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Our ref: ICAEW Rep 105/11

Julian Thompson  
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Dear Julian

### **Simpler Reporting for the Smallest Businesses**

ICAEW is pleased to respond to your request for comments on *Simpler Reporting for the Smallest Businesses*.

We welcome the work of BIS to examine where regulatory burdens on business may be lessened and enthusiastically support the department's efforts to enhance the business environment for entrepreneurialism and start-up activity. However, we are concerned that the current proposals are deeply flawed. We do not believe that cash accounting can provide an appropriate basis for business record keeping, can support appropriate management decision making or can supply the information that external users of company accounts require. Consequently we do not agree that the proposals in the discussion paper provide a viable basis for simplifying accounting for the smallest businesses.

In the pages that follow we set out in more detail our concerns with the proposals together with some suggestions as to how the regulatory burden on small businesses may be lessened. We would be most willing to discuss with representatives of BIS or FRC any of the points raised in this response and stand ready, if called upon, to assist in developing an optimal environment for small businesses.

Yours sincerely

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## ICAEW REPRESENTATION

### SIMPLER REPORTING FOR THE SMALLEST BUSINESSES

Memorandum of comment submitted in November 2011 by ICAEW, in response to the BIS/FRC discussion paper *Simpler Reporting for the Smallest Businesses*, published in August 2011.

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## INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the discussion paper *Simpler Reporting for the Smallest Businesses* published by BIS/FRC on 25 August 2011, 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 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.

## MAJOR POINTS ON SIMPLIFICATION

### We support simplification and cutting red tape for business

5. ICAEW is strongly supportive of government efforts to remove disproportionate regulatory requirements and to cut 'red tape' for business. It is particularly welcome that the attention of BIS and the FRC is focussed in this consultation on the smallest companies. Micro-businesses as a whole, if defined as those with fewer than 10 employees, comprise 95% of all enterprises in the UK and account for 32% of all employment<sup>1</sup>. Not only is this a substantial proportion of the UK economy, crucially it is in this sector that much of the innovation and entrepreneurial start-up activity, essential to the UK's future economic prosperity, will occur. But unnecessary or unduly onerous regulation can represent a real barrier to these innovative, growing enterprises, stymieing development and distracting management. Such obstructions should, as far as possible, be curtailed, and therefore we are very supportive of the commitment of BIS and FRC to explore ways in which regulation for this important sector may be rationalised. We note that on 25 October 2011 the European Commission released proposals to simplify disclosure requirements for all small companies through a revision of the Accounting Directive; these proposals may offer an alternative for achieving simplification in this area.

### Overall assessment of the proposals: deeply flawed

6. However, we believe that the proposals set out in the discussion paper are deeply flawed. We do not believe that cash accounting provides useful information for either the management of a business or to any third parties who rely upon the accounts to make decisions. Accruals data is the bedrock of a well-managed business. Unless cash-accounting can, as a practical expedient be substituted for accruals data because it is so close to it anyway (as in the case of some small charities), then cash-accounting is not appropriate for management purposes. In view of this, savings would be minimal or non-existent. Any larger 'saving' would only come from a company's choice not to run its business on sound management principles. This is not, we suggest, a real saving and is likely to prove damaging to the wider UK economy. We do not

<sup>1</sup> BIS, *Business Population Estimates for the UK and Regions*, 2010

believe that adequate consideration has been given to these potential effects and feel that it is remiss to suggest that conclusions can be reached on such fundamental issues on the basis of the evidence and arguments presented in the paper.

7. Indeed, we believe that the proposals carry a number of fundamental risks that have not been properly addressed in the paper. One concern is that if statutory reporting for incorporated businesses was changed to a cash basis, this might then incentivise them to use those cash accounts for business management; a risk that should be given further consideration. Another is that this would represent a fundamental shift in transparency requirements for limited liability companies and could result in information that is misleading for third party users. To support such a radical move, we would have to be convinced that a threshold had been identified below which the risk to, and needs of, management, any non-management owners and third parties were sufficiently minor to outweigh the relatively minor cost of converting accruals data to publication format. Many of our members doubt that cash accounting can be suitable even for the very smallest entities, and BIS have not provided the evidence on this issue to allow any contrary judgment to be made. Each of these risks is discussed in more detail below.

#### Inadequate time to properly consider proposals of this significance

8. Before setting out our views in detail, we would observe that two months is a woefully inadequate consultation period for an issue of this importance. Prior to the release of this document there has not been a specific UK consultation over potential accounting exemptions for the smallest companies. The current proposals have wide relevance, touching as they do by far the majority in number of UK companies. There are moreover, as we set out in this response, a variety of significant concerns with them. Given the fundamental nature of these issues, it is essential that those who will be affected by the proposals are clearly apprised of their potential implications and have a proper opportunity to respond. ICAEW has been active in informing its membership about the proposals and what they may mean in practice; but two months is an inadequate period of time in which to complete a consultative exercise of such breadth. In our opinion, any plans to take these proposals forward would necessitate further, very extensive consultation.

#### High quality financial information is essential to the management of a business

9. We support the principle underlying section 5 of the discussion paper, *Improving performance through better management information*. We agree that performance can be improved by the availability of regular, timely and appropriate financial information. However, as we explain below, this information would almost invariably include a profit and loss account and balance sheet. Consequently we are concerned that the arguments put forward in this section are not compatible with the cash-based accounting solution proposed in section 3.
10. We believe that the information requirements of management should be the primary driver of business record keeping, with companies then building upon this to publish information that meets user needs. At the lowest level, this means keeping a log of invoices raised, items kept in stock, invoices received and receipts and payments of cash. These records are indispensable, yet in a pure cash accounting environment only receipts and payments would need to be recorded. For businesses with material balances in any of these other categories this is untenable; their management need to have an awareness of the amount and timing of outstanding debtors and creditors and of the value of capital tied up in stock, property, plant or equipment. Accurate stock records and aged listings of creditors and debtors are also necessary for credit control, liquidity management, good financial housekeeping, for reclaiming input VAT, and so on. The drivers of the accruals accounting infrastructure are wholly unconnected with financial reporting requirements but come instead from the need for good management reporting. This information would still need to be kept, and consequently this significantly reduces any perceived saving from a switch to cash accounting.

11. Furthermore, regular management reports, prepared on an accruals basis, are essential to the assessment of such business fundamentals as liquidity, profitability and financial position. To be useful, this information needs to encompass three principal and well-established elements:
- performance – commonly measured through turnover and profitability;
  - position – the assets and liabilities a business possesses; and
  - cash flow.

Importantly, the first two of these elements rely for their calculation upon accruals assumptions. In the case of the latter any business clearly needs to know its accrued income and expenses in order to determine its future cash requirements. In short, for many businesses, while cash flow information is an essential part of the picture, it is impossible to assess properly where they are or where they are going without applying accruals principles. The current proposals do not, in our opinion, recognise these fundamental underlying requirements. Accruals-based record keeping and reporting is essential to most businesses and would need to be maintained regardless of regulatory reporting requirements. If these businesses then had to convert their accounting numbers to a cash basis, the result, rather than a saving, would be additional cost.

12. This may not be the only drawback of the proposals. Businesses could well choose to build their internal systems around the regulatory requirements in the belief that following these rules will supply them with adequate information. There would even be an incentive to use this information for management decisions if it would be required anyway for regulatory purposes. This is potentially dangerous; such businesses may discover the deficiencies of cash based reports only when it is too late. Employment may be lost or creditors prejudiced as a result.

#### The role of incorporation in the UK economy

13. The financial information published by companies is frequently used by third parties, particularly trade creditors, other lenders and investors; indeed as the recent BIS impact assessment *Audit Exemptions*<sup>2</sup> points out, the Companies House website has around 500,000 'hits' each day. There is a trade-off here between the benefits of disclosure against the costs of production - this is a delicate balance and views on how it might be struck vary. Some commentators believe that incorporation is a right and therefore that it should not carry incremental reporting obligations. Others hold that incorporation is a privilege which allows investors the opportunity to develop a business proposition and in doing so only risk the cash introduced - protecting their other assets from the company's creditors. Under this view, greater accountability is required in order to address the risks for separate owners and for third parties, and this is specifically addressed through the preparation and filing of accruals accounts. Moving to a cash basis would change this relationship. For third party users the limitations of cash based information are likely to be even greater than for management; without access to internal information and with no mechanism for assessing the scale of adjustment which might be necessary to cash-based numbers, the information these users receive may be misleading for their decision-making purposes. We believe that a very large number of businesses falling within the definition of micro are heavily dependent on funding from creditors and, in some instances non-employed shareholders. Were those parties to lose confidence in the financial information provided to them we believe that economic activity in this sector could be significantly impaired at a substantial cost to the UK as a whole.
14. The discussion paper (paragraph 3.4) claims that many user groups would in any case be able to access decision useful information, as they have either 'the commercial negotiating power to obtain the information they require or they have established relationships with the individuals involved'; we do not accept either argument. Most companies have multiple creditors, and it is unlikely to be practicable for many of these to arrange for the receipt of bespoke information even if they do have sufficient commercial leverage. To do so would be highly inefficient and costly; an effective and well used mechanism for disseminating this information, Companies House, already exists. It would be a retrograde step to reduce its utility by impairing the quality

<sup>2</sup> BIS 0301, *Audit Exemptions*, 5 September 2011, page 16.

of the information it holds. In any event by the time a company needs credit or borrowings it may be either impossible or too expensive to create historical accounts. The effect could be a profound impact on perceived credit-worthiness and may even stymie economic activity for affected businesses and their stakeholders in the wider economy.

15. In short, any proposal to remove accruals-based information from the public domain needs to be accompanied by an exploration of the full cost of the loss of this information. No such exercise has been presented for consultees to consider. If, having examined such an analysis, one were to conclude that there is a threshold below which separate owner/ third party information needs/ reliance are too minor to warrant the modest expense of preparing it, the next question would be whether there is any point in publishing information at all (in particular as cash-based information may be misleading). That question, too, would need to be examined by BIS and FRC, but has not been in the current discussion paper. This seems an extraordinary omission for what purports to be a radical paper.
16. Some would argue that this is a reasonable trade-off, that the quality of third party information could be reduced in order to lessen the regulatory burden – albeit, as explained in paragraphs 10 and 11, that such savings may prove to be minimal or non-existent. But the point is that this represents a fundamental shift in the nature of incorporation, and that such a change should not be contemplated without rigorous consideration of the wider implications and appropriate consultation – which the current consultation exercise has not achieved. Incorporation is, after all, a cornerstone of the UK economy. The limited liability company emerged as a pragmatic response to real business needs, and since it became accessible as a form of business organisation with the 1844 Act, its nature has evolved over time. In particular, it became an accepted requirement that ‘true and fair’ accounts be prepared. The current proposals would radically alter this established position. We do not believe that it can be appropriate to move forward with such fundamental change without adequate consideration of the evidence and a clear indication that there is widespread support for the conceptual shift that underlies it. Long lasting damage to the UK economy far exceeding any small regulatory savings could result from the current proposals.
17. We also note that, in any case, incorporated businesses are currently required by law to maintain accounting records. These are required to be prepared on an accruals basis and were this to be reworked, interconnections such as those with the insolvency regime would need to be explored and resolved. These complex interactions are not acknowledged in the discussion paper and, again, inadequate time has been made available for them to be considered fully by respondents. Furthermore, many of the small limited companies which it is claimed may benefit from this proposed de-regulation only incorporated for taxation or regulatory reasons. The proprietors of such companies already have the alternative of trading as sole traders where the accounting requirements are anyway much less burdensome. It is therefore difficult to see how making a small saving, just in terms of accounting requirements, would be a significant factor in incorporation decisions. A more efficient strategy may be to tackle the regulatory factors that had incentivised them to accept the greater administrative responsibilities of incorporation in the first place.

#### **Simplification could be achieved by better alignment of tax requirements with accounts**

18. Cash accounting is thus not the panacea that the paper appears to seek. Nevertheless, there are reporting efficiencies to be had, efficiencies that would be warmly welcomed by business. In particular, it should be noted that at present management requirements are not the only driver of accounting record keeping and disclosure; much demand for company financial information comes from HMRC. Tax information requirements are not limited to the annual accrual accounts, although these must be presented to HMRC. A range of records, calculations and supplementary schedules are also necessary for tax purposes. Some of these, such as capital allowances, differ from accounting practice (and change from time to time) for sound reasons of policy. Others, such as certain of the requirements around allowable and disallowable expenses, are onerous to administer. Such requirements could be simplified and the benefits from doing so are likely to significantly exceed any realised by

providing new accounting exemptions. Some areas of tax administration (eg, P11Ds or PAYE returns) could also be simplified, and 'disincorporation relief' for businesses that no longer wish to trade as companies may be helpful. Finally in this context, we note that the ICAEW Tax Faculty has previously advised HMRC that where provisions have been determined in accordance with GAAP, and accordingly the accounts give a true and fair view, it would be less burdensome for the tax treatment to follow the accounting treatment. Such expenses should only lead to tax adjustments where statute specifically prevents tax relief, for example the cost of entertaining customers.

### **Tax simplification initiative**

19. A key matter that we have been unable to assess adequately in the time available is the interaction of the paper with related proposals from the Office of Tax Simplification (OTS). OTS is currently consulting on a very limited form of cash accounting for income tax purposes. This regime could potentially apply to unincorporated businesses with turnover of £20,000, £30,000 or £70,000. The precise threshold and how this might be applied is under consideration. The unincorporated businesses which the OTS is focussing on have no regulatory requirement to prepare accounts other than for tax purposes and therefore design their record keeping, and such limited management reporting as they may use, to suit their needs. The ICAEW Tax Faculty has been examining these proposals from a tax perspective and has submitted comments to the OTS.
20. If cash accounting became permitted for unincorporated businesses for tax purposes, the issue might arise as to whether that regime should also be available to companies of similar size. Some of our members have suggested that there may be a very low level of activity (possibly for businesses with a turnover of say less than £20,000) below which cash accounting, if introduced for tax purposes, might be permitted for filing purposes as a practical expedient. Others very strongly disagree that cash-based reporting should ever be permitted for incorporated businesses. Given the lack of proper alignment between the two papers, particularly the significant disparity in proposed thresholds and the inadequate time allowed for consultation, we are unable to assess these potential interactions.

### **Business 'red tape' comes in many forms**

21. There are, moreover, many alternative ways in which the regulatory burden on entrepreneurial enterprises could be eased and which in our opinion should be given further urgent attention. These include employment regulation, health and safety, planning regulations and ONS reporting; on this last point, it would be a welcome development were ONS requirements to be conformed to those of other regulatory returns. In many of these areas requirements have significantly increased in recent years, to the extent that they now represent a dis-incentivising barrier to economic activity, and particularly to employment. We anticipate that these areas could yield significantly greater savings than any to be achieved in the accounting arena. That accounting represents a very significant burden on business is a myth that needs to be dispelled once and for all.
22. We stand ready to assist BIS and other government departments in their efforts to develop strategies for reducing these and other barriers to entrepreneurial activity.

### **OTHER KEY OBSERVATIONS ON THE DISCUSSION PAPER**

23. As set out in paragraphs 6 to 21 above, we do not support the cash accounting proposals outlined in section 3 of the discussion paper. Beyond these summary views we also have a number of detailed observations on the paper and these are set out in the paragraphs that follow.

## Exemptions currently being considered by the European Parliament would still require accruals accounting

**24.** It is important to note that before the proposals could be brought into effect for incorporated entities, an exemption for micro-companies from the accounting requirements of the EC 4th Directive (or its proposed successor) would need to be enacted. Although such a proposal had initially been mooted in Brussels, an alternative compromise proposal has since been agreed by the Council of Ministers. Accrual accounting would still be required under this compromise, which we believe offers better information. In any case, if, as is likely, the final amendments follow this model, it seems impossible to us to introduce the BIS/FRC proposals in their current form.

## Limited deregulatory benefit can be achieved without alignment of accounting and tax requirements

**25.** In our opinion, alignment with HMRC requirements will be necessary in order to achieve the full deregulatory objective of the proposals. In particular, HMRC will need to accept a cash basis for corporation and income tax accounting otherwise accruals accounts would still need to be prepared for this purpose. We understand that BIS will be consulting with HMRC and HM Treasury in this area, but we expect that reaching a resolution may be difficult. We foresee three principal problems:

- Firstly, the potential one-off loss of revenue HMRC may experience on transition. A typical profitable business holding one month of debtors (included in turnover) and one month of creditors (included in expenses but at a smaller figure than debtors) would benefit from an in-year tax saving when they switch. For those with stock (which would increase cash expenditure) the benefit is likely to be even greater. This could be a significant cost to the Exchequer in the year of change.
- Secondly, this loss could be exacerbated by any potential for arbitrage between the regimes and by the susceptibility of cash based information to manipulation. A number of new tax avoidance opportunities may become available through management of debtors, creditors, stock, etc. This would further threaten tax revenues.
- All of this may then prompt a fresh raft of anti-avoidance legislation from HMRC in addition to a need to step up its enquiry and investigation teams. In other words a whole new accounting regime will need to be created for accountants and businesses. This would not be deregulatory. Indeed these rules could end up being rather complex. Definitions will be needed of capital expenditure, leases, hire purchases, loans, barter transactions, etc. There is potentially a huge new raft of requirements here and the implications of this have not been fully considered. In effect this would just be moving the accounting rules from accounting standards to tax legislation, a much less flexible arrangement which has no proper governance over it in terms of other drivers for good financial information. This alone could frustrate the deregulatory intention of the proposals.

## The accounting regime proposed needs further refinement

**26.** As it is expressed in the discussion paper, the proposed accounting regime is in any case unlikely to achieve the full deregulatory intention. A 'statement of position' or balance sheet would still be required and this would include debtors, creditors, 'major assets' and shareholders' funds. To compile such a statement, all of the current accruals accounting records would still need to be maintained. As such not only is it likely that any potential cost saving would be negated, but much of the data necessary to prepare proper accruals accounts would still be available anyway.

**27.** If the proposals to move towards cash accounting were implemented (which we oppose), further consideration would have to be given to how payment of dividends might be supported. This is not addressed in the consultation paper. Accounts on a cash basis are likely to be

unsuitable for a variety of reasons, not least because distributions could perhaps then be permitted even where these may prejudice creditors. Conversely, a requirement for accounts to be on an accruals basis would negate any benefits of the cash regime. If the proposals were to be taken forward, it would therefore be necessary to consider an alternative regime for payment of dividends perhaps based on solvency rather than accounts.

- 28.** Transitional arrangements also need to be considered, as changing between the two regimes could prove difficult. An entity moving back to full accounts would need to recreate its accrual accounting opening position; this could be complicated and costly and would be a particular issue for growing businesses. In some cases, such businesses may well be better off adopting full accounts from the outset, but this may only be apparent with the benefit of hindsight.
- 29.** Continuity from year-to-year is a further consideration. At present an important part of accounts preparation is to ensure that profits reported one year correctly agree with the information presented the next year. Where an opening balance sheet position is not maintained, this continuity may be difficult to achieve. But although this crucial reconciliation would be omitted, unless HMRC proposed to remove all disallowables and capital allowances, micro-companies would still have to prepare reconciliations between their financial statements and tax returns. We note that paragraph 4.2 suggests that accounts depreciation could be aligned with capital allowances (eg, 100% write-off in year 1 in some cases), but this would be undesirable in situations where there was material capital expenditure as both the trading statement and 'statement of position' would be significantly distorted.

#### Key user groups have been omitted

- 30.** The proposals do not list investors as a key user group of micro-company accounting information. We understand that this group was omitted intentionally on the understanding that most micro-companies are owner managed. While this may be true, a significant number of entities benefit from external capital, and even where this is received from connected parties, these investors may well rely on the preparation or publication of high-quality accounting information. Similarly, we feel that the information needs of trade creditors have been understated while at the same time their commercial ability to obtain information has been overstated. In practice we feel that this group is most likely to be interested in publicly available financial information as it may be difficult or impractical for them to obtain this independently.

#### Standardisation of year-ends is highly inappropriate

- 31.** The proposals also suggest that year-ends would be standardised for all micro-companies and that these companies would need to file accounts within 12 weeks of that year-end. This is likely to amount to a new regulatory cost for business and could cause very significant difficulties in practice.
- 32.** At present, businesses choose their year-ends to fit with their requirements. For example, seasonal businesses may wish to report a complete season for management purposes, businesses with substantial stock may choose a period end when they are less busy. To remove this choice would impose an additional burden on them. For entities needing to report at certain dates other than those proposed, this may even mean that two sets of accounts would be required. Furthermore, more than a million sets of accounts would need to be produced within this 12 week window; this is likely to prove impracticable and costly if achievable at all. In fact this is an additional example of how the proposals serve to be regulatory rather than the opposite. The sole purpose of the standardised year-end would be to facilitate regulatory compliance rather than to meet any particular need of the companies themselves. This idea should not be pursued.

## RESPONSES TO SPECIFIC QUESTIONS

### Question 1

**Would benefits flow from de-regulating the reporting responsibilities of this category of micro-businesses? How would you quantify this? Would they outweigh any transitional costs associated with moving to a new regime? Are there other considerations that should be taken into account?**

- 33.** As set out in paragraph 5 above, we agree that this category of entity is very important to the UK economy, particularly as the incubator of entrepreneurial activity. We strongly agree that cutting red tape in this area can help to foster this activity and we welcome the efforts of BIS and the FRC to investigate how this may be achieved. Indeed in paragraphs 18 and 21, we suggest some ways in which the regulatory burden may effectively be reduced. However, we do not believe that the current proposals are a viable way of achieving these benefits.
- 34.** Firstly, a switch to cash accounting for records keeping purposes would be impractical and undesirable to many businesses (see paragraphs 10 to 12). Key elements of their performance and position, as explored in paragraph 11, could be obscured to management should this approach be adopted. Cash accounts may not meet the information needs of third-party users of company reports. Fundamentally, to move away from 'true and fair' accounts represents a significant conceptual shift in the nature of the company. It is inappropriate to consider such a move without further supporting evidence and consultation (see paragraphs 13 to 17). In addition, for the proposals to achieve their deregulatory potential, tax accounting requirements would need to be aligned with them. As we set out in paragraph 25, this is unlikely to be achievable. It should also be noted (see paragraph 24) that supporting action in Brussels is necessary for these proposals to be adopted; that may not be forthcoming. Our members who are involved in the preparation of accounts for micro businesses have said that they see little or no cost savings from implementation of the proposals.
- 35.** The paper has attempted to quantify the potential benefits of the proposals. However, these assume that accruals accounts would no longer be required, as we set out in paragraph 10 and 11, this is unlikely. In addition there is no reference to the cost of the impacts, outlined above. These drawbacks could be substantial and we believe they should be taken full account of in any assessment of the potential effects of the proposals.

### Question 2

**Would the proposed alternative reporting structure described in this Section meet the needs of users? If not, what changes would you recommend and why?**

- 36.** No. For many businesses falling within the proposed definition of 'micro', accounts prepared on a cash basis would be inappropriate and would be likely to be misleading (see paragraphs 10 to 17). Furthermore, for the reasons set out in paragraph 25 we also anticipate that the alternative structure may not be acceptable to the HMRC without considerable extra legislation and regulations which would negate any benefits.

### Question 3

**Would the Trading Statement and Statement of Position described above provide an acceptable basis of reporting by Micro-Companies? If not, what changes would you recommend and why?**

- 37.** No. As set out in paragraphs 10 to 17, a cash based trading statement would be misleading for many businesses falling within the scope of the proposals. We do not believe that the statement of position described in the paper represents a significant simplification over the current requirement (see paragraphs 26 to 29). A receipts and payments regime is already in operation for small charities; the paper does not reference this system, which we find surprising. In any case, although for small charities the regime is a practical expedient, these entities tend to be very simple. Business accounting is often much more complex, not least due to the presence of trade creditors or external investors and the need to generate returns

for capital providers. Because of this cash accounting is unlikely to be an appropriate model for many private sector companies.

#### Question 4

**Would the information to be included in Micro-Company Annual Returns (paragraph 31) be sufficient? If not, what changes would you recommend and why?**

**38.** No. With the online options now available, the submission of an annual return for the typical micro-company is not onerous and therefore on balance we do not see significant scope for simplification. Indeed recent BIS research<sup>3</sup> suggests such a process takes 'seconds not hours'. The retention of accurate details of directors at Companies House is essential, as this information is crucial to many users. The completion of an annual return is a useful check on the accuracy of this data and therefore we would not support the removal of the directors' details section. To notify Companies House of each change in shareholding would be onerous and, again it is better for this information to remain on the annual return.

#### Question 5

**Are the proposed filing obligations for Micro-Companies (paragraph 33) appropriate? If not, what changes would you recommend and why?**

**39.** We agree that, in principle, it is important that micro-companies file accounts at Companies House. This information is commonly relied upon by creditors and other users (although cash based information would not be decision useful and so would frustrate this purpose). Were that disclosed information no longer prepared on a true and fair basis, the institution of incorporation could be weakened dramatically. This could have significant negative implications for the UK economy (see paragraphs 13 to 17).

**40.** We strongly disagree with the proposal to standardise filing dates. Our objections in this regard are set out in paragraphs 31 and 32.

#### Question 6

**Are there any other matters that need to be addressed?**

**41.** Yes. We have set out in paragraph 5 to 32 above a range of other considerations that should be taken into account.

#### Question 7

**In principle, would the proposed approach to providing financial information to HMRC be an improvement (e.g. by being simpler and/or cost effective)? What key benefits and potential challenges do you foresee?**

**42.** Yes, we agree that a single filing for Companies House and tax purposes could represent a significant efficiency if the Annual Return regime was liberalised to follow the Accounts filing regime (which is not necessarily annual since you can extend an accounting period). If the proposal was that the accounting information had to be filed with the annual return, annually, or more frequently, then this could result in a minor efficiency – although it should be noted that a facility for depositing accounts with Companies House in a single step with the filing of the tax return is already available. To the extent that tax accounting requirements could be limited to the information already contained in the accounts, this would represent a real significant saving (see paragraph 18). Indeed, we are surprised that Companies House has recently stepped away from its commitment to joint iXBRL filing, as in our view this is a simplification that would be most worthwhile.

<sup>3</sup> Explanatory Memorandum to the Companies Act 2006 (Annual Returns) Regulations 2011, page 3.

## OTHER POINTS

### Thresholds will differ depending upon the accounting basis used

- 43.** At present, it is not clear whether the thresholds for the new regime would be determined on an accruals or a cash basis. We accept that this point will be soluble with further consideration, indeed a solution is already in place in the form of the small charities regime. However, this may be complicated in some cases, particularly because, under a pure cash based regime, the balance sheet measure would potentially become redundant (there would be no balance sheet except for cash). This is relevant for many businesses; for example there are many agricultural enterprises in the UK that would qualify as micro on most measures. Were they to apply the proposed Financial Reporting Standard for Medium-sized Entities, they may need to recognise an asset for their right to receive single farm payments. Such an asset may then breach the balance sheet size threshold.
- 44.** Indeed, there may be many entities in this middle zone whose qualification for the regime would depend upon the accounting basis selected. If cash accounting rules are to be used, then there is a risk that some entities with otherwise substantial (positive or negative) balance sheets may be able to qualify for the simplified regime, which would be inappropriate.

### Charitable companies have not been considered

- 45.** The proposals have been prepared from the perspective of for-profit entities. Unincorporated charities with revenues below £250,000 already have a receipts and payments regime so are unlikely to see any change from the proposals, but for other public benefit entities, and in particular charitable companies, they will be relevant. We understand that these entities were excluded from the document in the interests of simplicity, but it will be important in any development of the proposals that their interests are taken into account.

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