



BACK TO THE FUTURE

A Summary of Government Proposals for Financial Reporting and Audit

The past three months have seen four consultation and discussion papers issued by the Department for Business Innovation & Skills (BIS). These proposals could change the face of the accountancy and audit profession as we know it.

The four papers are as follows:

- Simpler Reporting for the Smallest Businesses;
- The Future of Narrative Reporting;
- Audit Exemption and Change of Accounting Framework;
- Proposals Reform the Financial Reporting Council.

Below is a summary of the key facts from each of the consultations.

Simpler Reporting for the Smallest Businesses

'The modern system of bookkeeping was invented by Fra Lucio Pacioli, an Italian monk, in 1494.' Or at least that is what we say on our Principles of Bookkeeping courses.

August 2011 saw radical proposals being made in a joint discussion paper with the Financial Reporting Council for reporting requirements which may require us to go back to the drawing board when preparing accounts for the smallest businesses.

Key facts

- The discussion paper is suggesting significant simplifications can be made to the accounting and reporting of both incorporated and unincorporated businesses using the recent EC Competitive Council criteria for a Micro-Entity;
- A Micro- Entity is a company with turnover of less than Euro 500,000 (£440,000), with a balance sheet total of less than Euro 250,000 (£220,000) and employing less than 10 people. The discussion paper suggests that 2 out of 3 of these criteria would need to be met to qualify;
- Qualifying entities would produce a Trading Statement rather than a Profit and Loss Account using the following features:
 - Income would be recorded on a cash received basis rather than income earned;
 - Costs would be recorded when actually paid rather than when incurred;
 - Grants would be recorded when received rather than when awarded;
 - The paper suggests that they would therefore not need to account for accruals, stock, changes in working capital and increases/decreases in values of fixed assets.
- Qualifying entities would produce a Statement of Position rather than a Balance Sheet which would record simply: Shareholder funds; Debtors and creditors; Cash; Loans; and any major assets;
- Micro-Companies would file a much simplified Annual Return though it is suggested that this might be within say 12 weeks of the end of the financial period.

- The paper raises the possibility of using the reported information to prepare tax returns, providing the basis for the annual tax return of both incorporated and unincorporated businesses. This could include simplifying accounts depreciation to match capital allowance rates together with a substantial alignment with VAT cash accounting.

Having disposed of the need for a system applying the accruals concept, the paper envisages cost savings for around 5 million UK businesses.

'The modern system of bookkeeping was re-invented by Vince Cable, Secretary of State for Business, Innovation and Skills in 2011.' Doesn't quite have the same ring to it!

For further consideration and discussion, see our blog entry ['I have a dream.'](#) The consultation closed for comment on 30 October 2011. Further details and the full discussion paper can be found [here](#).

The Future of Narrative Reporting

In September 2011, a separate discussion paper was issued outlining a new reporting framework for UK companies including proposals for a replacement of the Business Review and Directors' Report.

Key facts

BIS is proposing replacing the existing Business Review and Directors' Report with a Strategic Report and an Annual Directors' Statement.

The Strategic Report:

- Summarises company performance;
- Outlines principal risks and uncertainties, key performance indicators and key financial information;
- For quoted companies provides a clear indication of the strategy, business model, environmental and social information and financial results linked to the resulting rewards received by the company's directors;
- Would not be required for small companies.

The Annual Directors' Statement:

- Presents information in a prescribed structure with a set layout and standard headings;
- Forms the key source of detailed information on specific aspects of company performance;
- Presents information in a consistent and coherent format primarily aimed at online publication;
- Provides a platform from which future developments (such as the tagging of narrative information to make it more searchable) could be implemented;
- Has scope for voluntary disclosures (for example on social and environmental issues);
- Would be much clearer for users to follow and aids comparability;
- Provides a helpful checklist of the required disclosures for companies;
- Increases the visibility of the information.

Additional proposals include the simplification or removal of a number of Companies Act disclosure requirements such as disclosure of charitable donations, differences between market and book values of land and acquisition of own shares.

The consultation closes for comment on 25 November 2011. Further details and the full consultation document can be found [here](#).

Audit Exemption and Change of Accounting Framework

October's consultation is relevant to companies and LLPs who are currently subject to mandatory audit and would apply for accounting years ending on or after 1 October 2012.

Key facts

Proposals include a relaxation of the audit threshold by aligning mandatory audit thresholds with small company thresholds.

- To obtain the audit exemption in the UK, a small company must currently fulfil both the balance sheet and turnover criteria.
- Under these proposals, a small company would be able to obtain the audit exemption if it met any two out of the three criteria of turnover, balance sheet total and number of employees.
- Subsidiary company audit exemptions would be available where:
 - the subsidiary's parent company is registered in the EU; and
 - the parent has declared that it guarantees the debts of the subsidiary published by the subsidiary at Companies House; and
 - the subsidiary's shareholders unanimously have declared each year to dispense with an audit and this declaration must be published at Companies House; and
 - the subsidiary must be included in the consolidated accounts drawn up by the parent undertaking. The consolidated accounts and the consolidated annual report must be audited and filed in the company registry; and
 - the use of the exemption by the subsidiary must be disclosed in the notes on the consolidated accounts drawn up by the parent; and
 - the subsidiary is unquoted; and
 - the subsidiary is not in the banking or finance sector.
- Where a subsidiary is dormant, it would be exempt from not only mandatory audit, but also mandatory filing and preparation of accounts.

Additionally, following the consultation by the UK Accounting Standards Board on changes to UK Generally Accepted Accounting Principles (UK GAAP), the Government is also seeking views on whether to allow companies which currently prepare accounts under International Financial Reporting Standards (IFRS) more flexibility to change their accounting framework to UK GAAP.

In total, the October consultation document suggests, savings to UK businesses could amount to £612m per year. These moves are part of the Government's wider focus on cutting red tape and reducing unnecessary burdens on business, in particular addressing the impact of European legislation. Being accountants I'm sure we have worked out that when you post a credit somewhere, there has to be an equal and opposite debit posted somewhere else. For further consideration and discussion, see our [blog entry](#).

The consultation closes for comment on 29 December 2011. Further details and the full consultation document can be found [here](#).

Proposals to Reform the Financial Reporting Council

OK so this last one is unlikely to change audit and accountancy as we know it. Nonetheless, also in October 2011, BIS and the FRC have jointly embarked on a consultation to improve the structure of the FRC. The aim of the reforms is to:

- consider how better to focus the FRC's activities where it can make the biggest difference, taking into account its core mission;
- create a simplified structure which is easily understood by the FRC's stakeholders;
- reinforce its independence from those it regulates;

- ensure it has the powers to respond proportionately and effectively where problems are identified.

The consultation ends on 10 January 2012 with the intention of implementing the proposed reforms by April 2012. For further details, the full consultation document can be found [here](#).

Mercia Group Ltd
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