

EXPLANATORY MEMORANDUM TO
THE SMALL COMPANIES (MICRO-ENTITIES' ACCOUNTS) REGULATIONS 2013

2013 No. [XXXX]

1. This explanatory memorandum has been prepared by the Department for Business, Innovation and Skills and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

The Regulations introduce exemptions from certain financial reporting requirements for very small companies. They permit such companies to prepare and file abridged accounts, containing only minimum prescribed notes. They introduce a presumption that accounts prepared in accordance with minimum requirements give a true and fair view of a company's financial position.

3. Matters of special interest to the Joint Committee on Statutory Instruments

None.

4. Legislative Context

4.1 The Regulations partially implement Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (OJ No L 182, 29.6.13, p 19) ("the New Accounting Directive").

4.2 They implement certain financial reporting exemptions for very small companies currently set out in the New Accounting Directive but which, prior to the repeal of Council Directive 78/660/EEC by the New Accounting Directive, were contained in Directive 2012/6/EU of the European Parliament and the Council of 14 March 2012 amending Council Directive 78/660/EEC on the annual accounts of certain types of companies as regards micro-entities (OJ No L 81, 21.3.2012, p 3) ("the Micros Directive").

4.3 The Explanatory Memorandum (EM) on the Commission's proposal on the Micros Directive was submitted to the Commons European Scrutiny Committee and the Lords Select Committee on European Union on 17 March 2009 and was cleared. Updates on the original proposal were provided to the committees in August 2010, June 2011 and August 2012.

4.4. The EM on the Commission's proposal on the New Accounting Directive was submitted to the Common's European Scrutiny Committee and the Lords Select Committee on European Union on 29 November 2011. The EM explained that the Directive formed part of the EU's rolling simplification programme to reduce administrative burdens and its commitment to ensure the relevance, effectiveness and proportionality of its legislation. The EM explained the objectives of the Directive and the nature of the changes and potential impacts of the proposed changes. The Common's European Scrutiny Committee cleared the proposal on 21 May 2012.

4.5 A Transposition Note accompanies this Memorandum.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Parliamentary Under Secretary of State for Employment Relations and Consumer Affairs has made the following statement regarding Human Rights:

“In my view the provisions of the Small Companies (Micro-Entities' Accounts) Regulations 2013 are compatible with the Convention rights”.

7. Policy background

- What is being done and why

7.1 The Government's overall objective is to support growth and encourage enterprise, whilst reducing unnecessary burdens on businesses. In the *Plan for Growth*,¹ 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 domestic regulatory burden on business.

7.2 The New Accounting Directive provides a micro-exemption from certain EU obligations relating to the preparation and publication of annual financial statements and so eases burdens on the very smallest undertakings. The UK supports the micro-exemption, which sets an important precedent in EU legislation. It is the first deregulatory measure that recognises the micro-entity. A key benefit of the micro-exemption is that it will simplify the regulatory regime and will benefit a significant number of UK companies².

¹ http://cdn.hm-treasury.gov.uk/2011budget_growth.pdf

² There are approximately 1.56 million micro-entities 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-entities are of key importance in terms of economic growth.

7.3 Consistent with the Government's overall objective, the decision was taken to treat the micros-exemption as an "add on" to the existing small companies' regime, instead of creating a new regime for micro-entities. Companies excluded from the small companies' regime are also excluded from the micros-exemption.

- Consolidation

7.4 The Department will consider the consolidation of the financial reporting rules for small companies generally on the implementation of the remainder of the New Accounting Directive.

8. Consultation outcome

8.1 The Department for Business, Innovation and Skills published a consultation document entitled '*Simpler financial reporting for micro-entities: the UK's proposal to implement the Micros Directive*', which sought comments on the implementation of the various parts of the micros-exemption. The consultation, which built on the earlier discussion paper '*Simpler reporting for the smallest businesses*'³, 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 information.

8.2 The majority of the responses were broadly supportive of the objective to simplify financial reporting obligations for the smallest companies. 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 impact of the changes on the UK's established accruals accounting framework. Issues were also raised in relation to the interaction of the micros-exemption with other areas of company law, and taxation. Views were also expressed in relation to group situations, access to credit, minority shareholding, charities and notes to the accounts.

8.3 All responses were considered carefully and the Government concluded that it should implement the micros-exemption, with the exception of those parts of the exemption relating to the obligation to present prepayments and accrued income and accruals and deferred income in the accounts; and the obligation to recognise only certain prepayments and accrued income and accruals and deferred income. In addition, the Government has taken into account views highlighting the strong public interest in the transparency and accountability of charities and, in order to retain a higher level of public accountability, has excluded from the benefit of the exemption micro-entities that are charities. The Government has also taken into account concerns relating to the impact of the micros-exemption on group situations. It concluded that, with a view to eliminating the impact of the exemption on group accounts, micro-entities which were parent companies and which prepared group accounts on a voluntarily basis should not benefit from the exemption. Neither should micros-entities included in the consolidation for the purpose of group accounts prepared by another company.

³ Joint BIS and Financial Reporting Council paper issued August 2011.

9. Guidance

None.

10. Impact

10.1 The Government has identified transitional costs to business with an Equivalent Annual Net Cost to Business of £0.45m. This reflects the estimated familiarisation costs for preparers of accounts. The validated Impact Assessment will be published at www.legislation.gov.uk.

10.2 The impact on the public sector is £0.22m. This is the estimated cost to Companies House of upgrading their systems to allow micro-entity accounts to be filed.

10.3 Charities are excluded from the micros-exemption.

11. Regulating small business

11.1 The legislation applies to small business, in that it exempts very small companies from certain financial reporting requirements.

11.2 Because the legislation is deregulatory there was no need to minimise its impact on firms employing up to 20 people.

12. Monitoring & review

12.1 The implementation of these changes will be monitored and reviewed by 2018.

13. Contact

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