



The Society of Professional Accountants

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28 October 2011

To: Department for Business
Innovation and Skills
Spur 2, 3rd Floor
1 Victoria Street
London, SW1H 0ET

Dear Sirs

Re: Simpler Reporting for the Smallest Businesses

The Society of Professional Accountants welcomes the opportunity of commenting on this consultation and herewith is our response for your consideration.

Please let us know if you would like to discuss with us any aspect of our reply.

Yours sincerely

Peter J D Mitchell
Chairman



FRC / BIS

SIMPLER REPORTING FOR THE SMALLEST BUSINESSES

Response by

THE SOCIETY OF PROFESSIONAL ACCOUNTANTS

28 OCTOBER 2011

PETER J D MITCHELL, FCA, FCCA, CHAIRMAN

SIMPLER REPORTING FOR THE SMALLEST BUSINESSES

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SIMPLER REPORTING FOR THE SMALLEST BUSINESSES

BACKGROUND TO THE SOCIETY OF PROFESSIONAL ACCOUNTANTS

SPA is a wholly independent society of small practitioners holding a qualification issued by a recognised professional accountancy Institute. It was formed in early 1996 and currently there are some 1600 principals in 1200 member practices. Our members provide accountancy and taxation services to an estimated 175,000 private businesses and approaching 500,000 individuals.

The Society's stated policy is to promote and improve the relationship between members and their Institutes by providing constructive criticism together with practical proposals for improvements. Further to provide commentary and proposals to other authorities influencing members' practising environment.

SPA has previously made submissions on small businesses limited company activities to the DTI on Audit Exemption levels, to the Accounting Standards Board on Financial Reporting Standards for Small Entities (FRSSE), to the DTI on Modern Company Law 'Developing the Framework', to the Chancellor of the Exchequer concerning individual tax payers on 'Advancing Self Assessment Tax Return Filing Dates', and to HM Revenue and Customs on various tax and NI consultations impacting on small practices and their clients.

SIMPLER REPORTING FOR THE SMALLEST BUSINESSES

DETAILED RESPONSES TO QUESTIONS POSED

1. Introduction

1.8 The OTS consultation and European developments together create the opportunity to discuss the regime governing financial reporting by Micro-Entities and consider:

- What financial information should be prepared bearing in mind the needs of the main users of the financial information of the entity concerned;

Micro businesses, like all businesses need sufficient appropriate financial information on a timely basis to enable owner/managers to manage the business. For small, cash based businesses an income and expenditure account on a cash basis, may be sufficient. For any other business, where there is an element of credit in its business arrangements or for a business of sufficient size, it will be necessary to manage cash flow so that funds are available to pay liabilities as they fall due. For this purpose a simple, accruals based profit and loss account and balance sheet would seem to continue to be appropriate.

- The form in which any such information should be prepared;

A simple accruals based profit and loss account and balance sheet, with no unnecessary detailed disclosures

- What further information would be required

In all probability, none

- What, if any, information should be made available publicly.

This is a hard question – arguably for an owner-managed micro-business, however constituted, the affairs of the business are those of its owner/managers and there may be no compelling reason for public disclosure. In particular the usual argument, that some disclosure is a necessary quid pro quo for limited liability status, seems to be of

limited validity, when most lenders to small businesses require personal guarantees from its owner/managers.

Nevertheless a limited liability company, unlike a sole trade or partnership, becomes a legal person and the possibility for using such an entity to hide the identity of those who control it, possibly for criminal purposes should be considered. Because of this we take the view that there should be some public disclosure, which should consist of the ownership and management information currently given in the annual return and some financial information. If the profit and loss account and balance sheet were to be as simple as we suggest above, it should probably also be the information on the public record, which would avoid unnecessary duplication of effort. If, however, the financial reporting for micro businesses were to be made more complex, an abbreviated balance sheet along the lines currently filed, would be adequate.

2. Micro-entities and their role in the UK

Q1 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?

Benefits would flow to the owner/managers of micro-businesses if they had to spend less time complying with any regulations whether they concern reporting responsibilities or anything else. However it has to be recognised that similar benefits would flow from de-regulating any entity, not just micro businesses.

The principal benefit would be the time saved which would allow the owner manager to either spend more time in productive work – thus providing more input to the economy, on the assumption that available demand could absorb the increased supply – or in additional non-work activities thus presumably enhancing the quality of life and potentially leading to increased spending on leisure pursuits.

If the impact of any changes is to simplify the existing requirements, we find it hard to understand why there should be any transitional costs for the micro business. If there is a genuine simplification in the rules, they should be easier to apply and there should therefore be a benefit rather than a cost. If the proposal is to replace one set of complex rules, with a different set of complex rules, these proposals must clearly be fundamentally flawed.

Any value put on the saving must be treated with extreme caution – if the impact is to make redundant the work of any accountant or, indeed civil servant, whilst this may raise questions about the added value really provided by people in such roles (and we have no objection to such questions being raised) if the saving of one cost, results in the reduction of an equal and opposite revenue, then the impact on the national economy is at best neutral and may even be negative.

3. The information that micro-companies should be required to prepare and file

Q2 Would the proposed alternative reporting structure described in this Section meet the needs of users? If not, what changes would you recommend and why?

We represent accountants and, therefore, are open to the accusation that we represent a vested interest, but these proposals appear to us to be fundamentally flawed and to demonstrate a lack of understanding of both the principles of financial reporting and what actually happens currently in the real world.

It is hard to see how these proposals would meet the needs of users – whoever they may be. It is stated at paragraph 3.7 that:

“It is important to emphasise that companies providing the financial information summarised in paragraph 20 above would not be preparing financial statements that give a true and fair view.”

So what is being proposed here? Financial information which provides an unfair, untrue view? We find it hard to understand the purpose of such information. How can it possibly

provide information which is useful to trading partners or other stakeholders, or a fair basis for calculating taxation?

The current reporting requirements for **all** companies are needlessly complex, but particularly for smaller businesses. Many date from the Companies Act 1948 and some from previous legislation. When a revised, simplified format was proposed by the Company Law Review Committee it was ignored in the regulations incorporated into the Companies Act 2006. The proposals set out by the Company Law Review Committee may not be perfect, but they represent an improvement on what we have now, and at least would comply with true and fair principles.

We would therefore recommend that the current regulations for small businesses – set out in SI2008/409 The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 – should be radically revised in line with the recommendations of the Company Law Review Committee and that this would be a way to achieve greater savings than those proposed in this document.

It would, of course, be possible to simplify the disclosure requirements for statutory financial reporting purposes still further, but those suggested by the Company Law Review Committee appear to us appear to represent a sensible balance between public interest and commercial constraints.

Q3 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?

You will gather from our comments above that the simple answer to this is “No”.

These proposals are inherently self-contradictory and appear to demonstrate a failure to understand the purpose of financial reporting, or, indeed that it serves any purpose at all.

Cash based accounting is completely acceptable for cash based businesses, provided, of course the tax authorities are prepared to accept the principle of 100% first year allowances for capital expenditure, 100% allowances for all unpaid debtors and some quite radical proposals for what used to be called stock relief.

If the tax authorities are themselves not prepared to accept these aspects which are inherent in these proposals, then it would seem that there is little future in them.

For non cash based businesses it is highly probable that the proposed cash basis will produce volatile swings in earnings and, therefore taxable profits, which are unlikely to result in a fair basis for taxation.

Businesses of whatever size need to track what they are owed by their customers if there is any element of credit in their business arrangements – to pretend that this is unnecessary is, it seems to us, disingenuous. To survive, a business needs to collect in its debts. If it fails to do so it will go bust. In order to do so, it needs to know what those debts are, who they are due from and when they fall due. If it is to report for statutory purposes on a cash basis, but requires management information on an accruals basis, then these proposals impose greater, rather than less complexity. Much is made, later in these proposals, of the benefits of aligning statutory reporting with management accounting requirements. In this the proposals are clearly self-contradictory.

The requirement for a “statement of position” appears to be equally deficient in logic. We find it very hard to understand what such a statement is intended to represent, or what purpose it is supposed to serve.

For a cash based business, there may be some logic, although presumably the business would be required to provide some kind of reconciliation between the opening and closing position as a safeguard against non-allowable expenditure being disguised as trading expenses. For any other business, once assets and liabilities have been

identified and quantified to any meaningful extent, we find it hard to distinguish between this and a conventional balance sheet.

We would favour a profit and loss account and balance sheet produced on the accruals basis and designed to show a true and fair view of the results of the business for the period under review and its state of affairs at the balance sheet date. The disclosures could be radically simplified in comparison with those required by the current regulations. Public filing requirements may remain in line with current abbreviated accounts, although if the “full” accounts were simple enough, this might be seen as being additional rather than reduced regulation.

Q4 Would the information to be included in Micro-Company Annual Returns (paragraph 31) be sufficient? If not, changes would you recommend and why?

Again we find it hard to understand why these proposals have been made. For a micro-company at present, the requirements of the annual return consist of acknowledging information supplied by Companies House and very little else. These proposals would seem to increase rather than reduce the current requirements, and, consequently they should be rejected.

Q5 Are the proposed filing obligations for Micro-Companies (paragraph 33) appropriate? If not, what changes would you recommend and why?

It is quite hard to respond to a question containing non-existent cross references, but we presume that this question deals with the filing deadlines and the proposal to standardise the reporting year.

We suspect that, because compliance with filing deadlines represents an intrusion on the lives of those running businesses when they would rather be doing something else, there will always be a tendency to leave such matters to the last minute. It is probable therefore that for the majority of small businesses, the deadline could be brought forward, and indeed this could have some advantages in that compliance with the regulations could be “got out of the way” earlier and thus interfere less with the business

of the current year. Current technology also means that the relevant information can be compiled more quickly than was once the case. Nevertheless, it is a fact that some information, for some businesses still takes a certain amount of time to assemble and we would recommend a delay of 3 months to allow for this.

The proposal that the year ends of all micro-businesses should be standardised, on the other hand, makes no sense at all. Different businesses have different trading cycles, and to impose an arbitrary uniform year end on all businesses would adversely affect those where the reporting season clashes with a season of intense activity.

The demands on the regulatory process would also be huge with 1.5 million businesses all submitting their accounts at the same time. How could they all be processed promptly? Websites and servers would inevitably crash.

There is an underlying hint in these proposals as with other statements from BIS that the production of financial information represents nothing but a bureaucratic waste of effort. As accountants we believe that the production of reliable financial information serves a very real purpose in the effective management of the economy and providing a fair basis for raising taxation. We believe that accountants contribute to this effort by ensuring that the financial information produced is reliable both as a means for managing businesses and for establishing the tax base. If this is true, as we believe it is, then to stipulate that all businesses which wish to use the services of an external accountant should all do so within the same relatively short period, would almost certainly drive up the cost of those services because of the amount of overtime required, and may well have a detrimental impact on the quality of the work done.

Q6 Are there any other matters that need to be addressed?

We suspect that the matters raised above, are sufficient to cast severe doubts about the wisdom of the current proposals.

4. **Using the reported information to prepare tax returns**

Q7 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?

As stated above we believe that these proposals would be counter-productive in that they would lead to volatile profit swings and an unfair basis for taxation. The pure cash basis suggested in the earlier sections would almost certainly have unforeseen consequences for tax revenues and the mention of capital allowances in chapter 4 clearly suggests that the tax aspects of these proposals and the whole concept of the statement of position have not been thoroughly thought through.

We have no objection to the radical simplification of the tax code and its alignment with accounting principles. This would in itself greatly reduce the administrative burden imposed on all businesses including those at the very small end of the scale.

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