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Dear Maureen

Company law: providing a flexible framework which allows companies to compete and grow

ICAEW is pleased to respond to your request for comments on *Company law: providing a flexible framework which allows companies to compete and grow*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

COMPANY LAW: PROVIDING A FLEXIBLE FRAMEWORK WHICH ALLOWS COMPANIES TO COMPETE AND GROW

Memorandum of comment submitted in March 2012 by ICAEW, in response to the Department for Business, Innovation and Skills discussion paper Company law: providing a flexible framework which allows companies to compete and grow published in January 2012

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the discussion paper *Company law: providing a flexible framework which allows companies to compete and grow* published by the Department for Business, Innovation and Skills on 26 January 2012, a copy of which is available from this link.

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

4. The Audit and Assurance Faculty is a leading authority on external audit and other assurance activities and is recognised internationally as a source of expertise on audit issues. It is responsible for technical audit and assurance submissions on behalf of ICAEW as a whole. The faculty membership consists of nearly 8,000 members drawn from practising firms and organisations of all sizes from both the private and public sectors. Members receive a range of services including the monthly Audit & Beyond newsletter.

5. The Financial Reporting Faculty is recognised internationally as a leading authority on financial reporting. The Faculty's Financial Reporting Committee is responsible for formulating ICAEW policy on financial reporting issues, and makes submissions to standard setters and other external bodies. The faculty also provides an extensive range of services to its members, providing practical assistance in dealing with common financial reporting problems.

6. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

7. This response reflects consultation with the ICAEW Business Law Committee which includes representatives from public practice and the business community. The Committee is responsible for ICAEW policy on business law issues and related submissions to legislators, regulators and other external bodies.

MAJOR POINTS

Support for deregulatory initiatives

8. We are generally supportive of deregulatory initiatives, and are therefore delighted that ICAEW was able to arrange for Danielle Stewart to act as a 'champion' for the Department for Business, Innovation and Skills in relation the company law aspects of the Red Tape Challenge.

9. However, especially in relation to company law, we note that there is a distinction to be made between providing an enabling framework and moderating/policing regulation. We are in favour of the removal of unnecessary burdens and of simplification and efficiency. We accept, however, that most regulations have both negative aspects, as focused on by the Challenge, and positive aspects; positive because they are part of a regime that aims to achieve some

ultimate benefit; negative because they necessarily control or restrict something in order to achieve that aim. Company law is a prime example. It provides the ability to conduct business in a form that, for example, does not require owners to manage the business; does not require the business to be wound up when an owner wants to realise his interest (he transfers his ownership to another investor); and does not put owners at unlimited risk in relation to business liability. That is a tremendous benefit. The scale and nature of Britain's economic life today would be impossible without it. To effect this benefit it is, however, necessary to restrict or require certain things. For example, the publication of financial information is often viewed as the *quid pro quo* for liability limitation. Thus it is clear that a great many of the 128 sets of regulations, such as the Companies Act 2006 (Accounts, Reports and Audit) Regulations 2009 (SI 2009/1581), cannot be replaced at a stroke.

10. In addition to company law being broadly facilitative, it has also undergone a recent thorough overhaul and therefore to a large degree it 'already has its house in order'. This is supported by some research we conducted in late 2011, which sought to ascertain how onerous or burdensome company law is perceived to be, and which found that company law is least likely to be seen as a hindrance to the operation and development of a business.[1]

11. We also query the rationale behind looking only at the regulations, as it is often arbitrary as to what measures (or the detail around them) are contained in primary as opposed to secondary legislation. Therefore, looking only at the underlying regulations is only looking at half the picture.

Further exemptions from mandatory audit

12. We support a deregulatory approach to stimulate sustainable growth. We do not, however, believe that removing the UK's gold plating of the EU directives on audit will save UK businesses £612m per year. We have advised BIS on some of the potential percentage cost savings of not having an audit, but not on likely take-up rates or actual cost estimates on which the savings might be made. We received feedback from our members and held three regional fora which question these costs and the take-up assumptions. Some savings will be made, however, and would, we believe, be better re-invested in other accounting and assurance services which more closely fit the business needs of small companies and subsidiaries. There will also be some benefits lost, for example: the benefit to overall business confidence and the economy of mandatory audit for the exempted companies which do not continue with a voluntary audit. We also believe that without detailed legislation the proposed parent company guarantee will not be effective.

Partial exemption for small companies under the EU accounting directives

13. ICAEW urges BIS to oppose the proposed maximum harmonisation requirement for small company disclosure currently contained with the draft new accounting directive. More time is needed for UK constituents to consider the impact that the changes to the small and micro-entity reporting regime could have on businesses and wider stakeholders and it is imperative that this debate be held at the UK level. We note that the responses BIS received to its 2011 discussion paper *Simpler Reporting for the Smallest Businesses* have not been made public and unfortunately, therefore, it is not currently possible for constituents to gauge the diversity or strength of feeling on this issue.

14. With regard to micro-entities; the responses to the recent UK FRC consultation on simplifying micro-entity accounting has shown that this is a more complex issue than might otherwise be

[1] Of the specific regulatory issues reviewed, employment legislation, employment tax and health and safety regulation are most likely to be cited as hindering the operation and development of a business. Business tax changes, corporate governance and company law are less likely to be seen as a hindrance and, for each of these areas, perceptions are more mixed, with almost as many considering current regulations to help their business as think they are a hindrance. Source: (page 3) http://www.icaew.com/en/about-icaew/newsroom/press-releases/2012-press-releases/new-employment-regulation-to-have-little-impact-on-job-growth

expected, for example the tax and distribution issues that need to be addressed. The non-recognition of accruals and prepayments is, moreover, likely to lead to a reduction in the usefulness of micro-company financial statements without any significant reduction in costs. In any case, the rationale for a reduced regulatory regime for micros has been weakened given the proposed disclosure reductions for all small companies contained in the proposed new directive.

15. In our view therefore it is essential that the UK government will first undertake rigorous enquiry and consultation on the implications of the exemptions before any decision is taken on exercising the Member State option.

Additional deregulatory suggestions

16. **Auditor resignation:** We note that the government consulted on reform of the regime for auditor resignation statements in early 2010, but that no proposals have yet been issued regarding this regime, and we would urge the government to push ahead with appropriate reforms.

17. **Domestic mergers regime:** We believe that UK company law would be simplified by the introduction of a domestic mergers regime that would facilitate absorption of wholly-owned subsidiaries, derived from the procedure under the Cross Border Mergers Directive. We provide further details to support this suggestion in the Appendix.

18. **Illegal dividend payments:** We note that the law is very specific regarding process in this area and a breach of process (eg, failure by a public company to file accounts) renders a dividend unlawful by virtue of s836(4) even if the breach is subsequently rectified. For example, in respect of a public company interim dividend, if the interim accounts have been properly prepared but have not been filed before the dividend is declared (ie, there is a breach of the requirement in s838(6)), in our view it should be possible for such a 'technical' breach of process to be rectified (and the distribution 'made legal' after the event) by correction of the breach ie, by filing the accounts. This would be beneficial because even very well run companies can accidentally make illegal dividend payments if they inadvertently fail to observe all the detailed technical requirements of the law, which leads to potential personal liability issues for directors. Currently, these situations can only be corrected through some tortuous legal manoeuvres, which are time consuming and costly, involving external legal advice (usually including Counsel - sometimes at a very senior level, depending on the complexity of the group and the issues involved, and particularly where dividends or buybacks have been carried out with ultimate external shareholders) and accounting advice, in addition to internal management time.

19. **Charitable companies:** In the case of charitable companies, we would like to see this area streamlined to eliminate the present duplication of returns (and different deadlines). We note that the new form of 'Charitable Incorporated Organisation', which was intended to alleviate some of these duplicate filing issues, is still not available for use in England and Wales. Furthermore, once it becomes available, it will have a phased introduction, which means that it will not be available to existing charitable companies for some time to come. Therefore, we believe the filing requirements for charitable companies with Companies House and the Charity Commission should be reviewed/streamlined to alleviate this burden.

20. **Directors' advances:** The disclosure requirements around directors' advances are unfortunately not very clearly drafted. The government has indicated that this area will be addressed but until now no further action has been taken. We urge BIS to examine this area to determine how greater clarity can be achieved.

21. **Change of accounting framework:** In our response to the BIS paper '*Consultation on audit exemptions and change of accounting framework*' (ICAEW 124/11) we expressed support for proposed amendments to the law surrounding changing accounting frameworks. Relaxing the switch criteria would allow all of those companies wishing to take advantage of the forthcoming

new UK GAAP regime to move as well as offering relief to those currently unable to transition from IFRS back to UK GAAP and we therefore urge BIS to act to move these proposals forward.

22. **Objecting to a registered office address:** We note that BIS consulted on introducing a regime to enable legal occupiers to object to their premises being named as a registered office in early 2010 and that a summary of responses was published December 2010, with BIS's reaction which acknowledges that this regime can cause major issues in a relatively small number of cases but that, due to the likely cost and complexity of any solution, this is not a priority. Whilst this reform would not be deregulatory, it would mitigate the costs that arise in the absence of such a regime (which gives rise to costs for people eg, creditors attempting to file papers at the wrong address and also for legal occupiers whose address has been incorrectly given as a registered office and who can become inundated with unwanted correspondence) and we therefore believe this reform should be implemented at the earliest opportunity.

RESPONSES TO SPECIFIC QUESTIONS/POINTS

Question 1: Has the law on company names caused you problems and delays? If so, how could we make improvements?

23. Whilst this regime previously may have been burdensome when it was a paper-based regime, we understand that it is now very straightforward to conduct the requisite searches online and we are not aware of issues or delays caused by this regime in practice.

Question 2: Would companies find it useful to be able to file accounts and the annual return together? If so, what changes to the current system would make it easier for companies who wish to do one annual filing (annual return and accounts) at Companies House?

24. We agree that any changes that make it easier to deliver regulatory filings and to reduce the number of different filings required are welcome. As the consultation document notes, the UK already excels in this area and the electronic filing systems developed and operated by Companies House are both generally effective and very popular. As BIS recognises in the consultation document, having robust, transparent and efficient systems for company compliance are a source of national competitiveness and we therefore strongly support work to further develop this area. One complex filing was better or worse than multiple simple filings?

25. However, one complex filing can sometimes be worse than multiple simple filings (in practice, complicated documents are more frequently filed late than a number of short/simple ones). We are also not convinced that providing a single filing option for annual return and accounts would represent a particular cost saving; the accounts and the annual return have a different time scale for delivery and it has been found in the past that filing the two together can frequently result in the annual return being filed late. In our opinion it would be better to offer a simple box which could be checked when filing on-line if there were no changes to the data recorded on the annual return. We suggest that the standing data be visible to users at the point of completion such that any changes necessary can be made before submission. In cases where the data does not require amendment then no further action would be required, but such a process would ensure that standing data was still reviewed on an annual basis.

26. A significant efficiency could be to extend the online electronic filing facility to include audited and non-small company accounts (see Q4 below).

Question 3: Do you agree that there are benefits to be gained from submitting information only once to government and that information then being used for multiple purposes as appropriate and agreed?

27. In principle we support the proposal that one set of information should only be required to be filed with government once, rather than identical information being required to be filed more

than once. However, there are several practical issues involved when considering whether to send information to government only once, as we explain below.

28. Where identical information is being sent to two government departments at the same time, then clearly there are benefits to be gained if the single submission serves both departments. However, we think it is extremely important that use of such joint filing channels remains optional. We strongly oppose mandation of joint filing, particularly in relation to all aspects of online filing. (As usual, any change which shortens the amount of time available to file a return, or which changes the amount of information being made available to Government departments, should not be made without full consultation.)

29. The consultation document refers to the joint web registration service being designed as part of the 'One Click' agenda. This will be of benefit to some new companies, which we welcome, but not to all companies, and it is important not to overstate the usefulness of this facility. This new 'one click' registration service will be available to use as an alternative to the existing process, under which a new company is formed and first registers with Companies House. Companies House notifies HMRC that the new company exists and within six weeks, HMRC sends out a pack containing Corporation Tax forms and explanatory notes for new companies, including form CT41G (New company details). If the company is dormant it completes form CT41G (Dormant company insert) instead. We understand that currently only around 25% of the forms CT41G sent out are actually returned. Where a new company is being formed for a specific purpose and with a known time frame and business plan in mind, then clearly there will be advantages both to the business and to HMRC in being able to dispense with what is effectively the CT41G process immediately on forming the company, at the same web session. However, for many new companies it won't be possible to go straight on to the HMRC section, because there will be questions it can't yet answer. For instance, the company may not know when it will come within the charge to corporation tax, such as when it will start to trade. This is not always easy to define; it may open a bank account and do nothing, so not be chargeable to tax, or it may do so and pay cash in on which it earns interest. Similarly, it may not know the date to which it intends to prepare its accounts or even where its principal place of business will be. Another example arises with the use of shell companies, which they use or sell at a later date. Here, again, the HMRC notification won't come until much later.

30. Another example of a service recently introduced where a company can file once to two Government departments is where a company files its annual accounts with HMRC and Companies House using the joint filing service. The existing joint filing template shared by HMRC and Companies House is for iXBRL format accounts. Currently this format is mandatory for most accounts filings to HMRC, but voluntary for filings to Companies House. In principle, XBRL tagging should make the principle of 'submit once, use multiple times/ways' relatively easy to extend further, since it would enable various agencies to take the pieces of data (identified by the appropriate tags) to which they are entitled and ignore the rest. In practice, IT projects always take longer than originally envisaged, so this may be a few years ahead, but the potential should not be ignored. In principle we support the concept of a single filing for both HMRC and Companies House and we welcome the progress that has already been made in this regard. However, in practice there are a number of complications that may make further automation problematic. The filing deadlines and even some of the filing requirements (eg, in some instances of dormancy) differ between HMRC and Companies House and therefore joint filing may not be appropriate in all circumstances. Alignment of the requirements may not be desirable as this could serve to increase the regulatory burden. Therefore we believe that joint filing should remain an option rather than a mandatory automated process. If BIS is seeking to reduce administrative burdens through greater automation we suggest it should focus efforts on facilitating the acceptance of all categories of accounts electronically.

31. It would also be useful if, once filed, company data was searchable. We believe that iXBRL-tagged data should be made available to users of the accounts that have been filed at Companies House, and that those users should be able to search accounts using the tags. For example, a search for all companies with turnover in excess of £x and debtors in excess of £y.

At present, Companies House is collecting accounts with XBRL tags, but all that the 'consumer' can see is a graphics file, which is essentially just a picture of the printed-out paper accounts. That is no use for searching or for analysis, and would require re-keying. Companies House has invested in the means of receiving iXBRL accounts but has not yet provided any means for the public/business community to benefit from that investment by providing output in useable data format. Since Companies House's primary purpose is to be public repository, it would be logical for Companies House to provide XBRL-tagged data to consumers as soon as possible. Moreover, at present the private sector economy is bearing the significant costs of tagging the data but receiving no benefit in terms of being able to search Companies House data by tag.

Question 4: Are there particular filings that we require that cause individual companies problems? If so, how could these be improved?

32. As we mention above, there are currently limitations on the extent to which Companies House can accept electronic filings, and a significant efficiency would be to extend the online electronic filing facility to include audited and non-small company accounts. Also, Companies House's web filing service template refers to an out of date FRSSE, and restricts the number of accounting policy notes that can be included.

Question 5: Do you agree that registers should be available for inspection, and how can this requirement be achieved in the simplest way?

33. We consider that shareholder registers, which contain information regarding the interests and addresses of members, should remain at Companies House. Whilst Companies house data is publicly available, it is not so easily widely available and so is a slight discouragement to those without legitimate reason to access it. We would not support the publication of such registers by means of company websites as this would result in far fewer barriers to those who lack a legitimate interest and furthermore this information could more easily be distributed further if it were made available via a website.

Question 6: Are there benefits to newspaper proprietors registering with Companies House, or should the requirement be removed or changed?

34. The requirement to register newspapers with Companies House would appear to be us to be an outdated anomaly. The internet – especially now with smart phones and tablets – has enabled almost anybody to create a news website that is accessible worldwide, either for free or at a cost. However, creation of a print version must still be registered. This anomaly is illogical and does not appear to provide any benefit so we would support the abolition of this registration requirement. Moreover, it has nothing to do with company law.

Question 7: Do you agree that the UK system should be based on achieving compliance, and setting suitable penalties and fines to achieve this? Could improvements be made and high levels of compliance ensured in other ways?

As the recent BIS impact assessment on Audit Exemptions points out, there is a huge appetite for private company financial information, indeed we note that the Companies House website has around 500,000 'hits' each day. It is therefore important that the penalty and enforcement system operates effectively to encourage timely filing.

Question 8: Are there any provisions in Company Law or should any changes be made to simplify the design and operation of company share ownership schemes?

35. We are not aware of issues arising in respect of the design or operation of share ownership schemes due to the existence of company law pre-emption rights.

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APPENDIX

A domestic mergers regime?

Complex corporate groups are increasingly under the management spotlight as they can absorb considerable non 'value-added' costs within an organisation. In the current economic environment and with the increasing focus on effective corporate governance, corporate simplification has moved up the agenda. Simplifying group structures to reduce the numbers of active trading companies where appropriate to do so enables UK businesses to reduce embedded cost and align their corporate and operating structures.

A specific improvement would be to introduce a domestic mergers regime that would facilitate the mergers of subsidiaries, derived from the procedure under the Cross Border Mergers Directive. By 'merger' we refer to the fusion of two separate companies into a single company (a single body corporate) as successor to all of the legal rights and obligations of the predecessor companies.

The Companies (Cross-Border Mergers) Regulations 2007 are proving to be an effective method of restructuring companies intra-group within Europe. To date at least more than 30 of these types of transactions have been completed in the UK and the indications are that this number will significantly increase over time.

There are a number of reasons why mergers are preferred over the more traditional business transfer route as a means of simplifying corporate groups, or would be preferred if they were available;

(i) in a cross border context they can be more tax efficient than a sale of business followed by a liquidation of the transferor company;

(ii) although there may be greater complexity in the overall process (at least in the Directive model), a merger could generally be accomplished in a shorter period of time than a sale of business, followed by a distribution of the consideration and the liquidation or strike-off of the company;

(iii) The effect of a merger is that the transferor company is dissolved without going into liquidation and on dissolution transfers all its assets and liabilities to the transferee company. This provision removes the need for individual liabilities to be novated and therefore in comparison with a business transfer the amount of work that is required to ensure that the those liabilities have been assumed by the transferee company is significantly reduced;

The existing regulations, however, only apply to mergers by a UK company with at least one other EEA company and do not apply to transactions which involve combining solely UK incorporated companies. In the UK, subsidiaries are typically combined by way of a sale of business for consideration from one entity to another, the distribution of the consideration by the transferor company and the subsequent strike-off or liquidation of that company. There is usually a significant period of time after a business transfer is completed during which liabilities are either run off or novated before the company can be liquidated. It is not uncommon for this process to take more than a year before the transferring company is finally dissolved, whereas a merger could be achieved under the Regulations within 6 months. The total external costs of the process are not dissimilar from a merger but the cumbersome UK sale-and-strike-off practice can involve additional amounts of management time because:

(i) a company which has a current trading history is likely to remain in existence longer and will therefore still retain a board;

(ii) additional audit costs may be required;

(iii) active management of the "run-off" period is needed; and

(iv) there is a continued need for systems support.

This delays the realisation of benefits from combining the two companies.