

EXPLANATORY MEMORANDUM TO
THE LIMITED LIABILITY PARTNERSHIPS, PARTNERSHIPS AND GROUPS
(ACCOUNTS AND AUDIT) REGULATIONS 2016

2016 No. 575

1. Introduction

- 1.1 This explanatory memorandum has been prepared by the Department for Business, Innovation and Skills and is laid before Parliament by Command of Her Majesty.
- 1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

- 2.1 The Regulations amend legislation relating to the accounting and audit regulatory framework for limited liability partnerships (LLPs). They also introduce an exemption from certain financial reporting requirements for very small (micro) LLPs, and for very small (micro) partnerships (including limited partnerships) which are “qualifying partnerships” under the Partnerships (Accounts) Regulations 2008 (S.I. 2008/569). The Regulations are deregulatory in nature and reduce the burden of financial reporting and audit obligations, particularly for small LLPs, in order to achieve alignment with the financial reporting regime for companies.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 The Regulations also make a minor correction to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (S.I. 2008/410) (see regulations 65 and 66), to remedy an incorrect substitution made by regulation 38(2) of the Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015 (S.I. 2015/980).
- 3.2 The Department has decided not to apply the free issue procedure to the Regulations (after consulting the SI Registrar) for the following reasons. Although the Regulations contain the above correcting provision, the vast majority of the instrument concerns new provisions amending the law relating to accounts for LLPs and introducing a micro-entities regime for LLPs and qualifying partnerships.
- 3.3 The audience for the new provisions in the Regulations and for the correction is largely the same, i.e. the preparers and users of accounts, which is essentially a professional audience and not the general public. Many of these stakeholders (such as employees of accountancy bodies and accounting firms) are likely to be involved in financial reporting for all kinds of legal entities. An example of this is the preparation of consolidated accounts for groups that have both LLPs and companies in their organisational structures.
- 3.4 For these reasons, the Department’s view is that it would be disproportionate to issue the Regulations under the free issue procedure.

Other matters of interest to the House of Commons

3.5 The territorial application of this instrument includes Scotland and Northern Ireland.

4. Legislative Context

4.1 The Regulations amend the following:

- (i) the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 (S.I. 2008/1911) (which applies to LLPs, with modifications, provisions of the Companies Act 2006 regarding accounts and audit);
- (ii) the Small Limited Liability Partnerships (Accounts) Regulations 2008 (S.I. 2008/1912) (which applies to LLPs, with modifications, provisions of the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (S.I. 2008/409));
- (iii) the Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (S.I. 2008/1913) (which applies to LLPs, with modifications, provisions of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (S.I. 2008/410));
- (iv) the Small Companies (Micro-Entities' Accounts) Regulations 2013 (S.I. 2013/3008) (which introduced a micro-entities regime for companies that was not applied to qualifying partnerships);
- (v) the Partnerships (Accounts) Regulations 2008 (S.I. 2008/569); and
- (vi) the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (S.I. 2008/410) (which contain provisions regarding the preparation of accounts for large and medium-sized companies).

4.2 In 2015 BIS introduced the Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015 and the Companies, Partnerships and Groups (Accounts and Reports) (No.2) Regulations 2015 (S.I. 2015/1672) (together "the 2015 Regulations") to implement certain provisions of the EU Accounting Directive 2013/34/EU ("the Accounting Directive"). These made changes to the financial reporting framework, and reduced the administrative burdens associated with the preparation and publication of accounts, for limited companies and qualifying partnerships. In 2013 BIS introduced the Small Companies (Micro-Entities' Accounts) Regulations 2013 (S.I. 2013/3008) which implemented an option in the Accounting Directive to introduce a micro-entities regime for companies. The regime was not applied to qualifying partnerships.

4.3 LLPs are not subject to the Accounting Directive. They are, however, subject to a very similar accounting regime to limited companies, including the requirements as to the filing of accounts at Companies House, the contents of, and the auditing of, accounts. These Regulations introduce similar changes to the financial reporting framework for LLPs as have been introduced for companies, including the creation of a new micro-entities regime for very small LLPs. The changes will not fundamentally alter the financial reporting regime for LLPs but they will allow LLPs, particularly small LLPs, to benefit from a less burdensome financial reporting regime and will ensure that the legislative requirements for LLPs are aligned with those for limited companies. Alignment between the reporting requirements for companies and LLPs will also help to avoid unnecessary complexity for those preparing and using

accounts. Furthermore, groups which include LLPs and companies within their structures will be able to apply the same reporting requirements across the group.

4.4 The Regulations also introduce a micro-entities regime for very small qualifying partnerships. This is a further implementation of the option in the Accounting Directive (which has already been implemented for companies). The approach taken is to revoke the provision which prevented the companies' micro-entities regime from applying to qualifying partnerships.

4.5 The Explanatory Memorandum on the European Commission's proposal for what became Directive 2012/6/EU, which concerned the annual accounts of certain types of companies as regards micro-entities and amended Directive 78/660/EEC (which has now been repealed and replaced by the Accounting Directive), was submitted to the House of Commons European Scrutiny Committee and the House of Lords Select Committee on the European Union on 17 March 2009 and was cleared. Updates on the original proposal were provided to the committees in August 2010, June 2011 and August 2012 and the committees subsequently cleared the Explanatory Memorandum.

4.6 The Explanatory Memorandum on the European Commission's proposals for the Accounting Directive was submitted to the House of Commons European Scrutiny Committee and the House of Lords Select Committee on European Union on 29 November 2011. The Explanatory Memorandum explained that the Directive formed part of the EU's rolling simplification programme to reduce administrative burdens and its commitment to ensure the relevance, effectiveness and proportionality of its legislation. The Explanatory Memorandum explained the objectives of the Directive and the nature of the changes and potential impacts of the proposed changes. The proposal was subsequently cleared by the Committees.

5. Extent and Territorial Application

5.1 The extent of this instrument is the United Kingdom.

5.2 The territorial application of this instrument is the United Kingdom.

6. European Convention on Human Rights

6.1 The Parliamentary Under Secretary of State and Minister for Intellectual Property has made the following statement regarding Human Rights:

"In my view the provisions of the Limited Liability Partnerships, Partnerships and Groups (Accounts and Audit) Regulations 2016 are compatible with the Convention rights."

7. Policy background

What is being done and why

7.1 The Government's overarching aim is to make the UK the best place in the world to start and grow a business. It is recognised that this can be achieved in part by ensuring that regulation achieves its objectives without placing unnecessary burdens on business.

7.2 An LLP is a distinct legal entity (in the same way as a limited company is). The Limited Liability Partnerships Act 2000 was introduced in response to pressure from accountancy firms concerned by the potential liability of partners for substantial damages for the negligence of another partner. Like shareholders, the liability of the

members of an LLP is limited to their investment in the LLP (although in certain circumstances an individual member of an LLP may be personally liable to a third party). The 2000 Act does not, however, impose a structure for the management of an LLP, and subsequent legislation which applies the companies' regime to LLPs is tailored to reflect the less regulated structure of LLPs.

- 7.3 To maintain a level playing field in the UK and to closely align the framework for LLPs with the deregulated framework for companies, the Regulations introduce similar changes to the LLPs' financial reporting regime as have been introduced for companies. This includes the creation of a new micro-entities regime for LLPs.
- 7.4 There are approximately 58 000 LLPs in the UK. The vast majority (around 98%) of LLPs are small and will have the opportunity to benefit the most from these de-regulatory changes. The changes will also benefit some medium-sized and large LLPs as well as groups which include both companies and LLPs within their structures. Our estimate is that this policy will produce de-regulatory benefits over the current Parliament of £10 million. This will contribute towards BIS meeting its target of removing £805 million of red tape over the next five years.
- 7.5 Consultation responses supported our working assumption that the changes would be mostly of interest to preparers and users of accounts. Although the new regime offers some useful de-regulatory opportunities it does not substantially change the LLP financial reporting regime. Furthermore the limited number of LLPs means that the changes will have a limited impact and are unlikely to attract much public interest. There was however clear evidence from the consultation that stakeholders would prefer us to align the regime for LLPs with the regime for companies but at the same time to retain the differences in the frameworks which reflect the differing characteristics of LLPs and limited companies. The steady increase in the number of LLPs shown by our data further supports the conclusion that this alignment suits the industry.
- 7.6 In line with the changes already made to the financial reporting framework for companies, the main changes to the accounting and audit requirements for LLPs will:
- increase the thresholds used to determine the size of LLPs. This will enable around 400 medium-sized LLPs to be re-categorised as small and access the less burdensome small LLPs' accounting and audit regime. Similarly, around 40 large LLPs will be re-classified as medium-sized and will be able to access a reduced reporting regime;
 - reduce the number of mandatory notes to the accounts required of small LLPs;
 - provide LLPs with the opportunity to adapt the profit and loss account and balance sheet formats, provided that the information given is at least equivalent to the information required by the standard formats;
 - allow a small LLP to prepare and publish an abridged balance sheet and profit and loss account if approved by all the members of the LLP;
 - permit the use of the "equity method" in individual LLP accounts.
- 7.7 The Regulations will also amend the application of section 405(3)(b) of the Companies Act 2006 to LLPs. Under this provision, a subsidiary undertaking of a parent LLP can be excluded from inclusion in consolidated accounts if the costs of obtaining the necessary information would be disproportionate or obtaining that information would cause undue delay to completion of the consolidated accounts.

Under the amended provision a subsidiary will only be able to be excluded in “extremely rare circumstances”. Examples of such circumstances may include where a subsidiary is located overseas and legal or political circumstances (such as the imposition of sanctions, or impounding of records pending an investigation or conflict) mean that the cost of obtaining the information would be disproportionate or a potentially hazardous situation is preventing the obtaining of the information.

- 7.8 The Regulations also introduce a micro-entities regime for qualifying partnerships – the UK has an option to do so in the Accounting Directive. Qualifying partnerships are usually formed for investment purposes and are defined in regulation 3 of the Partnerships (Accounts) Regulations 2008i.

Consolidation

- 7.9 At the present time BIS does not intend to consolidate this legislation.

8. Consultation outcome

- 8.1 BIS published an online consultation¹ on www.gov.uk on 20 November 2015. The consultation closed on 21 December 2015. The consultation invited feedback on the costs and benefits of the proposed changes. Stakeholders contacted included accountancy firms and accountancy bodies known to have an interest in the proposals, to draw their attention to the consultation and to ask for specific information on the likely impact of the proposed Regulations on business and the UK’s accountancy framework. A link to the consultation was also tweeted on 20 November 2015 on the BIS Twitter account.

- 8.2 Thirteen responses were received: four from accountancy representative bodies; one from a representative body not directly related to accountancy, and eight from businesses that provide accountancy or professional advisory services. The respondents unanimously supported aligning the financial reporting regime for LLPs with the regime for limited companies. The majority also agreed with BIS’s proposal to introduce a micro-entities regime for LLPs and qualifying partnerships, and encouraged BIS to make the necessary legislative changes as soon as possible. The only reservation expressed by the respondents concerned minor technical issues, including timing, which have (where appropriate) been taken account of in the Regulations. A Government response to the consultation is available on: <http://www.gov.uk/government/consultations/limited-liability-partnerships-llps-and-qualifying-partnerships-deregulatory-changes>.

9. Guidance

- 9.1 The implementation of the Regulations will be supported by the Financial Reporting Council’s accounting standards. Guidance on the revised framework for LLPs will be available from Companies House.

10. Impact

- 10.1 The Government has identified annual benefits to business arising from the deregulatory provisions of these Regulations in the amount of £2.32m. This reflects

¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/480984/BIS-15-631-consultation-deregulatory-changes-for-LLP-and-qualifying-partnerships.pdf

savings resulting from the opportunities for deregulation offered by the provisions explained above. The Regulations will not have an impact on charities or voluntary organisations as these entities cannot adopt the LLP framework.

- 10.2 There is no impact on the public sector apart from some familiarisation costs to Companies House. These are so low that it was not felt necessary for them to be monetised.
- 10.3 A validated Impact Assessment is submitted with this memorandum and will be published alongside the Explanatory Memorandum on www.legislation.gov.uk.

11. Regulating small business

- 11.1 The Regulations apply to activities that are undertaken by small businesses. They exempt small LLPs from certain financial reporting requirements.
- 11.2 Because the legislation is deregulatory there was no need to minimise its impact on small business. The Regulations will permit eligible small LLPs to adopt a less burdensome reporting regime.
- 11.3 The basis for the final decision on what action to take to assist small businesses was to harmonise requirements for the financial reporting regime for small LLPs with that for small companies.

12. Monitoring & review

- 12.1 Review provisions have been inserted into the instruments listed above at paragraph 4.1 (i) to (iii), (v) and (vi), as required by sections 28-32 of the Small Business, Enterprise and Employment Act 2015 (c. 26). These commit BIS to reviewing the provisions in the instruments listed at paragraph 4.1 (i) to (iii) and (vi) which are amended by these Regulations, and also to reviewing the application of the companies' micro-entities' regime to qualifying partnerships.
- 12.2 The criteria for success for assessing the amendments made by the Regulations are firstly that the new regime avoids complexity by ensuring the alignment between financial reporting requirements for companies and LLPs. Secondly, it should also deliver a less burdensome accounting regime for small LLPs, and for LLPs and qualifying partnerships which are micro-entities, without harming the interests of other stakeholders such as creditors, investors and regulators. The intention is that the statutory reviews will run in parallel with a non-statutory review of the changes made to the financial reporting regime for companies by the 2015 Regulations.

13. Contact

- 13.1 John Conway at the Department for Business, Innovation and Skills Telephone: 020 7215 6402 or email: john.conway@bis.gsi.gov.uk can answer any queries regarding the instrument.

ⁱ A qualifying partnership is essentially a partnership formed under the law of any part of the UK each of whose members (or, in the case of a limited partnership, each of whose general partners) is (a) a limited company, (b) an unlimited company each of whose members is a limited company, (c) a Scottish partnership which is not a limited partnership, each of whose members is a limited company or (d) a Scottish partnership which is a limited partnership, each of whose general partners is a limited company, (or comparable undertakings incorporated in or formed under the law of another country).