



**Department
for Business
Innovation & Skills**

**SIMPLER FINANCIAL
REPORTING FOR MICRO-
ENTITIES: THE UK'S
PROPOSAL TO IMPLEMENT
THE 'MICROS DIRECTIVE'**

Government response

SEPTEMBER 2013

Contents

Contents	2
Simpler financial reporting for micro-entities: The UK’s proposal to implement the ‘Micros Directive’ – Government response	3
Executive summary.....	3
1. Background.....	5
2. The Consultation.....	6
3. Summary of Responses.....	6
4. Key issues	9
5. Other issues raised	10
6. Government’s response.....	11
7. Next Steps	12
Annex A: List of respondents.....	13

Simpler financial reporting for micro-entities: The UK's proposal to implement the 'Micros Directive' – Government response

Executive summary

This consultation sought views on the transposition of EU Directive 2012/6/EU (the "Micros Directive"), which exempts micro-entities from certain financial reporting obligations.

In the '*Plan for Growth*' published in March 2011, the Government set out its ambition "to make the UK one of the best places in Europe to start, finance and grow a business". It identified that this could be achieved in part by lessening the regulatory burden on business.

A key feature of the Micros Directive is that it provides the smallest companies with the opportunity to prepare and publish simplified financial statements (profit and loss account; and balance sheet) if they wish. A significant number of UK companies may benefit from this exemption and the intention is therefore to implement the Micros Directive as soon as possible.

A micro-entity is defined as meeting two of the three following criteria:

Balance sheet total: £316,000¹

Net turnover: £632,000

Average number of employees during the financial year: 10 (or fewer)

¹ The new accounting directive (2013/34/EU) which entered into force in July 2013 enables non-euro Member States to increase or decrease thresholds by up to 5% to produce a rounded figure in national currencies. The exchange rate of €1 = £0.85995 is that published in the Official Journal of the European Union as at the date of the accounting directive's entry into force on 19th July 2013 (2013/C 206/03)

The exemptions are optional and it will be for owners and directors of micro-entities to assess the possible effect of reduced disclosures on their company and to decide which form of financial reporting statement – micro, small or full – best meets their company’s needs.

The consultation asked for comments on the options for implementation available within the Micros-Exemption. The consultation, which built on an earlier discussion paper², was held over three weeks from 27 February 2013 to 22 March 2013, and received 33 responses from sector bodies, accountancy firms, and users of statutory accounts. We thank all interested parties for taking the time to respond.

The majority of the responses were broadly supportive of the objective to simplify financial reporting obligations for the smallest undertakings. However, significant concerns were raised in two key areas: the impact of the changes on the ‘true and fair view’ principle, which applies to all UK accounts; and the potential effect of changes on the UK’s established accruals accounting framework, with issues raised in relation to the interaction of the Micros- Exemption with other areas of company law and taxation. Views were also received relating to group situations, access to credit, minority shareholding, charities and notes to the accounts. More information on the detail of the responses is contained within sections 4 and 5 of this document.

All responses were considered carefully. We concluded that we should implement the Micros Directive except for those parts that would remove the obligation

- to present prepayments and accrued income and accruals and deferred income;
- to recognise only certain prepayments and accrued income and accruals and deferred income.

In addition, we will exclude companies which are charities from exercising the Micros-Exemption in the interests of transparency. The Government will bring forward regulations for Parliamentary consideration as soon as possible.

² Joint BIS and Financial Reporting Council paper – ‘Simpler reporting for the smallest businesses: discussion paper’, August 2011

1. Background

1.1 In the *Plan for Growth*³ published in March 2011, the Government set out its ambition “to make the UK one of the best places in Europe to start, finance and grow a business”. It identified that this could be achieved in part by lessening the regulatory burden on business.

1.2 The Micros Directive provides an Exemption from certain EU obligations relating to the content and publication of annual financial statements. This eases burdens on the very smallest of companies. The UK strongly supports the Micros-Exemption, which sets an important precedent in EU legislation. The Micros-Exemption may benefit a significant number of UK companies⁴ and the intention is to implement the Micros Directive as soon as possible. A key feature of the Micros Directive is that it provides the smallest companies with the opportunity to prepare and publish simplified financial statements (profit and loss account; and balance sheet) if they wish.

1.3 Current reporting requirements for companies are intended to address information needs that exist as between the principal (shareholder) and agent (manager), where there is a separation between ownership and management of the company. In the case of micro-entities, there is often no such separation of control. That is because micro-entities are, in many instances, effectively owner-managed. Statutory financial statements of micro-entities, therefore, may not need to facilitate communication between shareholders and management in relation to the company’s performance. For the smallest of companies, the burdens associated with comprehensive financial reporting requirements may be disproportionate when compared with other small companies⁵.

1.4 Micro-entities are often owner-managed and financed out of owner resources, with external finance being provided by trade credit and banks and other financial institutions (such as leasing companies). Owner-managers do not necessarily rely on the published financial statements. Similarly, external providers of finance are able to request specific information from a company and will often require more current financial information than publicly available.

1.5 [While not subject to the Companies Act 2006 directly, the UK applies the financial reporting requirements in Part 15 and Chapter 1 of Part 16 of the Companies Act 2006 to other entities including qualifying partnerships. We also apply the requirements to Limited Liability Partnerships (LLPs) with an ongoing policy of maintaining a framework for LLPs that continues to be comparable to that for UK companies. LLPs are not themselves subject to the EU

³ http://cdn.hm-treasury.gov.uk/2011budget_growth.pdf

⁴ There are roughly 1.2 million micro-companies in the UK (accurate statistical information is currently limited in respect of these companies) as compared with a total number of companies on the UK register of approximately 2.8 million. Therefore, micro-companies are of key importance in terms of economic growth.

⁵ Small entities classed as satisfying any 2 of the 3 criteria – turnover below £6.5 million, balance sheet total £3.26 million, fewer than 50 employees.

Directives. However, for the future, we will consider if it is appropriate to provide similar exemptions for all other entities required to prepare accounts to Companies Act 2006 standards.

2. The Consultation

2.1 The Department for Business, Innovation and Skills (BIS) ran a public consultation on the transposition of the Micros Directive from 27 February 2013 to 22 March. (This built on an earlier discussion paper⁶ which received 90 responses.) Interested parties and their representatives who would be impacted by the changes were invited to comment on the proposals. A total of 33 responses were received. In addition, views were also gathered through meetings held with professional accountancy bodies and accountancy practitioners to consider various technical and policy issues raised in the responses.

2.2 The consultation aimed to capture views on each of the exemptions permitted under the Micros Directive and to assess their impact on the UK's financial reporting regime for the smallest companies. It posed a total of 11 questions. Questions 1 – 8 sought 'Yes', 'No', and 'Other' responses, plus additional comments. Questions 9 – 11 sought comments only (see table below). Not all respondents answered all of the questions or provided supporting comments to the 'yes or no' responses.

3. Summary of Responses

3.1 The majority of responses are supportive of the objective to simplify financial reporting requirements for the smallest companies and to reduce administrative burdens. However, many raised concerns on how effective the Micros-Exemption will be in achieving this objective.

	Yes	No	Other	N/A
Q.1 Do you consider that the Government should implement all parts of the Micros-Exemption? If not, which of the exemptions do you see as providing the most benefit to micro-entities and why?	4	22	6	1
Q.2 Are there any costs or savings associated with the implementation of the Micros-Exemption that should be considered? Please provide examples, where possible.	18	5	8	2
Q.3 Do you agree that removing the requirement to present prepayments and accrued income, and accruals and deferred income will reduce burdens in the preparation of the accounts for micro-entities?	3	24	5	1

⁶ Joint BIS and Financial Reporting Council paper – 'Simpler reporting for the smallest businesses: discussion paper', August 2011.

Please give reasons.				
Q.4 Do you agree that the requirement to recognise charges other than the cost of raw materials and consumables, value adjustments, staff costs and tax will reduce burdens in the preparation of accounts for micro-entities? Please give reasons.	3	24	5	1
Q.5 Would this approach have any implications in relation to micro-entities access to credit?	20	7	6	
Q.6 Should any of the existing notes on the accounts be retained in addition to the minimum set out in the Micros Directive? If so, which notes are required as an absolute minimum, and why? Would the benefits outweigh the costs associated with this? Please provide evidence.	18	4	8	3
Q.7 If the notes identified in response to Question 6 will no longer be required of small companies on the implementation of the New Accounting Directive, should they be retained in the period between implementation of the Micros Directive and implementation of the New Accounting Directive and, if so, why? Would the benefits outweigh the costs?	9	9	9	6
Q.8 Do you agree that this is appropriate? Would the benefits outweigh the costs? Please provide evidence.	9	10	9	5
Q.9 What do you consider to be the advantages and disadvantages of this approach? What are the potential cost savings this offers? Please provide evidence.	<p style="text-align: center;"><u>Narrative response only</u></p> <p>This question sought views on enabling micro-entities to submit financial data in the form they felt most appropriate, instead of filing in the fixed format of the balance sheet. Responses were mixed, with some noting some possible small savings, whilst others commented that no savings would be achieved particularly as micro-entities would need to prepare the balance sheet for tax purposes. It was also felt it would introduce variability in financial returns. Users of accounts noted the possibility for confusion for</p>			

	<p>those interpreting the information, and potential difficulties for suppliers to compare a company against its previous performance or within a business sector.</p>
<p>Q. 10. If the above information is required to be filed in electronic format only what do you consider to be the advantages and disadvantages to this approach? Would the benefits outweigh the costs? Please provide evidence</p>	<p><u>Narrative response only</u></p> <p>This question sought comments on whether companies adopting the approach outlined in Q.9 should only file their accounts electronically, and any costs or savings associated with this approach. As Q.9, responses were mixed with slightly more in favour of this approach. However, concerns were raised around loss of flexibility and choice, noting that not all micro-entities are able to deal with matters electronically, and highlighting that certain groups are not able to use electronic means. No significant savings were identified.</p>
<p>Q. 11 What do you consider to be the cost savings associated with producing an abridged balance sheet and profit and loss account compared with the existing small company option to file an abbreviated balance sheet and profit and loss account? Please provide evidence</p>	<p><u>Narrative response only</u></p> <p>Most responses noted there would be either limited or no cost savings, as the majority of costs are incurred in the preparation of the accounts. Once entered into an accounting software package, the accounts information can easily be placed into a statutory format for filing.</p>

4. Key issues

Role of accounting standards and 'True and Fair' view

4.1 Whilst not the subject of a question in the consultation document, a considerable number of responses expressed significant concerns about the impact of the provision in the Micros Directive which states that accounts prepared in accordance with the requirements in the Directive must be deemed to give a true and fair view of the financial position of the company ("the deeming provision"). It was noted that in the UK company accounts are considered to provide a true and fair view only if they are prepared in accordance with the UK Generally Accepted Accounting Practice (UK GAAP). UK GAAP consists of the provisions set out in company law (primary legislation and regulations) and accounting standards issued by the UK's standard setter.

4.2 Many respondents sought clarification of the relationship between accounting standards and the Micros-Exemption, and commented that the Micros Directive appears to rule out the application of accounting standards. It was felt that the implementation of the deeming provision would mean a micro-entity would only need to meet the minimum requirements prescribed by law in order to produce a set of 'true and fair' accounts. The result, it was noted, would be the undermining of a fundamental concept in UK accounting, causing considerable confusion amongst preparers of accounts, auditors and the users of financial statements. Some commented that such accounts should be clearly identified as conforming to a set of minimum legal requirements only.

4.3 More detailed points were raised in relation to the proposed exemption from the requirement to present prepayments and accrued income and accruals and deferred income and the proposed partial exemption from the requirement to recognise the same. In addition, comments noted the potential for the exemption to be poorly applied by the smallest companies, leading to management of the business on a cash basis and failure to record certain assets and liabilities material to an understanding of their financial position.

4.4 All responses from professional bodies requested that BIS provide clarification in relation to the application of the true and fair view principle to the accounts of micro-entities. Respondents noted it would be important to have any changes to accounting standards (if applicable) in place in time for implementation of the Micros Directive.

Accruals accounting

4.5 A significant majority opposed the exemption from the requirement to present prepayments and accrued income and accruals and deferred income and the partial exemption from the requirement to recognise prepayments and accruals; and were not convinced that it would reduce burdens. Nearly all opposed the introduction of an inconsistent approach to measurement in a company's accounts, attributable to the fact that the requirement to recognise prepayments and accruals is removed in relation to certain items only (because the related exemption is partial). It was noted that, as it is already possible to ignore items that are considered immaterial under existing rules, the exemption would be applied to material items. That approach would lead to confusion for micro-entities and add unnecessary complexity to the preparation of the company's financial statements. It was also noted that such an approach could

have significant implications for a company in the context of a wider range of issues such as profit distribution, tax liability and insolvency (sub-paragraphs 4.9, 4.10 and 4.11 refer).

4.6 Several respondents commented that figures for prepayments and accruals are generated without any difficulty by accounting software, meaning that any savings associated with the exemption would be extremely small or possibly non-existent. Further, unless the approach was acceptable to all users of accounts – e.g. Government bodies, banks etc., micro-entities may still be required to prepare accounts on a full accruals basis for other purposes e.g. obtaining credit, which could contribute to additional costs and burdens.

Interaction with other areas of Company Law

4.7 Responses noted the need for company directors to assess their company's liabilities very carefully to satisfy common law obligations and fiduciary duties. Many stressed that, failure to address the issues arising in relation to (a) the application of the true and fair view principle to micro-entities' accounts and (b) accruals accounting could lead to conflicts with those duties. Several commented that micro-entities would need to understand how the Micros-Exemption might interact with other areas of company law. One example of this is the rules on profit distribution set out in Part 23 of the Companies Act 2006.

4.8 Respondents noted there may be a requirement to make changes to other legislation, such as Insolvency legislation, so that any distributions in excess of profits available for distribution were automatically recoverable without the need to prove intent to defraud creditors.

4.9 Professional accountancy respondents stated there should not be any uncertainty about the impact of these exemptions and requested that BIS provides clarity and certainty before implementation.

Interaction between Company Law and Tax Law

4.10 A number of responses asked about the relationship between the Micros- Exemption and HMRC requirements. Several expressed the opinion that HMRC may need to consider some alignment with the Micros-Exemption in order to achieve the full benefits of deregulation, particularly if the exemptions relating to 'prepayments and accruals' were implemented. Many noted that any small cost savings would be lost if abridged micros accounts are not accepted by HMRC as the basis for tax computations and micro-entities are required to prepare full accruals accounts for corporation tax purposes.

4.11 In addition, some concerns were raised around the potential for tax arbitrage and avoidance opportunities.

5. Other issues raised

Group situations

5.1 Respondents noted that Directive does not address the issue of group situations. One response suggested that a micro-entity parent should only be entitled to take advantage of the micros-exemption if the whole group is within the thresholds applicable to micro-entities. It recommended that a micro-entity that is a member of an ineligible group as currently defined in the Companies Act 2006 should be prohibited from taking advantage of the exemptions offered.

Minority shareholders

5.2 A small number of responses noted the situation of minority shareholders. They commented that some micro-entities are family-owned businesses with complex ownership arrangements. It was suggested there should be additional protection for minority interests in the form of a requirement that all holders of equity in a micro-entity approve the application of the Micros-Exemption to the accounts.

Charities

5.3 Significant concerns were raised about micro-entities with charitable status. Understandably there is a strong public interest in the accountability of companies which are charities. The resultant degree of accountability is implemented by the Charities Act 2011 and reflected in the principles of the Statement of Recommended Practice: Accounting and Reporting by Charities (SORP). There was concern about possible reductions in the amount of financial information placed on public record and respondents strongly recommended that charities are excluded from the Micro-Exemption in order to retain the higher level of public accountability. The Charity Commission emphasised the importance of particular disclosures, particularly in relation to related party transactions for public accountability and favoured exploring simplifications in the context of a future consultation on the small company framework.

Notes to the accounts

5.4 Although many respondents indicated they would prefer certain notes to the accounts to be retained, the responses were evenly divided.

Access to credit

5.5 A majority of respondents indicated that the application of the Micros-Exemption could impact on both access to credit, and the costs of obtaining credit. Many also expressed the view that, in the current economic climate, access to credit for very small companies is already highly challenging and that the proposals could prove counter-productive in relation to obtaining credit for some. Some respondents noted that credit reference agencies would have less information to build and optimise models for credit scores and recommendations, which could lead to increased delays in decision-making.

5.6 A consequence might be that micro-entities are required to respond to repeated requests for additional data, for example from lenders and trade suppliers; or that credit becomes unavailable, if credit providers feel unable to ascertain a company's true financial position. However, a number of respondents did not expect the proposals to make much difference, as credit providers will continue to have the option to request more information, as currently, and micro-entities are likely to have prepared such information for internal use.

6. Government's response

6.1 All the responses have been carefully considered, and there has been discussion with professional bodies and sector partners. We note the range of issues raised by respondents and recognise that the application of the Micros-Exemption will not be a suitable option for all micro-entities. Clearly, the owners and directors of micro-entities will need to assess the possible effect of reduced disclosures on their company and decide which form of financial statement – micro, small or full – best meets their company's needs. However, we consider that the Micros Directive offers the opportunity for some small companies to produce greatly simplified accounts whilst still meeting their business needs and the needs of their shareholders

and investors. Therefore, the Government has decided it will adopt the following approach to the transposition of the Micros Directive.

6.2 All parts of the Micros-Exemption will be transposed into UK law with the following exceptions. We will not implement those parts of the Directive which (a) remove the requirement to present prepayments and accrued income and accruals and deferred income and (b) partially exempt micro-entities from the requirement to recognise the same. This is because of the significant concerns expressed in response to the consultation and the potential wider impacts, related costs and minimal savings associated with this aspect of the Micros- Exemption.

6.3 We are exploring how best to ensure that the directive's requirement that "Micros" accounts are true and fair can best be reflected in the implementation.

6.4 We recognise the special position of charities. Therefore, for reasons of transparency and public interest, companies which are charities are excluded from the scope of the Micros-Exemption.

6.5 The Micros-Exemption will apply to individual company accounts, reflecting the Micro Directive's amendments to the Fourth Company Law Directive⁷. If a micro-entity is a member of an ineligible group, the micros-exemption will not apply. We are exploring the implications of the Micros-Exemption for group situations with a view to minimising its impact on group accounts.

6.6 We will not require that all shareholders agree to take up the Micros-Exemption as proposed by some respondents as this would require the UK to impose a condition not required by the Micros Directive. However, we may have a further opportunity to consider the issues around groups and minority interests in the context of the new Accounting Directive, which aims to introduce a 'lighter touch' regulatory approach to the small company regime.

7. Next Steps

7.1 The Government will lay regulations implementing the Micros Directive as soon as possible.

⁷ Fourth Council Directive of 25 July 1978 on the annual accounts of certain types of companies (78/660/EEC). The Directive sets down the requirements for individual company annual accounts and reports.

Annex A: List of respondents

Association of Certified Chartered Accountants
Baker Tilly LLP
Baldwin Cox & Co
Butler Jackson Partners LLP
Charity Commission
Chartered Accountants Ireland
Creditsafe Business Solutions Limited
Deloitte LLP
Disclosure Solutions Limited
Dun & Bradstreet Ltd
Equifax Limited
Finance and Leasing Association
FIT Estates Limited
Grant Thornton UK LLP
Graydon UK Ltd
Institute of Credit Management
Institute of Certified Bookkeepers
Institute of Chartered Accountants in England and Wales
Institute of Chartered Accountants of Scotland
Institute of Financial Accountants
IFA
Jill Collis
John W
Kingston Smith LLP
Office of the Scottish Charity Regulator
OpenCorporates
RSM Tenon
R W Markham
Sage (UK) Ltd
The Money Bureau
Totteridge Associates Limited
UHY Torgersens
Woolford & Co

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Any enquiries regarding this publication should be sent to:

Department for Business, Innovation and Skills
1 Victoria Street
London SW1H 0ET
Tel: 020 7215 5000

If you require this publication in an alternative format, email enquiries@bis.gsi.gov.uk, or call 020 7215 5000.

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