

November 2021

Does your UK subsidiary require an audit?

A significant number of overseas groups with UK subsidiaries remain unaware of the statutory requirements for audit under UK law. Failing to comply can be costly; we set out here a simple but comprehensive guide to the audit requirements of UK subsidiaries.

By law, all UK companies require an audit. However, there are certain exemptions from this rule available based on achieving specific criteria.

Eligibility criteria for taking exemption from audit are based on the size of both the company and the group as a whole. 'Group' here refers to the consolidated position in an accounting sense, ie the parent company consolidated with its subsidiaries.

An exemption from audit is available to small companies. A company will be small if it achieves any two of the following thresholds:

- **Turnover:** £10.2 million or below.
- **Total assets:** £6.1 million or below.
- **Average number of employees in the period:** 50 or fewer.

If the company is non-small (ie by breaching two of the above), it will not qualify for the small company exemption.

If the company is small, management must then consider the size of the global group of which it is a member. Where the global group exceeds any two of the three thresholds set out below, it is probable that the UK subsidiary will require an audit:

- **Turnover:** Net: £10.2 million, or gross: £12.2 million.
- **Total assets:** Net: £5.1 million, or gross: £6.1 million.



- **Average number of employees in the period: 50.**

'Net' means after consolidation adjustments. Turnover is pro-rated for periods longer or shorter than 12 months.

A group can satisfy the relevant requirements on either a net or gross basis or a combination of the two.

Prior year rules state that two or more of these thresholds can be breached in a year and a company can still qualify as small, providing that two or more thresholds were not breached in the prior year.

Exemption for parental guarantee

UK companies with an overseas parent will be able to take an exemption from audit in certain circumstances. Such an

exemption is available to UK companies with a parent company established in the European Economic Area (EEA) for periods commencing on or before 31 December 2020. Among other detailed qualifying conditions, the EEA parent company is required to give a guarantee over the subsidiary and any non-controlling interests in the subsidiary must also agree to the exemption. Where the exemption is applied, the parent company's consolidated audited accounts must be filed on the UK public register, in English. In some cases, this will result in information going on the public record that would not otherwise be freely available, therefore advice should be sought when considering a parental guarantee.

For accounting periods commencing on or after 1 January 2021, the parental guarantee will only apply to UK subsidiaries of parent companies

registered in the UK. UK subsidiaries of an EEA parent may need to be audited, unless meeting an alternative exemption.

Special cases

Even where a company achieves exemption due to its size, there are circumstances where an audit will still be required. A company must obtain an audit if it is:

- Required to do so by virtue of its articles of association or its shareholders have required an audit to be obtained.
- Required to do so as a condition of a shareholders' agreement, debt instrument or other similar obligation.
- Itself a public limited company (ie a plc).
- In a group where any member of the group is a Public Interest Entity.
- A Financial Conduct Authority (FCA) regulated entity performing certain regulated functions.
- A business performing certain insurance, investment or banking services .
- A subsidiary of a group in which the group auditor deems the subsidiary is significant enough to require an audit as part of the group audit.

Advice should be taken where there is uncertainty whether a company will fall within these categories.

Penalties for failing to comply

UK company directors are required to comply with a broad range of duties and responsibilities. Penalties for failing to comply with these range from fines to

Case study

Fred Ltd is a UK subsidiary of Wilma Inc., a US holding company with subsidiaries around the world. Fred Ltd has five employees, turnover of £1 million and gross assets of £250,000, so is a small company in its own right. Its principal activity is to provide sales and marketing support services in the UK for the US parent.

The group as a whole has 100 employees, turnover of \$90 million and gross assets of \$15 million.

Q: Does Fred Ltd qualify for any audit exemptions?

A: No. The size of the worldwide group exceeds the 'small group' thresholds and as the US parent company is outside the EEA the company cannot apply a parental guarantee.

criminal proceedings taken against the directors personally.

Failing to plan and organise an audit when required can also have practical consequences:

- For the company itself, earlier periods' annual accounts may require an audit and directors need to consider if previously filed unaudited accounts should be refiled, both of which can be costly and time consuming;
- Critical dates may have passed, such as accounts filing deadlines for which Companies House levy penalties of up to £1,500 for private and up to £7,500 for public companies; and
- Failure to have prepared audited accounts may restrict or delay a company's ability to seek investment or funding.

- Working with overseas management on overseas GAAP to UK GAAP transition issues;
- Implementing suitable transfer pricing arrangements between overseas parents and UK subsidiaries;
- Bespoke assurance assignments on behalf of shareholders; and
- Analysis of impacts of reporting under either IFRS (optional in UK) or UK GAAP (including FRS 101 and 102).

If you would like to discuss whether or not your UK subsidiary meets the qualification criteria for audit exemption then please do get in touch with Martyn Dobinson, Partner, T: +44 (0)161 200 8392 E: martyn.dobinson@saffery.com

This factsheet is based on law at 1 November 2021.

How we can help you

We have extensive experience of advising UK subsidiaries of overseas parent companies. Our experience includes:

- Planning and organising efficient and value-add audits of UK subsidiaries;

www.saffery.com

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