Changes in financial reporting

Micro-entities Q&A and sample accounts

Legislation that came into force on 1 December 2013 means that for financial years ended on or after 30 September 2013 some companies may be entitled to prepare and file micro-entity accounts.

In April 2014 the FRC published amendments to the FRSSE to allow micro-entities to comply with the standard. In February 2015 the FRC published a draft, simplified financial reporting standard applicable to micro-entities, FRS 105 (currently FRED 58). This updated version of our Micro-entities Q&A and Sample Accounts is designed to provide an overview of the exemptions available.

What is a micro-entity?

The government has introduced a new sub-classification of small company known as a ‘micro-entity’. The legislation, which is contained in Statutory Instrument 2013/3008 - The Small Companies (Micro-Entities’ Accounts) Regulations 2013, followed a European initiative to reduce costs for small and medium-size enterprises.

The legislation came into force on 1 December 2013 and is effective for financial years ending on or after 30 September 2013, where the company’s financial statements are filed at Companies House on or after 1 December 2013.

Currently, micro-entity reporting exemptions are only available to companies, and even then some companies such as charitable companies are explicitly excluded from the regime.

How does a company qualify as a micro-entity?

A micro-entity company must meet at least two of the three following conditions:

- turnover not more than £632,000;
- balance sheet total not more than £316,000;
  - average number of employees not more than 10.

The turnover figure should be adjusted proportionately if the accounting period is not a year.

A company will qualify as a micro-entity in relation to its first financial year if the qualifying conditions are met in that year. In a subsequent year, a company will qualify as a micro-entity if the qualifying conditions are met in that year. However, in relation to a subsequent financial year, where on its balance sheet date a company meets or ceases to meet the qualifying conditions, that affects its qualification as a micro-entity only if it occurs in two consecutive financial years.

In the case of a company which is a parent company, the company qualifies as a micro-entity in relation to a financial year only if:

- the company qualifies as a micro-entity in relation to that year;
- the group headed by the company qualifies as a small group, as determined by section 383(2) to (7) Companies Act 2006; and
- the company has not voluntarily elected to prepare group accounts.

Are any companies excluded from the micro-entity regime?

Yes. A micro-entity must first qualify as small which means that where it is a plc, a company carrying on an insurance market activity, an ineligible financial services company, or a member of an ineligible group, it is ineligible for micro-entity exemptions.

Companies that are part of a group will also need to take care when assessing micro-entity status. Further to micro-entity exemptions not being available where the company is a parent company preparing group accounts, the exemptions are also unavailable for non-parent companies that are included in consolidated group accounts for that year. Investment undertakings, financial holding undertakings, credit institutions, insurance undertakings and charities are also ineligible for micro-entity exemptions.
What's in a full set of micro-entity accounts for the members?

A directors’ report is required, although, of course, the small company exemptions can be claimed in preparing this. Narrative reporting changes, also effective for financial years ended on or after 30 September 2013, will leave most micro-entity directors’ reports disclosing nothing more than the names of the directors and the fact that they have taken advantage of small companies’ exemptions in preparing the report. Legislation that becomes effective for periods commencing on or after 1 January 2016 (and can be early adopted one year before this date) removes the requirement for a micro-entity to prepare a directors report.

The micro-entity regulations introduced two optional balance sheet formats and a profit and loss format into the small company regulations (SI 2008/409). Micro-entities can choose to produce their individual accounts in accordance with these reduced information formats.

The usual company law and accounting standard notes to the accounts are not required. The micro-entity regulations state that the notes to the accounts that are required must appear at the foot of the balance sheet. These notes are from:

Section 413 Companies Act 2006 - Information about directors’ benefits: advances, credit and guarantees; and

Paragraph 57 of Part 3 of Schedule 1 to the small company regulations - Guarantees and other financial commitments.

Note that the general rules and accounting principles of the small company regulations must be applied unless these are amended as otherwise by the micro-entity regulations. Therefore, the company is still presumed to be carrying on business as a going concern; accounting policies should be consistent; assets and income and liabilities and expenditure should not be netted off; comparative figures are required and regard should be had to the substance of transactions, etc.

The regulations state that the alternative accounting rules and fair value accounting do not apply to a company that qualifies as a micro-entity. Revaluations for example, are not therefore allowed.

See our sample micro-entity accounts for more information.

What are the filing requirements for a micro-entity?

The ‘full’ micro-entity financial statements for members can be filed at Companies House. Alternatively, as with small companies, there is an option to not file the directors’ report and / or profit and loss account. The balance sheet filed, however, must include the notes at the foot of the balance sheet discussed above.

The concept of abbreviated accounts does not apply to micro-entities.

How do micro-entity accounts show a true and fair view?

From a legal perspective, the government has legislated to state the position for micro-entities. Additional notes and disclosures are not required and micro-entity accounts are presumed to give a true and fair view.

The figures in the accounts must, however, still be prepared in accordance with generally accepted accounting practice, even though the usual range of disclosures are not required.

What changes have been made to the FRSSE?

The FRC amended the FRSSE 2008 and 2015 to allow micro-entities to comply with the standards whilst taking advantage of available exemptions. The amendments, in addition to reflecting the reduced disclosure requirements for micro entities, also make amendments to reflect other micro-entity considerations. These include micro-entities not being permitted to adopt a policy of revaluation in respect of tangible fixed assets, measure fixed asset investments at market value, account for investment properties at market value or measure current asset investments at current cost.

It is clear, therefore, that revaluations are not permitted in micro-entity accounts. There are no transitional provisions available for entities that had previously revalued fixed assets (including investment properties). A company retaining revalued amounts in its accounts would not be able to take advantage of the micro-entities regime.

Some clarification is also given where the rules regarding asset valuation policies result in a change in accounting policy. For example, where assets that were previously revalued are now accounted for at cost less depreciation and impairment, the change should be accounted for by restating the amounts for the current and corresponding periods on the basis of the new policy.

FRSSE 2015 will be available for small companies and micro-entities for accounting periods commencing on or after 1 January 2015 although the FRC plans for the removal of FRSSE 2015 one year later with non micro-entity small companies then falling within the scope of FRS 102.
What is FRS 105?

The FRC is introducing a new simplified accounting standard that will replace the FRSSE for qualifying micro entities for periods commencing on or after 1 January 2016. FRS 105: The Financial Reporting Standard applicable to the Micro-entities Regime offers simplified recognition and measurement requirements in a number of areas when compared to the equivalent small entity FRS 102 requirements applicable from the same date.

FRS 105 includes removal of fair value accounting and deferred tax requirements further to simplification in a number of other areas including financing transactions and pensions.

It is expected that early adoption will be permitted from the date of issue, expected to be July 2015.

Micro-entities: What are the benefits?

Choice. The Department for Business, Innovation and Skills (BIS) Impact Assessment for the Micro-entities regulations notes that the bulk of benefits arising are ‘non-monetised’ and occur due to the simplification and additional choice conferred on micro-entities.

Application of the existing rules offers limited benefits in terms of time savings. While it will take marginally less time to prepare and check a micro-entity set of accounts, it is not the presentation of the accounts that takes time and money; it is largely the aggregation and preparation of the information following generally accepted accounting practice.

However, in the longer term, the story is different. Small company legislative changes will remove the option of filing abbreviated accounts. Recognition and measurement requirements for those same small entities will also align with FRS 102. This will lead to more small company information being publicly available and potentially an increased cost of complying with a more complex accounting standard. The simplified micro-entity recognition, measurement and reporting exemptions available to qualifying entities may therefore offer a route to cheaper accounting and reduced information in the public domain.

Are there any potential draw-backs?

The micro-entity proposals received a mixed reception from accountants and professional bodies throughout the entire consultation process leading to the final regulations.

There is a potential loss of transparency. Credit rating agencies and banks, for example, may need provision of additional information that could hold up credit decisions. This is similar to where a small company currently files abbreviated accounts. It may be the case, therefore, that additional non-statutory analysis is still undertaken in order to satisfy external reporting needs.

Micro-entity companies need to be aware of the options available to them for financial reporting, which may include taking advantage of exemptions, but also enhancing them with additional financial information suited to the business needs, or continuing with existing formats.

A sample set of micro-entity accounts is shown on the next page.

How can Mercia help?

The Q&A and sample accounts in this document are based on extracts from our Audit Exemption Specialist Assignment Manual, which includes micro-entity pro forma accounts, a disclosure checklist and detailed guidance notes. To check that you are using the most recent versions of our technical manuals click here.

The micro-entity changes are part of much wider changes to generally accepted accounting practice in the UK.

We have been keeping you up-to-date with the development of these new accounting requirements with our:

- courses
- webinars
- client letters
- newswire
- blogs
- e-learning library

You can rest assured that we will continue to keep you up to date and take closer other areas of change using all of these channels in the months ahead. You will find details of everything that we do on our website at www.mercia-group.co.uk and a subscription to our free monthly newswire is a great way of keeping yourself up to date with these.

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MERCIA MICRO ENTITY LIMITED

UNAUDITED FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 SEPTEMBER 2013

Company registration number: 12345678

DIRECTORS’ REPORT FOR THE YEAR ENDED 30 SEPTEMBER 2013

DIRECTORS
The directors who have served during the year were as follows:

Mr Icro Entity
Mrs Ercia Group

The report of the directors has been prepared taking advantage of the small companies’ exemption of section 415A of the Companies Act 2006.

ON BEHALF OF THE BOARD

Icro Entity
Mr Icro Entity, Director
1 May 2014

These sample micro-entity accounts reflect narrative reporting requirements effective for financial years ending on or after 30 September 2013. The reporting exemptions for micro-entities are not available for financial years ending before this date. Additional potential disclosures required within the directors’ report include:

i) policies on disabled employees (where average number of employees exceeds 250)

ii) political donations and expenditure (where donations / expenditure exceed £2,000)

iii) third party indemnity provisions.

The directors’ report of a micro entity is not required to be filed with the Registrar.

Note that the requirement for a micro entity to prepare a directors’ report is removed for periods commencing on or after 1 January 2016 (early application permitted for periods commencing on or after 1 January 2015).
## Profit and Loss Account

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>£630,000</td>
<td>£500,000</td>
</tr>
<tr>
<td>Other income</td>
<td>£5,000</td>
<td>£5,000</td>
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<tr>
<td>Cost of raw materials and consumables</td>
<td>(£310,000)</td>
<td>(£270,000)</td>
</tr>
<tr>
<td>Staff cost</td>
<td>(£155,000)</td>
<td>(£125,000)</td>
</tr>
<tr>
<td>Depreciation and other amounts written off assets</td>
<td>(£10,000)</td>
<td>(£10,000)</td>
</tr>
<tr>
<td>Other charges</td>
<td>(£60,000)</td>
<td>(£50,000)</td>
</tr>
<tr>
<td>Tax</td>
<td>(£20,000)</td>
<td>(£10,000)</td>
</tr>
<tr>
<td><strong>Profit</strong></td>
<td><strong>£80,000</strong></td>
<td><strong>£40,000</strong></td>
</tr>
</tbody>
</table>

As per the qualification criteria for small companies, micro-entity exemptions are determined on a two-out-of-three, two year assessment, based on limits including turnover. ‘Other income’ amounts are not included within this limit when determining size.

The profit and loss account for micro entity is not required to be filed with the Registrar.

## Balance Sheet - 30 September 2013

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Called up share capital not paid</td>
<td>£100</td>
<td>£100</td>
</tr>
<tr>
<td>Fixed assets</td>
<td>£85,000</td>
<td>£40,000</td>
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<tr>
<td>Current assets</td>
<td>£125,000</td>
<td>£60,000</td>
</tr>
<tr>
<td>Prepayments and accrued income</td>
<td>£25,000</td>
<td>£20,000</td>
</tr>
<tr>
<td>Creditors: amounts falling due within one year</td>
<td>(£85,000)</td>
<td>(£50,000)</td>
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<tr>
<td>Net current assets (liabilities)</td>
<td>£65,000</td>
<td>£30,000</td>
</tr>
<tr>
<td>Total assets less current liabilities</td>
<td>£150,100</td>
<td>£70,100</td>
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<tr>
<td>Creditors: amounts falling due after more than one year</td>
<td>(£15,000)</td>
<td>(£20,000)</td>
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<tr>
<td>Provisions for liabilities</td>
<td>(£5,000)</td>
<td>(£5,000)</td>
</tr>
<tr>
<td>Accruals and deferred income</td>
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<td>(£5,000)</td>
</tr>
<tr>
<td>Net assets</td>
<td>£120,100</td>
<td>£40,100</td>
</tr>
<tr>
<td>Capital and reserves</td>
<td>£120,100</td>
<td>£40,100</td>
</tr>
</tbody>
</table>

### Notes to the accounts

1. **Directors’ benefits: advances, credit and guarantees**

   During the year the company made an advance of £295 to a director of the company, to provide advance funds for expenses she was expected to incur when attending a personal training course. The balance was fully repaid at the year end.
2. Guarantees and other financial commitments

The company is being sued by a former employee for unfair dismissal. Solicitors have advised that the maximum potential liability amounts to £6,000. No provision has been included in the financial statements on the basis that legal advice obtained by the directors sets out that the case is unlikely to be successful.

The company had capital commitments contracted but not provided for in the financial statements totalling £8,000.

For the year ending 30 September 2013 the company was entitled to exemption from audit under section 477 of the Companies Act 2006 relating to small companies.

Directors’ responsibilities:

• The members have not required the company to obtain an audit of its accounts for the year in question in accordance with section 476;
• The directors acknowledge their responsibilities for complying with the requirements of the Act with respect to accounting records and the preparation of accounts.

These accounts have been prepared in accordance with the micro-entity provisions and in accordance with the Financial Reporting Standard for Smaller Entities (effective April 2008).

Approved by the board of directors and signed on behalf of the board,

Icro Entity

Mr Icro Entity, Director
1 May 2014

Company registration number: 12345678