a basis consistent with previous years, and in compliance with Corporation Tax and Company Law requirements .

It is most unlikely, and certainly rarely found in practice, that the owner/managers of a small company (often husband and wife), would have the knowledge required to draft statutory accounts acceptable to both the Inland Revenue and Companies House. It is for these purposes in part that assistance from an external accountant is sought - someone who knows the rules and the procedures.

RESPONSES TO INDIVIDUAL QUESTIONS POSED

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| 7.1 | Do you agree that private companies should be permitted to make provision in their articles for a 14 day notice period for all general meetings? | Yes |
| 7.2 | Should private companies be able to make provision in their articles to pass written resolutions by less than unanimity? If so, should the relevant majority required to pass the written resolution be calculated on the basis of votes eligible to be cast or votes actually cast? And should the majority be 75% and 50% for special and ordinary resolutions respectively, or should a higher majority be required? | Yes 75%, and 50% of eligible votes. |
| 7.3 | Should the requirement to notify the auditors, if any, of a written resolution be abolished? | Yes |
| 7.4 | Do you agree that the restrictions on financial assistance for the purchase of shares should be abolished for private companies? | Yes |
| 7.5 | Do you agree that the directors' declaration of solvency, required in connection with a reduction in capital, need not be supported by an auditor's report? | Yes |
| 7.6 | Do you agree that the requirement for alterations or reductions of share capital or purchase of own shares mentioned in paragraph 7.27 to be authorised in articles of association should be abolished? | Yes |
| 7.7 | Do you agree that section 80, requiring shareholder authorisation for directors to allot shares, should not apply to private companies? | Yes |
| 7.8 | If so, should this relaxation apply to all types of allotment (including redeemable shares), or should it be restricted to cases where the company has, and will after the issue continue to have, only one class of shares? | All shares issued |
| 7.9 | If directors are able to determine the terms of redemption of redeemable shares, should details of the terms be included in the return of allotments delivered to Companies House when the shares are allotted? | Yes |
| 7.10 | Should the present requirements on pre-emption be retained, requiring companies which want to opt out of them to make specific provision in their constitution? | Yes |

RESPONSES TO INDIVIDUAL QUESTIONS POSED (continued)

- 7.11 Should the requirement for private companies to appoint a secretary be abolished:
- (a) for all private companies? (a) Yes
 - (b) for those below a certain threshold (in which case, what should that threshold be)? (b) No
- 7.12 If the requirement to appoint a company secretary remains for at least some private companies, should their company secretary be required to have relevant qualifications or experience? Is there any case for further defining the role of the company secretary? Not applicable
- 7.13 Should transactions requiring shareholder approval under Part°X be capable of being approved by a written resolution under the procedure outlined in paragraphs 7.12 to 7.14? Yes
- 7.14 In the case of a sole director, should the requirement to disclose interests in contracts to the board be replaced by
- (i) a requirement to record the interest in writing; or
 - (ii) a requirement to disclose the interest to the shareholders? (ii)
- 7.15 Would an arbitration scheme along the lines of that outlined in paragraphs 7.44 - 7.69 help to encourage private companies to make greater use of arbitration? Yes
- 7.16 If you support the encouragement of arbitration, should this be further strengthened by a statutory presumption in favour of arbitration and/or by cost sanctions for those who unreasonably refuse to go to arbitration? Statutory presumption
- 7.17 Do you agree that the principles set out in paragraphs 7.74 - 7.81 provide the right basis for preparing a new model constitution for private companies? Yes
- 7.18 Do you agree with the proposed substantive amendments to the present Table A set out in paragraph 7.82? Yes
- 7.19 Do you have any comments on the outline model constitution for private companies at Annex D? No further comments at this time.
- 7.20 Do you agree with the proposal that the simpler procedures, currently available to private companies by means of an elective resolution, should become the norm for new companies, applying automatically unless a company opts for more formal procedures? Yes
- 7.21 Do you agree that private companies should be able to dispense with any or all of the more formal procedures by means of a special resolution? Yes

RESPONSES TO INDIVIDUAL QUESTIONS POSED (continued)

- 7.22 Do you agree that private companies should be able to adopt the more formal procedures by means of an ordinary resolution? Yes
- 7.23 Would it be desirable to pursue further any of the options for owner-managed companies outlined in paragraphs 7.95 - 7.135? Not at this time.
- 7.24 Do you believe that our proposals for private companies strike the right overall balances? Yes
If not, how would you alter that balance, and in particular what additional proposals would you make? Not applicable
- 8.1 Do you agree:
- (a) with the proposal to distinguish between small and large companies with a view to permitting small companies to file accounts with a substantially simplified form and content, with the threshold set out the Fourth Directive limits? Yes
- (b) with the proposal that small companies should be exempt from audit where they satisfy at least two of the following: less than £1 million turnover; balance sheet total under £500,000; fewer than 25 employees? Yes
- (c) with the proposal that the accounts of small companies above the audit exemption threshold should be subject to an Independent Professional Review? No - See separate commentary
- (d) with the detailed proposals for a simpler form of report and accounts for small companies, as set out in Annex E? Yes, except that this should continue to be Balance Sheet only as this most importantly reflects solvency or not - the Profit and Loss information is private but will be disclosed if demanded to lending banks or similar third parties.
- (e) that the time limit for preparation and filing of small company accounts should be reduced to 7 months, with an aim of bringing this down to 5 months in due course? No, Companies House filing should be in parallel with Corporation Tax payment - currently 9° months
- (f) that the distinction between the form and content of accounts to be prepared for members and of those to be filed (abbreviated accounts) should be abolished? Yes

RESPONSES TO INDIVIDUAL QUESTIONS POSED (continued)

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| (g) that the standards regime for small companies should follow that in Chapter 5 for large ones? | No - Current Accounting Standards are for large companies. This should provide minimum standards for small companies, then widen this detail for large companies. |
| (h) that the present, very limited, exemption for accounts prepared and laid by medium-sized companies should be abolished? | Yes |