



PROFESSIONAL OVERSIGHT BOARD FOR ACCOUNTANCY

**REVIEW OF HOW ACCOUNTANTS SUPPORT THE NEEDS
OF SMALL AND MEDIUM-SIZED COMPANIES AND THEIR
STAKEHOLDERS**

MARCH 2006

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The Professional Oversight Board for Accountancy
Aldwych House
71-91 Aldwych
London
WC2B 4HN

Tel: 020 7492 2300

Email: j.rose@frc-poba.org.uk

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Executive Summary

The Professional Oversight Board for Accountancy (POBA) provides independent oversight of the regulation of the accountancy profession by the professional accountancy bodies. The objective of this review is to assess how the accountancy profession supports the needs of small and medium-sized companies and their stakeholders. The Board decided to undertake the review having considered the overall importance of this sector and the significant changes made in recent years to the financial accounting and reporting arrangements for these companies.

Key measures of the number of relevant companies and the information they file on the public record are summarised in Table 1, below:

Table 1 - Number of companies

Measure (2005 unless stated)	Quantity	Source
Business enterprises in the UK (2004)	4.3 million	Small Business Service
Incorporated business enterprises	2.2 million	Companies House, Companies Registry
Accounts filed at Companies House - total	1.4 million	Companies House, Companies Registry
Accounts filed at Companies House - non-dormant	1.2 million	Companies House
Accounts filed at Companies House - non-dormant, small companies	1.1 million	Companies House, FAME
Small companies filing audit exempt accounts	0.9 million	Companies House

Our survey of companies found that around 85 per cent of small and medium-sized companies use some form of external support with their accountancy work. In nine out of ten cases this support is provided by professional accountants, with around 30,000 professional accountants working in around 18,000 accountancy practices supporting small and medium-sized companies. We considered the extent to which these support arrangements currently meet the needs of company directors and users of their accounts.

Meeting the needs of company directors

In our survey of companies, over three-quarters of the company directors reported having experienced no significant accounting and auditing problems and 88 per cent said that the accountancy profession offered appropriate support to help with their accounting and auditing needs. Our interviews with company directors and their accountants found many good and long-standing working relationships, with most directors being content with the accounting and auditing services they obtained.

Despite this many accountants and other business advisers told us that many companies do still experience problems in financial accounting and reporting, even if these are not recognised as or considered significant by company directors. Our research the following issues in relation to the financial accounting and reporting options now available to company directors:

- **Types of external advisers:** Directors of many small companies now have a choice of different types of advisers, from those that have no accountancy training to professional accountants. To help directors to make informed decisions, a clear explanation of the role of professional accountants including their professional obligations and the services they offer is required.
- **Full or abbreviated accounts:** Many company directors appear to see the choice of filing full or abbreviated accounts as a technical matter to be decided by their accountant. Professional accountants may in this situation recommend filing abbreviated accounts, to avoid any risks associated with divulging information unnecessarily. For some companies however, filing abbreviated accounts could have additional commercial implications, possibly including less favourable credit arrangements or greater difficulty in winning business. To help directors to make informed decisions, a clear explanation of the implications of filing full or abbreviated accounts is required.
- **Audited or unaudited accounts:** Directors of many small companies appear to be unclear whether they are filing audited or unaudited accounts, and some appear to believe that using a professional accountant means that the accounts are audited. Certain user groups, particularly credit managers, do look for an audit and may be more cautious in the absence of it. To help directors to make informed decisions, a clear explanation of the implications of filing audited or unaudited accounts is required.
- **How directors of smaller companies work with professional accountants:** Many directors receive advice from their professional accountant in understanding and interpreting financial information. This can help directors to benefit from good financial management, rather than seeing accounting merely as a regulatory burden. However some directors tend not to look for external support beyond the preparation of accounts, even when this is offered by the professional accountant as part of the standard accounts preparation service. To help directors to make informed decisions, a clear explanation of how professional accountants can help businesses to use accounting information is required.

Providing confidence to users

We estimate that 260,000 (around 25 per cent) of small and medium-sized companies had their accounts audited in the year to April 2005 and around 890,000 companies (75 per cent) used audit exemptions. Of those that were audited, around 180,000 would qualify for audit exemption but had 'voluntary' audits; 45,000 were small companies that did not qualify for audit exemption, and 35,000 were medium-sized companies that are required to file audited accounts. For comparison, there are 15,000 to 20,000 large companies. Our research suggests that most small and medium-sized companies that are now audited do see the cost of the audit as a good investment, and therefore want an independent and thorough audit that will provide appropriate assurance to themselves and other users of their accounts.

We considered whether the increase in the number of companies using audit exemption was causing problems to users of their accounts. Some user groups were able to meet their needs without an audit. For example, the absence of an audit is not seen by HM Revenue and Customs as a valid reason for enquiring into a company's accounts or tax return. Equally, HMRC will challenge audited accounts when necessary. The British Bankers' Association told us that following the increases in the audit threshold, their members' operating procedures have changed such that in the vast majority of lending decisions for small companies an audit is not required.

Our research suggested that other users, particularly individuals and companies who are considering doing or are already in business with unaudited small companies, do have an interest in assessing the reliability of financial accounts. However, in the absence of an audit, there is not usually any visibility as to the involvement of professional accountants in the preparation of accounts. A clear explanation of the role of the accountant could benefit the businesses concerned by giving users of their accounts a degree of confidence from the involvement of an independent professional. We have suggested that greater clarity could be achieved through use of a cross-profession compilation report that included a description of the scope of engagement of the professional accountant together with a positive description of professional accountants' obligations. This report would not include any assurance opinion; we identified no interest amongst users for a new level of assurance opinion, and believe that the introduction of an alternative form of assurance at this time would only lead to confusion. As use of such a report would be voluntary, we consider that it preferable that it should be developed and implemented by the bodies rather than by the FRC. Should the bodies be unable to achieve this within a reasonable timescale, the approach should be reconsidered.

As a supporting measure, there is a need for improved clarity and security over reporting the involvement of professional accountants when accounts are filed at Companies House. Users should have confidence that where the involvement of a professional accountant is shown this is genuine. Companies House told us that it is happy to work with the profession to find an appropriate way to achieve improved clarity and security. With the introduction of electronic filing of accounts at Companies House, the professional accountant's identity could be recorded, using a registered list of accountants. Firms of accountants could also then check filings made in their name. The accounts might also be able to show the nature of the professional accountant's involvement whether in the form of an audit, the cross-profession compilation report or no report.

Quality of financial accounts

To help assess the effectiveness of the accounting arrangements we reviewed the quality of accounts filed at Companies House. This involved a high level review of the primary statements and notes and any other information included within the financial statements. We selected 185 sets of accounts of companies in England and Wales, 85 companies in Scotland and 85 in Northern Ireland. Within each of these groups we selected companies based on company registration numbers that were generated at random. Of the 355

filings, 75 were reviewed by POBA and 280 by the bodies (the ACCA, ICAEW, ICAI, and ICAS) under our supervision.

The majority of accounts reviewed were generally informative but appeared to include some technical disclosure or minor computational errors. A sizeable minority of the sets of accounts appeared to include more significant technical issues, material computational errors or other evidence of a lack of care in preparation that, taken together, could undermine the usefulness of the accounts. Problems with the quality of accounts filed at Companies House were found across sets of accounts where no professional accountant was named, where a professional accountant was named but no audit carried out, and audited accounts. Similarly problems were found across sets of accounts prepared by all types of firms, from sole practitioners to the 'big four'.

Far too many accounts which had been prepared with the involvement of professional accountants showed a lack of care in preparation. If company directors and users of their accounts are to value the involvement of professional accountants, it is vital that the quality of professional accountants' work is more consistently high. The bodies shared our concern and have undertaken to improve the situation that was identified by our review.

The bodies have agreed a series of actions which include raising awareness of the issue among members in practice, investigating the issue further to identify root causes and providing appropriate technical and practical support to members, reviewing their quality assurance programmes, and further ongoing monitoring of quality through desk-top reviews of accounts filed at Companies House and the Companies Registry. We consider that these actions are appropriate and should help to achieve consistently high quality work. We will monitor progress both through our ongoing oversight of the monitoring of audit practices by the bodies and consideration of the results of the further desk-top reviews that the bodies will undertake.

Recommendations

We have made seven recommendations to the professional bodies (next page). Our recommendations are worded to give the bodies flexibility in implementation; they should therefore be considered in the context of the relevant chapter. Although we consider it likely that each of the recommendations could be implemented at a cost that would be small compared to the benefits, it would be for the bodies to fully evaluate the relative costs.

Table 1 - Summary of recommendations

Number	Recommendation	Page
1	The bodies should consider how, on an ongoing basis, the profession can give directors of small companies a clear explanation of the role of professional accountants, including their professional obligations and the services they offer.	22
2	The bodies should consider how, on an ongoing basis, the profession can give directors of small companies a clear explanation of the implications of filing abbreviated or full accounts.	24
3	The bodies should take steps (including those they have proposed) to help improve the quality of financial accounts which have the involvement of their members. The bodies should keep POBA informed on the steps being taken and should report formally to POBA on the effectiveness of these steps in April 2007.	26
4	The bodies should consider how, on an ongoing basis, the profession can give directors of small companies a clear explanation of how professional accountants can help businesses to use accounting information to achieve good financial management.	31
5	The bodies should consider how, on an ongoing basis, the profession can give directors of small companies a clear explanation of the implications of filing audited or unaudited accounts.	36
6	The bodies should consider how, on an ongoing basis, users of the accounts of non-audited companies could be given a clear explanation of the extent and relevance of the involvement of professional accountants in the preparation of those accounts. For this purpose, the bodies should consider the use of a cross-profession compilation report that includes a very broad description of the scope of engagement of the professional accountant together with a positive description of professional accountants' obligations.	41
7	The bodies should consider taking up the offer from Companies House to work with the profession to achieve greater clarity and security over reporting the involvement of professional accountants when accounts are, in future, filed electronically.	41

One – Introduction

The Professional Oversight Board for Accountancy (POBA) provides independent oversight of the regulation of the accountancy profession by the professional accountancy bodies. POBA is an operating body of the Financial Reporting Council (FRC) and in carrying out its duties it supports the FRC's mission which is to promote confidence in corporate reporting and governance. Details of POBA's functions are shown in Annex A. In carrying out this review, POBA has worked closely with other parts of the FRC, including the Accounting Standards Board's Committee for Accounting for Smaller Entities and the Auditing Practices Board's Small and Medium-Sized Entities Audit Sub-Committee.

The objective of this review is to assess how the accountancy profession supports the needs of small and medium-sized companies and their stakeholders. The Board decided to undertake the review having considered the overall importance of this sector and the significant changes made in recent years to the financial accounting and reporting arrangements for these companies.

Much of this Board's work is focused on listed companies and other entities in whose financial condition there is a major public interest. Weaknesses in accounting and auditing of individual small or medium-sized companies are unlikely to be of major public interest or have a significant impact on confidence in corporate reporting and governance. However as over 95 per cent of companies are small or medium-sized, it is important that the accounting arrangements in this sector work effectively. A systemic weakness in financial reporting across small and medium-sized companies could affect confidence generally and therefore is a matter of public interest.

The arrangements for financial accounting and reporting in this sector have changed significantly in recent years. Most small companies can now choose to file non-audited accounts and/or abbreviated accounts. The regulatory framework for accounting and auditing has seen the evolution of UK accounting standards, the introduction of international accounting standards, enhanced ethical standards for auditors and the introduction of international auditing standards.

This report summarises our research. Following an introduction, there are chapters covering each of the main aspects of financial accounting. Chapter 2 considers bookkeeping, the process of initial data entry into the accountancy system; chapter 3 considers financial accounting and reporting, the process of producing accountancy information using the data recorded during bookkeeping; chapter 4 considers financial management, the process of using financial information within the company; and chapter 5 considers how companies give confidence to users of their financial statements.

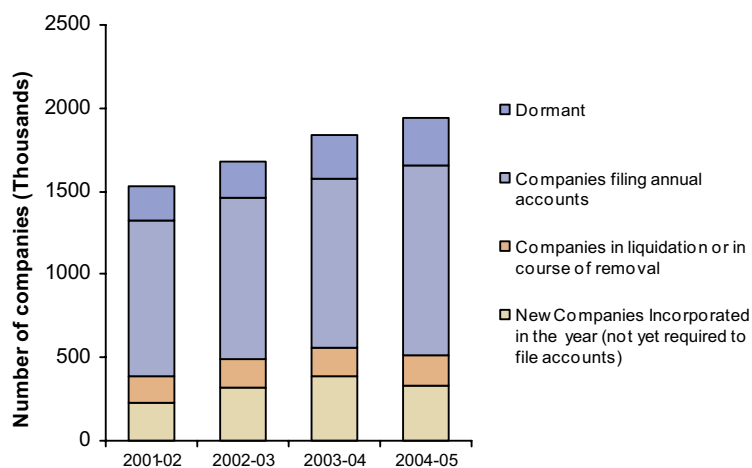
Our recommendations are directed to the professional accountancy bodies and address how the bodies regulate their members who work in public practice. In addition to the points covered by our recommendations, we expect that our findings will be relevant to the bodies and other regulators when

considering wider aspects of the financial accounting and reporting arrangements for small and medium-sized companies.

1.1 Small and medium-sized companies in the UK

There were 4.3 million business enterprises in the UK at the start of 2004 according to the Small Business Service, an agency of the Department of Trade and Industry. Around 2.2 million of these enterprises were incorporated. Statistics from Companies House show that the number of companies filing accounts has been growing steadily in recent years (Figure 1.1, below). The total number of accounts filed in 2004/05 is less than 2.2 million because of some companies incorporated in the previous year not yet having been required to file their first set of accounts and some companies not filing on time.

Figure 1.1 – Analysis of the Companies Register



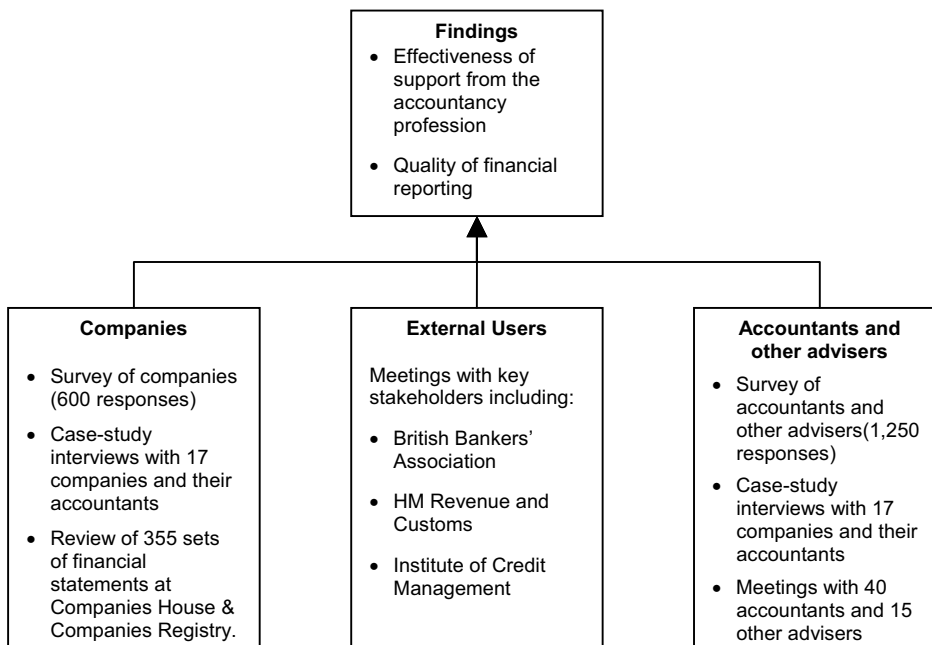
Source: Department of Trade and Industry, *Companies in 2004–2005*,

At least 95 per cent of the 1.1 million active (non-dormant) companies that filed annual accounts in 2004-05 were small. The Companies Act defines small companies as having at least two of: annual turnover of £5.6 million or less; balance sheet total of £2.8 million or less; and an average number of employees of 50 or fewer. Around 35,000 were medium-sized, with turnover usually less than £22.8 million, and around 15,000 to 20,000 were large. The accounting and reporting requirements for small and medium-sized companies are summarised in Annex B.

1.2 Methodology

Our research programme was designed to collect information from companies, users of their accounts and their providers of accountancy services to investigate how effectively professional accountants support the needs of small and medium-sized companies and their stakeholders. We also reviewed the quality of the financial accounts of these companies to help assess the effectiveness of this support. Key elements of the research are summarised in Figure 1.2, below.

Figure 1.2 – Research methodology



Surveys

The Small Enterprise Research Team, an independent, non-profit charitable association hosted at the Open University Business School, carried out a postal and on-line survey of companies in which 600 companies participated. Nottingham University Business School's Business Adviser Barometer carried out an on-line survey of accountants, accounting technicians, bookkeepers and other advisers in which 440 individuals participated. The ICAEW carried out an on-line survey of its members in which 760 accountants participated.

Interviews

Case-study style interviews with 17 companies and follow-up interviews with their accountants were carried out by a team comprising Professor Neil Marriott and Pru Marriott from Glamorgan University and Dr Jill Collis from Kingston University. POBA staff met around 40 accountants, accounting technicians, and

bookkeepers. Our consultants, ABA Limited, met 15 general business advisers. We met with user groups including HM Revenue and Customs, the Institute of Credit Management and the British Bankers' Association.

Other research

We analysed summarised data on accounts filed at Companies House and examined a sample of sets of accounts filed there. We reviewed a wide range of previous research in this area, a summary of which is included in Annex C.

In common with any research programme, each of our activities has inherent strengths and weaknesses, but we consider that taken together this research provides a good basis for identifying issues with the current arrangements. Detailed findings of the research are available on our website.

Limitations of scope

We have sought to understand the impact of the current regulatory framework for accounting and auditing, including rules covering audit exemption threshold, the filing of abbreviated accounts, ethical standards for auditors, and financial reporting standards for small company reporting. We have not sought to review the framework itself, as that is the responsibility of the appropriate regulatory bodies. In addition, our emphasis has been on the regulatory framework for financial rather than tax accounting.

Our review considered only incorporated businesses, i.e. not sole traders or partnerships. The FRC's activities are mainly directed towards companies required to prepare accounts under the Companies Acts. We expect, however, that some of our findings may also be relevant to unincorporated businesses.

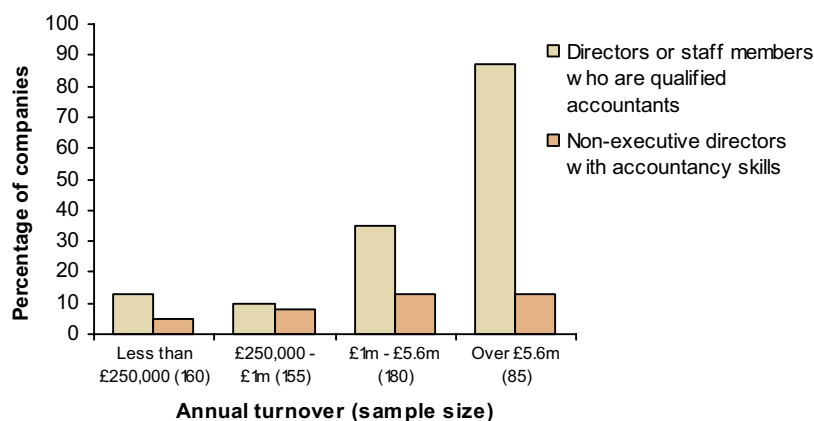
Although most charities are not incorporated, around 25,000 are set up as companies and others have incorporated trading subsidiaries. Our review has not considered separately the accounting and auditing needs of charities and their stakeholders as this is an area that has been examined recently by the Government, leading to the Charities (Accounts and Reports) Regulations 2005 and the 2005 revision of the Statement of Recommended Practice, Accounting and Reporting by Charities. Similarly we have not given special consideration to the needs of other specialised entities, for example the users of the accounts of around 2,000 Registered Social Landlords.

1.3 Overview of current arrangements

Internal accountancy expertise

Smaller companies generally do not have internal accountancy staff or directors with accountancy skills and are therefore likely to look to outside advisers for support with their accountancy. In our survey of companies, around 10 per cent with turnover of less than £1 million reported having accountancy expertise. This increased to 35 per cent for companies with turnover between £1 million and £5.6 million and 87 per cent for medium-sized companies (see Figure 1.3, below).

Figure 1.3 – Internal accounting resources by size of company



Source: SERTeam survey

Use of external accountancy support

We estimate that around 50,000 of the UK's 250,000 accountants work in public practice¹, with around half of these working in approximately 20,000 practices² handling mainly small and medium-sized companies, the rest being with the larger audit firms.

Only accountants who are members of the chartered professional bodies can call themselves chartered, for example chartered accountants, chartered certified accountants, chartered management accountants or chartered public accountants. The six chartered bodies form the Consultative Committee of Accountancy Bodies (CCAB) with the stated aim of providing 'a forum in which matters affecting the profession as a whole can be discussed and co-ordinated'.

¹ Estimate based on our publication, Key Facts and Trends in the Accountancy Profession, February 2005, Tables 1 & 4, and results of the Business Adviser Barometer survey and ICAEW survey.

² Estimate based on information from the professional bodies

Companies can choose to use external advisers who are not members of the chartered bodies for support with their accountancy needs other than statutory audit. These include members of other accountancy bodies, accounting technicians, bookkeepers, and general business advisers.

Obligations of professional accountants

As in most other countries in the European Union, professional accountants compete against other providers of accountancy services. A recent report of the European Federation of Accountants concluded:

In the vast majority of activity areas in which professional accountants are engaged, there are no market rules restricting or prohibiting the entry of other service providers in the overwhelming majority of countries surveyed. In these cases, there are no statutory requirements obliging consumers to acquire services from members of the accountancy profession. As a consequence, professional accountants compete with other service providers who are not submitted to the same education and training requirements, ethics and quality control practices. However, it is important to note that in these activity areas where there are no market rules, there appears to be significant market appreciation of the benefits of using the services of professional accountants.

Fédération Des Experts Comptables Européens, Provision of Accountancy, Audit and Related Services in Europe: A Survey on Market Access Rules, December 2005

Our case study interviews demonstrated that directors of small companies can find the accounting service that they feel meets their needs from different types of accountants. We visited accountancy practices run by bookkeepers and technicians and members of the non-chartered bodies and observed very strong commitment to the needs of their business clients. However features of the accountancy support available from say, a member of the AAT are likely to differ from that available from, say, a member of the ICAI. We describe below some of the regulatory requirements of members of the CCAB bodies, and return to these later in the report.

Regulatory arrangements in relation to professional accountants who are members of the CCAB bodies include:

- Around three years of part-time study with formal assessment of capabilities and competence is required prior to initial qualification;
- Relevant practical experience is required prior to initial entry to the profession;
- Members are required to undertake ongoing 'continuous professional development' training to maintain relevant skills;
- Members who provide services to companies other than their employers are required to register as working in public practice;

- Procedures for handling complaints and, where appropriate, taking disciplinary action against members;
- Quality monitoring of public practices; and
- Requirement for members to adhere to a code of ethics.
- Independent oversight by POBA of how the professional bodies regulate their members.

The profession's code of ethics may be of particular relevance to the work of professional accountants in this sector. These standards are in the process of being revised to comply with the International Federation of Accountants' (IFAC) Code of Ethics for Professional Accountants, with the revisions expected to be in place across the bodies by July 2006. Key requirements in the IFAC Code include:

110.2 A professional accountant should not be associated with reports, returns, communications or other information where they believe the information:

- Contains a materially false or misleading statement;
- Contains statements or information furnished recklessly; or
- Omits or obscures information required to be included where such omission or obscurity would be misleading.

130.1 The principle of professional competence and due care imposes the following obligations on professional accountants:

- To maintain professional knowledge and skill at the level required to ensure that clients or employers receive competent professional service; and
- To act diligently in accordance with applicable technical and professional standards when providing professional services.

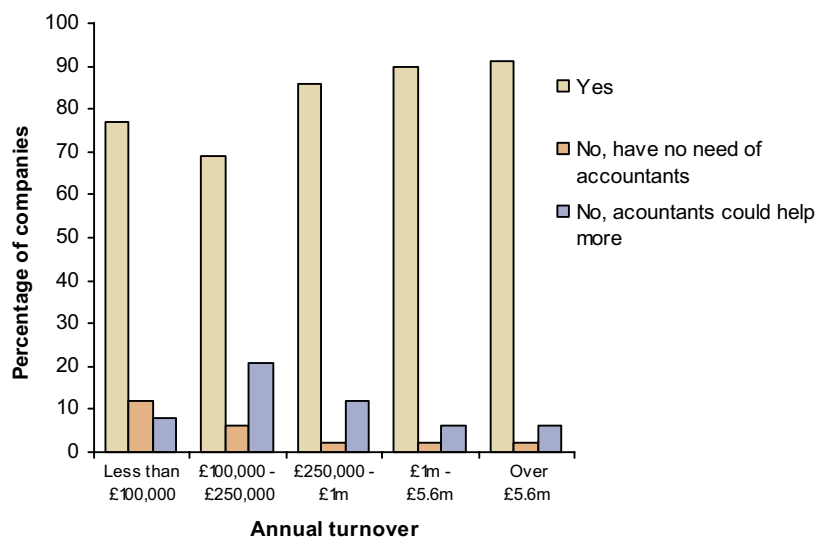
130.4 Diligence encompasses the responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis.

From Code of Ethics for Professional Accountants, International Federation of Accountants, June 2005

Satisfaction with accountancy profession

In our survey of companies, over three-quarters of the companies reported having experienced no significant accounting and auditing problems. Most said that the accountancy profession offered appropriate support to help with their accounting and auditing needs (Figure 1.4, below). However around one in five companies with turnover of between £100,000 and £1 million reported that the profession could help more.

Figure 1.4 – “Does the accountancy profession offer appropriate support to help your business with its accounting and auditing needs?”



Source: SERTeam survey

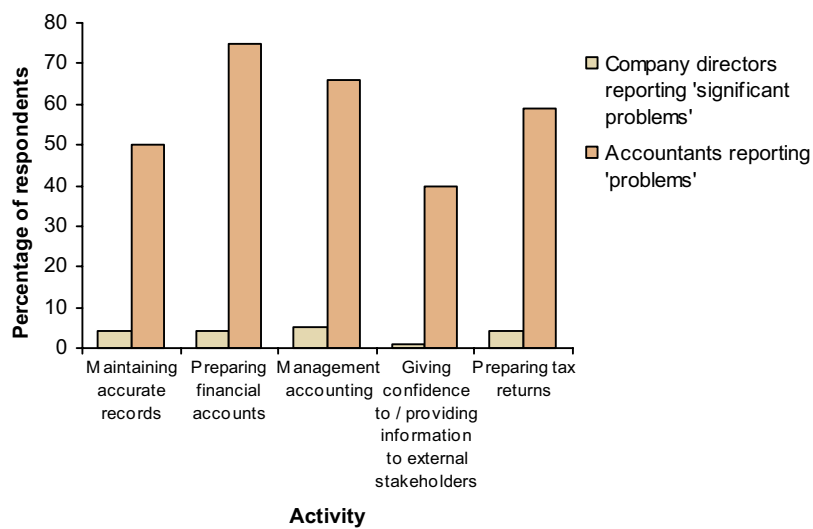
Other research has pointed to similar levels of satisfaction with accountants. The team carrying out our case study interviews with companies and accountants concluded that that ‘the accounting and auditing needs of small and medium-sized companies are diverse but are being adequately met by their current internal arrangements and the external relationships that exist with their providers of accountancy and auditing services’. A survey of over 2,000 businesses for Sage in 2005 found that 88 per cent of businesses are ‘extremely or fairly likely to recommend their accountant’s services to a friend’.³ A survey by the Institute of Directors in 2001 found that 67 per cent of IOD members said their accountant gave a high level of service⁴.

³ Sage, Accountants Business Collaboration Survey, November 2005

⁴ Institute of Directors, Accountancy Services, 2001

These positive survey results need to be put in context. Although most company directors report few significant problems in relation to accounting and auditing, their accountants report that small companies often do experience problems in relation to accounting and auditing (Figure 1.5, below) . Business advisers from outside of the accountancy profession suggested that many company directors are unaware of their problems and, therefore, the benefits of more appropriate support from accountants. The advisers told us that many of the directors they work with do not understand the importance of good financial information and the benefits of putting in place systems that can provide useful management accounting information.

Figure 1.5 –Problems reported by company directors and accountants



Sources: SERTeam survey, Business Adviser Barometer survey, ICAEW survey

Two – Bookkeeping

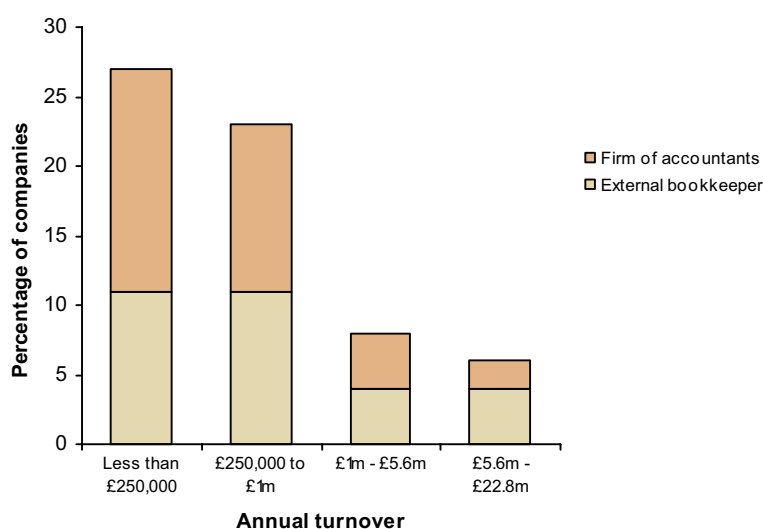
Section 221 of the Companies Act requires that companies to keep accounting records which are sufficient to show and explain the company's transactions and are such as to: (a) disclose with reasonable accuracy, at any time, the financial position of the company at that time; and (b) enable the directors to ensure that any balance sheet and profit and loss account complies with the requirements of the Act. In this section we consider the extent to which companies need, and are able to obtain, support in keeping these records (section 2.1). We then consider the needs of external stakeholders for information as to how companies have fulfilled their record keeping responsibilities (section 2.2). We conclude with our summary of the issue in this area (section 2.3).

2.1 Needs of companies

Around 50 per cent of accountants reported that small companies experienced problems in this area. However company directors did not see any such problems as significant, with only 4 per cent of company directors reporting significant problems in the area of maintaining accurate records.

The majority of companies do their own bookkeeping. In our survey, 16 per cent of companies with turnover less than £250,000 reported that they obtained assistance from a firm of accountants with bookkeeping and 11 per cent reported that they obtained assistance from an external bookkeeper. This level of external support falls steadily as companies grow in size (Figure 2.1, below).

Figure 2.1 – Assistance with Bookkeeping – by annual turnover



Source: SERTeam survey

Professional accountants told us that they help their clients to set up manual or computerised bookkeeping and accounting systems or to find an external bookkeeper. Many accountants preferred not to carry out bookkeeping work for clients in-house because they could provide better value for money in areas that required more accounting expertise. Notwithstanding this inclination of some practices to avoid offering a bookkeeping service, our survey of accountants found that, on average, small accountancy practices employ as many bookkeepers and accounting technicians as professional accountants.

Some accountants, particularly those in smaller practices, reported a shortage of 'good quality' bookkeepers. 'Good quality' was defined as having appropriate skills in accountancy and bookkeeping systems together with a basic level of business acumen that enable the bookkeeper to prepare accurate accounting information to trial balance stage. By contrast, many bookkeepers may be competent at processing routine transactions onto a company's books and records without necessarily having the skills to check that the records are reasonable or complete. Accountants told us:

Good bookkeepers are worth their weight in gold. There are far more mediocre ones than first class ones, and an awful lot of people are not at all good.

Very few can do more than basic processing - data entry. They don't have the technical skills to take a stage further to basic accounts preparation.

Finding skilled bookkeepers is a nightmare - we never wanted to do bookkeeping in the office here but we have to.

Other accountants did not identify an issue in this area. Part of the job of the professional accountant, we were told, was to check that the record-keeping was in order. Where problems were identified, the accountant would advise the company to find a better bookkeeper. In this way the market would ensure that work is directed towards good quality bookkeepers. Some accountancy practices subcontract bookkeeping work to low-cost accountancy practices, for example in India.

Our meetings with bookkeepers were with members of the Institute of Certified Bookkeepers (ICB) who run their own public practices. These individuals may well not be representative of most bookkeepers; for example, local newspaper advertisements for bookkeepers are more likely to ask for experience in a particular accounting software package than a formal bookkeeping qualification. Members of the ICB typically prepare the accounts for their clients to a trial balance stage and then pass the information to a professional accountant to compile the statutory accounts. They told us that their working relations with professional accountants were generally good, with accountants often placing considerable reliance on their work. In their view, they supported professional accountants by preventing inaccuracy in companies' records and ensuring that all figures are supported by relevant documentation.

Bookkeepers told us that the use of a professional independent bookkeeper demonstrated a commitment by companies to keeping accurate records. Clients also benefited from frequent, often weekly, contact with their bookkeeper who could help to produce regular management accounting information and identify where there was a need for further support from professional accountants.

2.2 Needs of users

Users are generally interested in the output of accountancy, i.e. the quality of financial reporting, rather than the process of bookkeeping. The authenticity of bookkeeping records is, however, a key concern to HM Revenue and Customs. Their Enquiry Manual states that one of the first tasks when examining records will be to decide whether they are 'an authentic and contemporaneous statement of the business transactions'.

2.3 Issue - bookkeeping

Professional bookkeeping practices can provide a valuable service to companies and, in so doing help establish a strong foundation for high quality accounting. However, some accountants told us that there is a shortage of bookkeepers who have appropriate skills in accountancy and bookkeeping systems together with a basic level of business acumen. This could result in professional accountants having to spend more time dealing with routine record-keeping (or inquiries into bookkeeping matters raised by tax inspectors) and less time applying their skills to more value added activities.

POBA does not oversee the regulation of bookkeepers and therefore we have not sought to confirm this issue or to investigate possible causes. We note however that future policy decisions, which are a matter for the Sector Skills Development Agency and others, could be usefully informed by more targeted research possibly under the auspices of the professional bodies.

Three – Financial accounting and reporting

Section 226 of the Companies Act requires directors of companies to prepare accounts for each financial year and for the accounts to provide a true and fair view. Directors have a duty to file the accounts, or where eligible an abbreviated version of them, with the registrar of companies. In this chapter we consider the extent to which companies need, and are able to obtain, support in preparing these accounts (section 3.1). We consider the needs of external stakeholders for information as to how companies have fulfilled their responsibilities in this area (section 3.2). We then review the quality of accounts filed at Companies House as a measure of the overall effectiveness of the current arrangements (section 3.3).

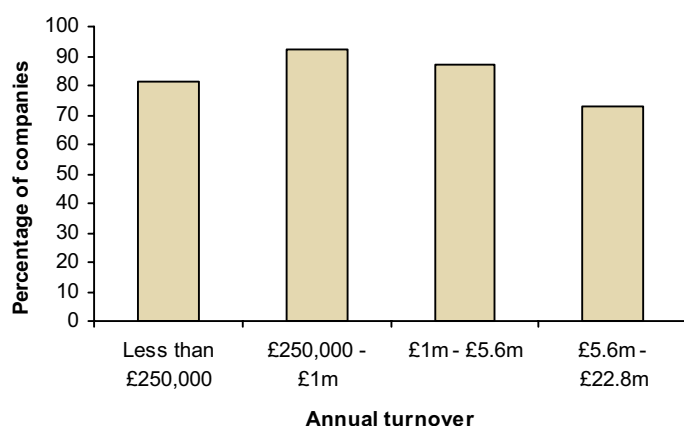
3.1 Needs of companies

75 per cent of accountants reported that small companies experienced problems in this area. However company directors did not see any such problems as significant, with only 4 per cent of companies in our survey reporting significant problems in the area of preparing statutory financial accounts. In this section we consider first the types of external support available to companies, and the level of use of each type. We go on to describe the services available from professional accountants.

Types of external support

Most companies outsource the preparation of their statutory financial accounts. In our survey of companies, 85 per cent reported that they obtained assistance from a firm of accountants with the preparation of their financial accounts (Figure 3.1, below). This level of support is highest at 92 per cent for companies with turnover between £250,000 and £1 million and drops to 73 per cent for medium-sized companies. This question did not specify any particular type of firm of accountants.

Figure 3.1 - Use of assistance from a firm of accountants with preparation of statutory financial accounts

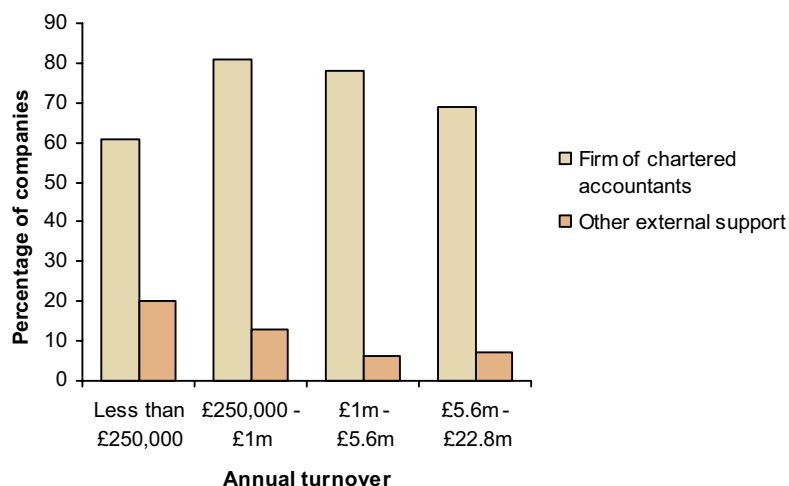


Source: *SERTeam survey*

Between 1967 and 1994 all registered companies were required to use chartered accountants because they were required to file audited accounts. The introduction of audit exemptions in 1994, with subsequent increases in the audit exemption threshold in later years, means that there is no longer any obligation on directors of most small companies to use professional accountants (details of the trend in use of audit exemption are included in chapter five). We examined trends in the use of professional accountants to inform our understanding of how accountants support the needs of companies and their stakeholders.

We asked companies what types of external support they used to help with any aspects of their accountancy work (Figure 3.2, below). In this question in our survey we referred specifically to ‘chartered accountants’ rather than using the term ‘professional accountants’ that could be less familiar to directors. Companies with annual turnover of less than £250,000 were most likely to use support from providers other than chartered accountants. Such providers include around 2,000 practices registered with the largest non-chartered accountancy bodies, being the Institute of Financial Accountants (IFA), the Association of International Accountants (AIA) and the Association of Accounting Technicians (AAT).

Figure 3.2 – Types of external support used for help with accountancy work



Source: SERTeam survey

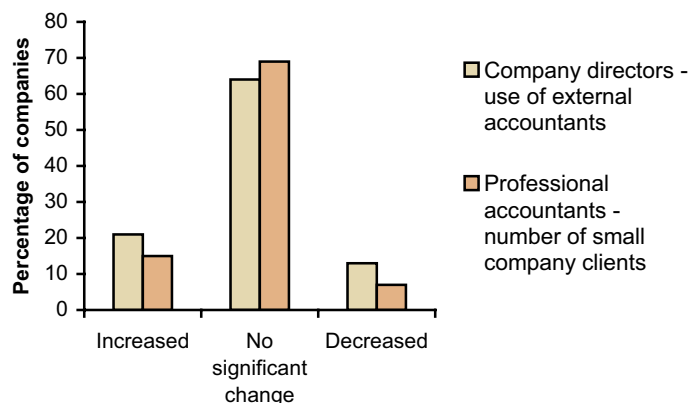
Some companies obtain support from individuals who are trading as accountants but either have not obtained relevant qualifications or have let their membership of a professional body lapse. In our case-study interviews, the accountants used by two companies were retired tax inspectors who were not accountants. Both companies said they were more concerned with the quality of the service provided than the qualifications of the person providing it.

Many of the accountants we met confirmed that their clients were more interested in a good quality, low cost service than the body to which the accountant was a member. One accounting technician told us that he typically charged clients between £500 and £1,000 for their annual accountancy bill, which he said was usually around half of the amount they would be charged by a chartered accountant in that part of the country.

Trend in use of external support

We examined whether there had been a movement away from using professional accountants following the increase in the audit threshold. In our survey of companies we asked directors: ‘Has the amount you use external accountants changed in the past five years?’ 21 per cent of companies had increased their use of external accountants in the past five years compared to 17 per cent that had reduced their use. In our survey of accountants, we asked: ‘Has the number of small companies that your firm has as clients changed as a direct result of the increase in the audit threshold?’ 13 per cent reported an increase in the number of their small company clients as a direct result of the increase in the audit threshold compared to 7 per cent who reported a decrease (Figure 3.3, below).

Figure 3.3 – Changes in use of professional accountants in past five years



Source: SERTeam survey, Business Adviser Barometer survey, ICAEW survey

Our case-study interviews with companies and their accountants found that once a successful relationship between a company and its accountant had been formed, the company was unlikely to replace the accountant. One company had been with the same firm of accountants for 20 to 25 years, another for over 50 years. One said:

We have an excellent relationship with our accountant who has been our accountant both from an audit point of view and as a financial adviser for the last 20 to 25 years. This company in the last 80, 90 years has only ever had three accountants; we seem to inherit long standing accountants so they have a very close understanding of the business.

Director, medium-sized company

Services offered by professional accountants

The needs of companies for support with their financial accounting and reporting vary depending partly on companies' in-house capabilities or their use of external bookkeepers. Professional accountants told us they take the financial records of companies in whatever state these are provided and from these compile the financial statements, making enquiries of the company or its bookkeeper as the accountant considers necessary. We refer to this as a 'compilation service'.

Each of the bodies provides guidance to their members on the compilation of financial statements and on issuing a statement on this work. The guidance differs in respect of the work needed to review or verify the data provided to the accountants:

- ICAEW guidance (which is also adopted by the ICAI) states that when compiling financial information, accountants 'consider the underlying financial records of the entity and make such enquiries of management and undertake such procedures as they judge appropriate'
- ACCA guidance specifies that the accountant is 'not required to make any enquiries of management to assess the reliability and completeness of the information provided' although then goes on to point out that 'professional prudence, however, will lead the accountant to consider undertaking certain procedures to avoid the risk of association with misleading accounts, for example some sort of critical review.'
- ICAS 'best practice' guidance suggests the accountant should carry out certain verification work, including an 'overall analytical review of the accounts together with follow up of any unexpected variances arising, by discussion with management'

The guidance of the different bodies also varies in how members are expected to report on their compilation work. Each includes a sample report that confirms that the accountant has compiled the set of accounts in accordance with the terms of their engagement. Each confirms that the accounts have not been audited or otherwise verified. The guidance varies in respect of when the reports should be used:

- ICAEW guidance does not specify when such a report should be used
- ICAS guidance states that the accountants would normally attach such a report to the accounts
- ACCA guidance states that it is usual for the accountant to make a report, but recommends that 'no report should be included with the filing copy of the financial statements, because such a report would be superfluous for filing purposes'

In our sample of 355 accounts filed at Companies House and the Companies Registry only around 5 per cent of those that were not audited included a compilation report. It is possible that other compilation reports had been issued to company directors but not included with the filed copy.

Notwithstanding the apparent differences between the bodies' guidance, the professional accountants we met from all the bodies told us that they would only put their name to a set of accounts if they were confident that the accounts were not misleading. The work needed to reach this level of confidence varied by client. Some accountants were concerned that companies and users of their accounts had little appreciation of the extent of the work they carried out. One told us:

We are actively discouraging unnecessary audits....We can't put our name to anything that is misleading. We check all bookkeeping and need working papers and supporting information to make sure accounts are accurate. We'd look foolish and lose our reputation otherwise.

Recommendation

Following the introduction of audit exemption, directors of many small companies now have a choice of different types of advisers, from those that have no accountancy training to professional accountants. To help directors to make informed decisions, a clear explanation of the role of professional accountants including their professional obligations and the services they offer is required. The professional bodies, working individually, already promote the services of their members on their websites and elsewhere. We consider they could help directors further by working together to agree a common explanation of the role of professional accountants.

Recommendation 1: The bodies should consider how, on an ongoing basis, the profession can give directors of small companies a clear explanation of the role of professional accountants, including their professional obligations and the services they offer.

Use of FRSSE

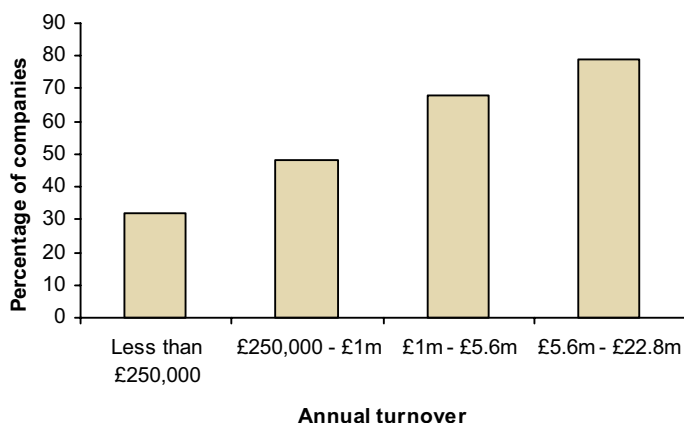
Accountants told us that it is standard to apply the Financial Reporting Standard for Smaller Entities (FRSSE) when preparing accounts for small companies; not least because accounting software designed for small companies is often designed to meet the requirements of the FRSSE. Most of those we met saw the FRSSE as helpful in reducing disclosure requirements but not significantly changing the work involved in preparing accounts.

3.2 Needs of users

In this section we consider the financial information needs of key stakeholder groups. We discuss separately the level of assurance that users can have over this information in chapter five.

Our survey of companies found that a majority of companies with turnover of less than £1 million did not regularly supply their financial accounts to external stakeholders, other than through Companies House (Figure 3.5, below). The case study interviews found that, with the exception of one company, directors thought they gave a copy of their accounts to their bank, whether or not requested to do so. Many of them said they also gave copies of the accounts to potential or existing customers. In most cases the directors said that their accountant sent the accounts to HM Revenue and Customs to support the tax return.

Figure 3.5 – Percentage of companies regularly supplying annual financial accounts to external stakeholders



Source: SERTeam survey

The Institute of Credit Management told us that prior to the introduction of the options to file abbreviated or unaudited accounts the credit industry was able to make fairly safe and more accurate assessments of companies based on financial accounts. Credit providers and agencies now collect data from other sources but may still be left with less certainty that could be reflected in more cautious credit policies.

The British Bankers' Association told us that following the increase in the audit threshold banks do not routinely request annual statutory accounts from their small company clients. The banks meet their information needs primarily by looking at the businesses' financial acumen and free cash flow as evidenced by the operation of bank accounts rather than accounting information. Research looking at the needs of venture capital investors has found that investors generally prefer to rely upon their own procedures and processes when evaluating potential investments, rather than financial accounts.

HM Revenue and Customs requires companies to file a self-assessment tax return annually. Companies and their accountants use accounting data in preparing the tax return and submit a set of accounts with the tax return. HMRC carries out initial checks on the tax return, and following risk assessment will undertake detailed enquiries on some returns. These enquiries are likely to involve requesting financial records that were used to put together the company accounts.

Most small and medium-sized companies can choose to file abbreviated versions of their financial accounts at Companies House. Around 60 per cent of the 355 sets of accounts we examined were abbreviated. This is consistent with our survey of companies where just over half said they filed abbreviated accounts.

The case-study interviews with companies found that the decision to file full or abbreviated accounts was usually made by the accountant, with directors being somewhat disinterested in the choice made. Two directors said that they had 'nothing to hide' but one had still left the accountant to file abbreviated accounts. Another said:

I think [we file] just abbreviated accounts...I think the assumption was that you give as little information in terms of detail about your costs and income as possible just on the basis [that] competitors maybe could look it up. So why give away more information than you need to give?

The accountant for another small company usually filed abbreviated accounts for clients:

[We file] Abbreviated because the clients want as little information going to Companies House as possible. [With] competitors, creditors and customers seeing it... they want the minimum amount of information as possible [filed].

Recommendation

Many company directors appear to see the choice of filing full or abbreviated accounts as a technical matter to be decided by their accountant. Professional accountants may in this situation recommend filing abbreviated accounts, to avoid any risks associated with divulging information unnecessarily. For some companies, however, filing abbreviated accounts could have additional commercial implications. We consider the profession could help directors by working together to agree a common explanation of the implications of filing full or abbreviated accounts.

Recommendation 2: The bodies should consider how, on an ongoing basis, the profession can give directors of small companies a clear explanation of the implications of filing abbreviated or full accounts.

3.3 *Quality of accounts*

To help assess the effectiveness of the existing accounting arrangements in this sector we reviewed the quality of accounts filed at Companies House and the Companies Registry. This involved a high level review of the primary statements and notes and any other information included within the financial statements. We selected 185 sets of accounts of companies in England and Wales, 85 companies in Scotland and 85 in Northern Ireland. Within each of these groups we selected companies based on company registration numbers that were generated at random. Of the 355 filings, 75 were reviewed by POBA and 280 by the bodies (the ACCA, ICAEW, ICAI, and ICAS) under our supervision.

The review included the following steps:

- Check that company name, number and the year-end were clearly displayed with the year-end consistent throughout;
- Summation of the financial statements via casting and cross-referencing the primary statements and notes;
- Check that the Directors' Report had been signed and dated and included the necessary wording in accordance with the Companies Act;
- Check that the auditor's report contained all the necessary statements, and note whether for non-audited accounts, the Bodies' recommended compilation statement had been used;
- Check that notes to the accounts were in accordance with the FRS/FRSSE requirements;
- General examination of the accounts with respect to clarity and user friendliness, including whether prior year comparatives were displayed where necessary, whether the units of the figures and currencies were noted and whether figures were appropriately recorded as positive or negative.

The majority of accounts reviewed were generally informative but appeared to include some technical disclosure or minor computational errors. In many cases, notes to the accounts were not fully compliant with relevant accounting standards. Examples included: on the fixed asset note, depreciation rates not being detailed; on the stock note, no statement on whether the stock balance was recorded at the lower of cost or net realisable value; on the deferred tax note, no details of opening or closing balances; and on the pensions note, no record of cost or any outstanding or prepaid amounts for the period.

A sizeable minority of the sets of accounts examined by POBA and the bodies appeared to include more significant technical issues, material computational errors or other evidence of a lack of care in preparation that, taken together, could undermine the usefulness of the accounts. Examples included: balance sheets not balancing by a material amount; prior year adjustments when the company was incorporated during the period reported; and in audited accounts, called up share capital exceeding that authorised.

Problems with the quality of accounts filed at Companies House were found across sets of accounts where no professional accountant was named, where a professional accountant was named but no audit carried out, and audited accounts. Similarly problems were found across sets of accounts prepared by all types of firms, from sole practitioners to the 'big four'.

Far too many accounts which had been prepared with the involvement of professional accountants showed a lack of care in preparation. If company directors and users of their accounts are to value the involvement of professional accountants, it is vital that the quality of professional accountants' work is more consistently high. The bodies worked with us during this review and shared our concerns. The bodies are taking the following actions to improve the situation:

- To advise their members in practice to take appropriate, and early, steps to review their existing quality control procedures;
- To investigate the root causes of the issues, prior to raising awareness of important issues amongst members in practice and providing appropriate technical and practical support;
- To review and modify quality assurance programmes through which the quality procedures of members firms are reviewed; and
- To carry out further sampling and desk-top reviews of accounts filed at Companies House as a means of monitoring improvements and identifying further issues that may emerge.

We consider that these actions are appropriate and should help to achieve consistently high quality work. We will monitor progress both through our ongoing oversight of the monitoring of audit practices by the bodies and consideration of the results of the further desk-top reviews that the bodies will undertake.

Recommendation 3: The bodies should take steps (including those they have proposed) to help improve the quality of financial accounts which have the involvement of their members. The bodies should keep POBA informed on the steps being taken and should report formally to POBA on the effectiveness of these steps in April 2007.

Four – Financial management

Directors are required by the Companies Act to carry out their duties with a reasonable degree of skill and care and most company directors require financial information to help them to run their business effectively. However, as most are non-accountants, few can be expected to have any significant degree of skill in accountancy matters. It follows therefore that many will need support in using financial information to run their businesses. This need was well expressed by practitioner and ICAEW council member, Mark Spofforth:

What we have forgotten is that accountancy is a language, a means of communication, and a means of informing. It is all very well to construct from that language a work of great literature, but most of the people we are communicating with do not even understand our arcane language. We have got to get back to using it for the purpose it was invented: to help us to measure, interpret and analyse, make decisions, and solve problems.

So we, the accountants, have got to stop spending so much time producing and checking clever numbers. We've got to start using our expertise in interpreting the numbers. We've got to start to teach the language, to spend more time in sharing our expertise with business, more time in helping to grow small businesses, helping them to achieve their objectives with the least stress.

Excerpts from seminar run by Mark Spofforth, quoted in Paul Dunn & Ron Baker, *The Firm of the Future*, 2003, John Wiley

In this chapter we consider the extent to which company directors need, and are able to obtain cost-effectively, support with their financial management needs (section 4.1). We then briefly consider the needs of external stakeholders for information about how companies meet their financial management needs (section 4.2). Finally we consider issues in relation to financial management (section 4.3).

4.1 Needs of companies

Around 70 per cent of accountants reported that small companies experienced problems in the area of understanding and interpreting their statutory financial accounts. Most company directors did not appear to see any such problems as significant, with only 5 per cent of companies in our survey reporting significant problems in the area of management accounting including budgeting and planning.

Overall, 20 per cent of companies in our survey obtained assistance from a firm of accountants with management accounting. This level of support was highest at 26 per cent for companies with turnover between £250,000 and £1 million and dropped to 11 per cent for medium-sized companies.

A common theme across the research strands and previous research was that few small and medium company directors find their annual statutory accounts useful for internal management purposes. This reflected the complexity of these statements and the fact that they are usually prepared well after year-end, by which time they are often seen as too out of date to assist in managerial decision making. Most professional accountants we met also provide more straightforward and, in some cases, timely reports, often described as trading accounts, as part of their standard accounts preparation service. The extra cost of producing two formats of accounts was usually low, we were told, because they were produced from the same accounting system. One accountant told us:

Statutory accounts have a significant value to external stakeholders – but not to most owner-managers. [For internal use] the focus should be on producing information that is relevant to the business, which is very much industry and client specific. So it is right that there is a single format for statutory accounts and accountants supplement this with something unique for the client.

Professional accountants told us that they also offer to help their clients to understand their accounting information. Some, particularly those from larger practices, told us that they insist on a meeting with their clients to review the accounts rather than sending accounts out in the post. Others, often from smaller practices, would offer to talk through the accounts and make suggestions, although many clients would choose not to take up this offer. An accountant supporting the licensed trade sent accounts in the post but would follow-up by phone to discuss any issues such as where figures varied from industry norms. He suggested that practices with specialist sector expertise were better equipped to efficiently help clients to use financial information.

In comments made when responding to our survey, some company directors gave further insights into how the accountancy profession could support their needs more appropriately. Many comments were very positive but lower charges, better service and less regulation were also common themes. Among the suggestions made by directors were:

Be more proactive and ideas driven rather than just bookkeepers.

I think the accountancy profession should try to hold back on the extras and get the basics right first.

Significantly reduce the use of accountants' nomenclature - use words the layman understands.

We also asked accountants for their views on how the profession could support the needs of companies more appropriately. Common themes included need for less regulation of financial reporting for smaller companies, less regulation of accountancy practices, closer working relationships between accountants and their clients and providing more training for client staff. Among the more specific suggestions made by accountants were:

Need to better identify and market the application of professional accountancy expertise to businesses that fall below the audit threshold and help them become more effective and profitable, not just maintaining accurate historical records that have limited value.

Transfer their skills to the business at an affordable/ grant funded price. This includes systems development, reporting development and administration training.

Publicise its members' quality due to regulation procedures, and the range of services most accountants can provide.

Computerised accounting systems

In our case study interviews, many companies seemed adept at using their computerised accounting systems to produce the information they considered they needed to run their businesses. In many cases these systems were set up in conjunction with their accountants. As one director put it:

It's basically an in-house thing which was recommended by our accountants... we were able to say what our needs were when we changed from a manual accounting system to computerised... It's an adapted system which gives us our management accounts. All our financial director does is punch in the figures and out it pops.

Company director, 101-150 employees

In other companies that had not yet put in place computerised accounting systems, directors were less likely to be able to generate monthly management accounts or other reports. They were more likely to focus on simple, readily available information, typically sales figures and cash balances:

I have an on-line bank facility... So I can see what's coming in and out every day... The other tool that I use on a daily basis is a record of our sales against our budget and last year.

Company director, 31-40 employees

Nearly all the companies interviewed appeared to monitor closely the latest information against target or the previous period, although this analysis was often not well-documented. The directors appeared to maintain close control through their detailed knowledge and experience of the business, rather than spending time maintaining detailed formal systems of control.

Views of business advisers

To obtain an informed, external perspective of the effectiveness of the support provided by accountants to companies, we consulted business advisers from outside of the accountancy profession, including advisers from Business Link, Development Agencies and members of the Institute of Business Advisers. The fifteen individuals selected generally had a minimum of five years' experience in providing business advice to mainly companies with turnover between £100,000 and £5 million, with particular exposure to companies that required assistance with financial management.

Business advisers told us that many company directors do not understand the importance and benefits of financial information. Many directors who believe that they have sufficient financial acumen still tend to focus only on short term aspects of performance such as their bank balance. Comprehensive, useful, timely management information is the exception rather than the rule, found in only 10 to 20 per cent of companies. Directors often do not see a need for accountancy support beyond the basic compliance work of preparing annual statutory accounts and tax returns. Most accountants, therefore, provide only statutory accounts and tax services because this is what their clients demand.

On the supply side, business advisers were sceptical about the ability of many accountants to provide effective general financial management support to small and medium companies. Larger accountancy practices were seen as offering excellent practical interpretation and advice, although at a price that is often not affordable or at least not perceived as good value by smaller companies. Accountants in smaller practices were seen by the business advisers as sometimes lacking relevant practical experience, being too focused on compliance and tax matters, and lacking the motivation to work outside of their 'comfort zone'. In the experience of the advisers, some accountants did not offer business advice because of concerns about increased risk and implications for their indemnity insurance. They said:

Generally they are not supportive of SME management information needs or their lack of knowledge. There is little diagnosis undertaken to discover what should be measured and how it can be.

In the main, accountants are there to do the accounts and tax, which they do competently. They could be more proactive in advising the company but that is generally not their brief and not their experience.

Those SMEs that do take an interest in their financial information normally have to try out accountants on a trial and error basis to find one that will help them properly.

In my experience over 14 years, the best clients I have had, and those where I have been most effective, have been those where the accountant and I have shared a common goal and have shared a common trust, to the advantage of all parties.

The business advisers told us that company directors they see need a clearer understanding of the benefits of good financial information. This clearer understanding should lead to a greater appreciation of the value of working with accountants. To help achieve more successful working relationships between companies and their accountants, there would also be a need for accountants to develop their 'softer' skills in client management, and for accountants to work more closely with other support professionals.

4.2 Needs of users

Credit managers were concerned that many small businesses do not have monthly management accounts or forecasting systems in place. This can result in many companies only discovering that they are in financial difficulty when it is too late to remedy the situation.

Banks told us they expect to see management accounts from clients with larger business loans. For at least one bank, the existence of timely management accounts is seen as providing greater assurance that appropriate financial management and control processes are in place in smaller companies than a decision to have the financial accounts audited.

4.3 Issues – financial management

The case study findings have demonstrated that directors of many small companies, supported by their accountants, operate simple but effective financial management processes. Many also benefit from support from their professional accountant in understanding and interpreting financial information, often as part of the standard accounts preparation service. However other directors appear not to appreciate the value of good financial information; these directors do not look for support in understanding or interpreting financial information, often see accounting merely as a regulatory burden and may not have good management information to inform their decision making.

To help these directors to make an informed choice in selecting the financial management support that would best help them to meet their business objectives, a clear explanation of how professional accountants can help businesses to use accounting information to achieve good financial management is required. We consider that the bodies could best help directors by working together to agree a consistent explanation.

Inevitably, some accountancy practices are better equipped to offer support in financial management, including computerised accountancy systems, than others. However if the demand for such support were to increase, we expect more practices will invest in building their capabilities or may form alliances with others to ensure they can satisfy their clients' requirements.

Recommendation 4: The bodies should consider how, on an ongoing basis, the profession can give directors of small companies a clear explanation of how professional accountants can help businesses to use accounting information to achieve good financial management.

Five – Confidence in financial reporting

All companies were required to file audited accounts at Companies House between 1967 and 1994. In 1994 many very small companies with a turnover below £90,000 were given the option to file unaudited accounts. Between 1994 and 2004, progressively higher audit exemption thresholds were introduced with the headline turnover threshold being increased to £350,000 in 1997, £1 million in 2000 and £5.6 million in 2004. By 2004-05 only around 20 per cent of active (i.e. non-dormant) companies were audited, with 160,000 more unaudited accounts being filed in 2004-05 compared to the previous year. Recent increases in filing of unaudited accounts include many new companies and companies that were eligible for exemption in earlier years as well as companies that became eligible following the most increase in the threshold to £5.6 million.

We sought to understand the effects of this significant change on confidence in financial reporting of small companies. Where companies are audited, this confidence should come largely from the audit provided users have confidence in the audit process. By giving companies the choice of whether to have an audit, it is likely that those using audit will appreciate its value and therefore want it done well. In the words of Professor Ian Percy:

It is important that audit is not perceived as an overly expensive overhead, but a cost willingly paid for value rendered both to the audited organisation and to stakeholders auditors are ultimately serving.

Professor Ian Percy, International Journal of Auditing, 2000

However it is also important that users of non-audited accounts are not left with insufficient information to be able to use a set of accounts. Ian Percy told us:

It is clearly important that those who wish to rely on information produced by companies who have the privilege of limited liability and are on the public record have some degree of confidence which is not overly expensive or stifling from the point of view of the company itself.

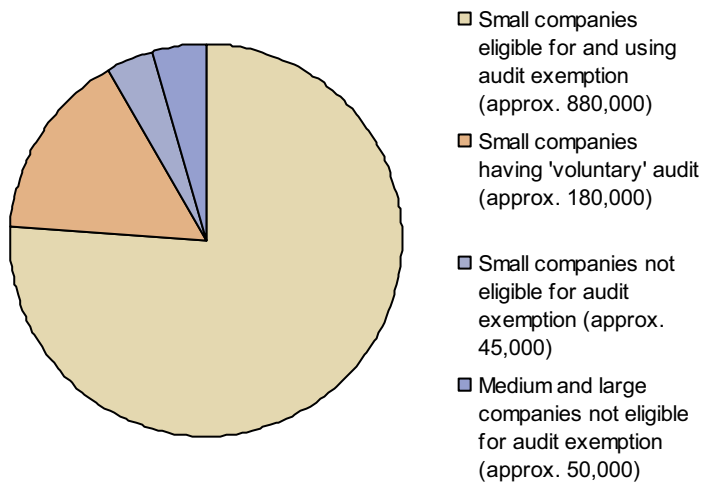
In this chapter we consider first the use of audit by small companies (section 5.1). We consider whether the current arrangements for providing users with confidence in financial reporting meet the needs of key user groups (section 5.2). We then discuss whether the needs of users of non-audited accounts could be better met (section 5.3).

5.1 Use of audit by small companies

Most companies that are 'small' by companies act definitions are also eligible for audit exemption (Figure 5.1, below). We estimate that small companies not eligible include:

- 14,000 with assets over £2.8 million: Eligibility for audit exemption is defined in the Companies Act by a two-stage test: First, the company must be small. Second, the company must also have assets below £2.8 million and turnover below £5.6 million (See Annex B);
- 8,000 in financial intermediation and insurance;
- 20,000 which are part of a holding company where the group would not qualify as small;
- 2,000 public limited companies; and
- 1,000 charities with turnover above £250,000 or £100,000 in Scotland.

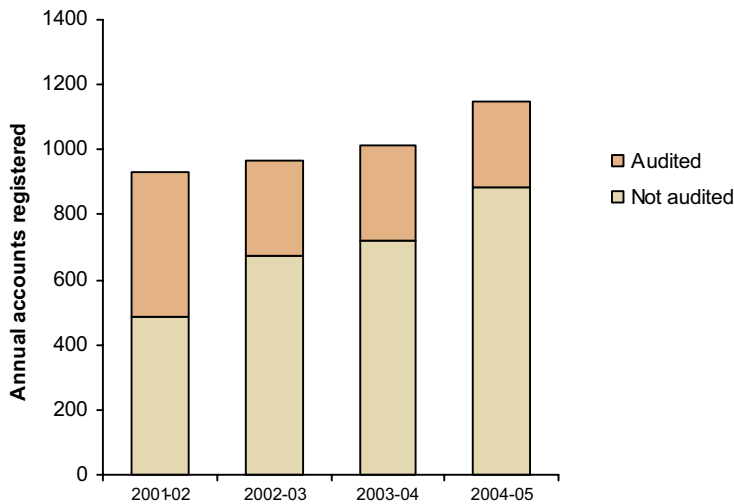
Figure 5.1 – Audit status Great Britain Percent of non-dormant accounts filed at Companies House



Source: POBA analysis based on data from DTI (*Companies in 2004–2005*), HM Revenue & Customs, & FAME

The number of companies audit exemption has grown steadily in recent years (Figure 5.2, next page). In the year to April 2005 around 80 per cent of eligible small companies used the exemption.

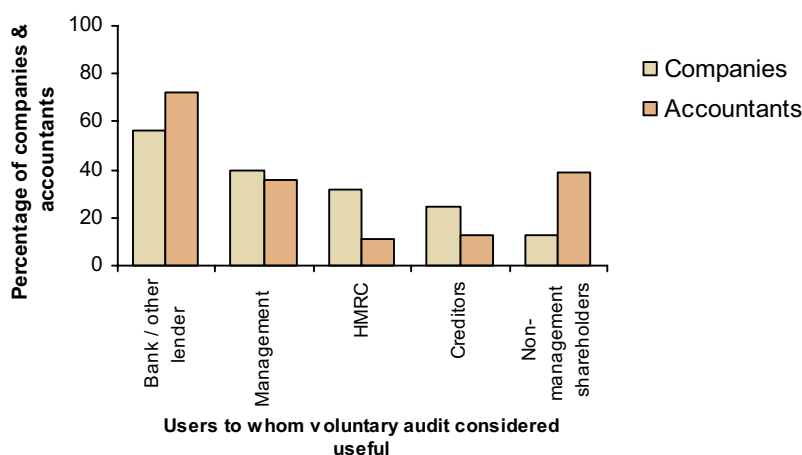
Figure 5.2 – Annual accounts registered at Companies House by type, 2001-02 to 2004-05 (excludes dormant companies)



Source: Department of Trade and Industry, *Companies in 2004–2005*

Around 180,000 companies that would qualify for audit exemption chose to have an audit in 2004/5. Reasons for this decision to have a ‘voluntary’ audit are summarised in Figure 5.3, below. This figure compares the views of company directors with those of accountants, based on our surveys.

Figure 5.3 – Reasons for voluntary audits



Source: SERTeam survey, Business Adviser Barometer survey, ICAEW survey

In our case-study interviews with companies, the value of the audit to outside investors, either current or potential, was apparent among those still being audited. Directors said:

I suppose the unspoken rationale [for the voluntary audit] is that if we come to sell the company it's a lot easier to sell a company with audited financial statements.

[Name of audit partner] asked us about that [voluntary audit] quite early on and said... "You don't have to do this, but if you do it, it won't cost you that much because we already know the systems and everything... You may want to ask the board, but I wonder, given the nature of the investors that you have [syndicate of business angels] and the fact that at some point you might want to sell the company, doing this kind of thing might be a good practice to get into." We spent about 5 seconds thinking about it and thought "Yes".

Professional accountants told us that following the increases in the audit threshold, many of their clients who were eligible for exemption had weighed up the costs and benefits of audit. Those continuing generally see the audit as a cost-effective solution to their internal needs and those of their stakeholders, and wanted the audit to be done properly – meaning (according to these accountants) independently and thoroughly. Some accountants suggested that having recognised the value of the audit, company directors were willing to invest more to use a firm with a strong local reputation in audit work.

Although most small company clients who are still audited appreciated the value of their audit, some accountants were concerned that audits for small companies that did not qualify for audit exemption because their assets were worth over £2.8 million were sometimes not seen as useful. These included audits for some farms, nursing homes and property investment companies. Based on FAME, we estimate that around 14,000 small companies have assets over £2.8m. We note that future policy decisions in this area, which are a matter for the Government, might be usefully informed by more targeted research possibly under the auspices of the professional bodies.

Professional accountants told us that the most common driver for stopping audit was an absence of external stakeholders for whom the audit could be helpful. Some general business advisers told us that directors of small companies they worked with could not see the point of paying a firm of accountants to prepare and then audit its own work. Advisers told us that an independent audit was seen by their clients as more likely to identify errors as well as providing greater comfort to users of the accounts.

Although directors of many audited companies appear well informed on the value of their audit, our surveys suggested some confusion amongst company directors over both their eligibility for audit exemption and their use of the exemption. In the year to April 2005 around 80 per cent of eligible small companies used the exemption. However, in our survey of companies, only 25 per cent of directors of small companies reported they were filing unaudited accounts at Companies House. Some 25 per cent of directors of small companies believed that their company was not eligible for exemption.

Directors of many small companies appear to be unclear whether they are filing audited or unaudited accounts, and some appear to believe that using a professional accountant means that the accounts are audited. Certain user groups, particularly credit managers, do look for an audit and may be more cautious in the absence of it. To help directors to make informed decisions, a clear explanation of the implications of filing audited or unaudited accounts is required. We consider that the professional bodies and their members could help directors by working together to provide such an explanation.

Recommendation 5: The bodies should consider how, on an ongoing basis, the profession can give directors of small companies a clear explanation of the implications of filing audited or unaudited accounts.

Audit ethics

One factor in the cost of audit is the regulation of audit work. We sought to understand from the accountants we met the possible impact of implementation of the Auditing Practices Board's (APB) standards on ethics for auditors. Most had not, at the time of our meetings, fully assessed the impact as audits were not yet required to be carried out under the new rules, but in general the impact was not expected to be substantial. The most obvious reason for this was the shift away from audits by the majority of small companies.

A few accountants were concerned about specific independence questions in relation to the new ethical standards; at least some of these questions appeared to us to be straightforward to resolve. We understand that the professional bodies, with the assistance of APB, have provided further guidance to their members in these areas.

The most difficult area seems to be whether auditors should also be allowed to provide accounting services to their audit clients. The result of the survey of companies illustrates the extent to which smaller companies need accounting support. For small companies, 64 per cent of directors reported that an external firm of accountants prepared their annual financial accounts; and 83 per cent reported some assistance with the preparation of their accounts by a firm of accountants. For medium sized companies, 24 per cent of directors reported that an external firm of accountants prepared their annual financial accounts; and 73 per cent reported some assistance with the preparation of their accounts by a firm of accountants. These results do not show explicitly whether that accounting support was provided by the firm of auditors but this is likely. These arrangements would not be prohibited by the APB standards, providing the medium-sized companies had 'informed management' and the auditor had put appropriate safeguards in place. For small companies more general relief is provided in these circumstances by the APB's ethical standard 'Provisions Available for Small Entities'.

5.2 Needs of users

HM Revenue and Customs' Enquiry Manual states that an audit is not required where companies are eligible for audit exemption. The absence of an audit is not seen by HMRC as a valid reason for enquiring into a company's accounts or return. Equally HMRC will challenge audited accounts when necessary. The manual states that 'the audit process normally provides officials with reassurance during the course of an enquiry', but is also notes that 'much audit work is delegated to junior staff, who may not be professionally qualified and [are] probably under training'.

The British Bankers' Association told us that following the increases in the audit threshold their members' operating procedures have changed such that in the vast majority of lending decisions for small companies an audit is not required. One bank bases lending decisions on the operation of existing bank accounts for companies with up to around £4 million turnover who wish to borrow up to around £50,000, and we understand other banks have similar policies. For larger loans, financial accounts may be used to inform the banks' decisions. Banks may also look for evidence of good financial governance including monthly management accounts. As seen in Chapter 4, subsequent to the lending decision, the availability of timely management information can be more important to banks than the availability of audited accounts. The banks may, therefore, be placing less reliance on audits than many company directors and accountants perceive (see figure 5.3) although we understand from our case study interviews that audits are still required by banks to support loan agreements that may have been in place for some time.

Small and medium companies are themselves a significant user group for other companies' accounts. A recent survey for Better Payment Practice Campaign found that around 90 per cent of purchases made by small and medium-sized companies are bought on trade credit. At least two-thirds of small and medium-sized companies check the creditworthiness of prospective customers before granting credit to them. Accountants told us that their clients may use a credit rating agency for this purpose or increasingly may obtain from Companies House or other online sources a set of recent accounts to review.

The Institute of Credit Management considers the audit important in enabling the credit worthiness of a company to be assessed effectively. In the experience of its members, unaudited accounts provide less comfort and may therefore contribute to lower credit scores. The Institute believes that companies filing non-audited accounts will find it more difficult or expensive to obtain credit. The Institute told us:

It is important that end users (particularly credit grantors) have confidence in the financial statements provided. For non-audited accounts, we suggest that accountants clearly define, in simple terms, the level of their involvement at the outset for the user to see. The information will enable the user to attach an appropriate level of credibility to the accounts he/she is scrutinising. It would indicate that a professional accountant has cast an independent eye over the records of the business and would, therefore, give a degree of comfort. If more confidence is not forthcoming, then the cost of trade credit will become more expensive by way of security being sought, or by credit not being offered at all.

The Office of Government Commerce (OGC), an independent office of the Treasury, provides guidance to public sector organisations on the financial appraisal of suppliers⁵. OGC policy is that 'all candidates, whatever their size, should be treated fairly and with equal diligence during the financial appraisal process. Small and Medium-sized Enterprises (SMEs) should not be inadvertently disadvantaged'. The guidance states that suppliers should provide the most recent audited accounts, however where audited accounts are not available, other information should be requested that is 'considered sufficient for a current assessment of a candidate's financial standing'. We understand from some professional accountants that local authorities generally now ask potential suppliers whether their accounts are audited rather than requesting audited accounts, but many company directors interpret this question as a requirement for audited accounts. The OGC told us that although it discouraged unnecessary burdens on SMEs, public sector organisations needed financial information that could be reliably appraised. Therefore the OGC would welcome any proposals which could strengthen the credibility of company accounts in the absence of formal audit.

5.3 *Meeting users' needs for non-audited accounts*

In this section we consider the needs of users of non-audited accounts, including individuals and companies who are considering doing or are already in business with any of the (currently) 880,000 unaudited small companies. We discuss the extent to which the involvement of a professional accountant can give users some degree of confidence in the quality of a set of unaudited accounts, and whether more confidence could be provided without significant extra cost or risk.

Accountants and credit managers told us that directors of small companies do look for the involvement of an independent professional accountant when looking at a set of accounts of another business. Several factors appear however to restrict the degree of confidence that users can attach to such involvement:

- Firstly, the set of accounts may not show clearly what type of accountant was involved. Most professional accountants attach their practice name to any set of accounts they prepare. In our sample of 355 sets of accounts around 75 per cent showed the name of a professional accountant who was a member of a CCAB body although very few showed the name of the professional body. Around 5 per cent showed the name of an accountant who was not registered with any of the CCAB bodies. There was no information about the involvement of any external accountant in the remaining 20 per cent.
- Secondly, where the accounts showed the involvement of a professional accountant, there is a risk that this is not accurate. There have been reports of two types of deception in relation to use of the terms 'chartered' or 'certified' accountants. The first is where accountants call themselves chartered or certified accountants or registered auditor without being appropriately qualified and authorised. In our sample of 355 sets of accounts there was only one case where a firm described

⁵ Office of Government Commerce, 2001, Supplier financial appraisal guidance

itself as an auditor but was not registered with a recognised supervisory body. The second is 'passing off' where the name of a professional accountant is attached to a set of accounts dishonestly. Examples of this are reported from time to time in the accountancy press. We were told by the bodies and others that this was a serious concern both within the profession and amongst users of accounts. It would however be very difficult to measure the frequency of 'passing off' and we did not attempt to do so.

- Thirdly, users are unlikely to have more than a very sketchy understanding of the difference between professional accountants and other types of accountants. For example, users may not appreciate that professional accountants are prohibited by their code of ethics from being involved in accounts which they believe to contain materially false or misleading information.
- Fourthly, there is usually very little information in financial accounts about the scope of the accountant's involvement in the reporting company's accounting work. Without knowing the nature and extent of the accountant's role, the user would find it difficult to form a view on whether the accountant was likely to have identified where information could be materially false or misleading.

Compilation reports

Arrangements by which the role of a professional accountant in a set of accounts can be explained to users already exist in the form of compilation reports. However several factors appear to be limiting the value of compilation reports to users:

- Firstly, very few sets of accounts on the public record include a compilation report. In our sample of 355 accounts only around 5 per cent of those that were not audited included a compilation report. A few others included various forms of 'accountant's report' that typically stated briefly that the accounts were in accordance with the records kept by the company.
- Secondly, even where they are attached, the report and the guidelines it is based on vary between the bodies and this might cause confusion were the reports to be more widely used.
- Thirdly, the wording of the reports gives very little useful information to users of the accounts and does not set out clearly the nature and extent of the accountant's role. The reports state that the accountants have complied with ethical guidance without saying what this guidance requires. Much of the content is in the form of negative statements which describe the limitations of the work undertaken.

Steps needed to give users of non-audited accounts more information

We concur with the sentiment of the Auditing Practices Board's 2001 report, Field Trials of the Independent Professional Review:

The research demonstrates the importance that some stakeholders place on statutory accounts and the important role that external accountants have in assisting many small companies produce them. The research also reveals the effort that many accountants take to ensure that the accounts they help to produce are 'accurate' irrespective of any requirement to undertake either an audit or an IPR. Little, if any, of this effort is explained in normal 'compilation' reports issued by accountants and this highlights the need for the accountancy profession to reassess what ought to be communicated in such reports.

From Foreword to Findings of the Field Trials of the Independent Professional Review, 2001

We consider that users should be provided with a straightforward explanation of the extent and relevance of the involvement of a professional accountant. This could be achieved through clearly explaining what most chartered accountants already do, rather than requiring significant changes to working arrangements thereby involving extra cost, regulation or risk. In particular, we have identified no interest amongst users for a new level of assurance opinion, and believe the introduction of an alternative form of assurance at this time would only lead to confusion.

This explanation could be achieved by rewording the compilation report to include a positive description of the accountants' obligations. The report should also include a description of the scope of engagement, for example identifying whether the firm took a trial balance from the reporting company, or whether the firm also maintained the underlying accounting records. To be effective, we consider this report and the procedures underlying it would need to be common across the professional bodies. Use of the report would remain voluntary, although the bodies would need to encourage its use if users are to become familiar with it.

Some professional accountants were concerned that providing a straightforward description of their professional obligations and involvement in a set of accounts would increase their exposure to litigation. We believe this concern is overstated; the professional obligations are already published elsewhere, and the description of involvement need only be stated in general terms to be useful. Further, given such a service would not be an audit there would be no legal restraint on the preparer reaching limitation of liability arrangements with their client. We understand that many practices are already contracting in this way on a number of services. As use of the service and report would be voluntary, we consider that it preferable that it should be developed and implemented by the bodies rather than by the FRC. Should the bodies be unable to achieve this within a reasonable timescale, the approach should be reconsidered.

Users also need to be confident that where a set of accounts appears to show the involvement of a professional accountant, that this is the reality of the situation. As a supporting measure, therefore, there is a need for improved clarity and security over reporting the involvement of professional accountants when accounts are filed at Companies House. Users should have confidence that where the involvement of a professional accountant is shown this is genuine. Companies House told us that it is happy to work with the profession to find an appropriate way to achieve improved clarity and security. With the introduction of electronic filing of accounts at Companies House, the professional accountant's identity could be recorded, using a registered list of accountants. Firms of accountants could also then check filings made in their name. The accounts might also be able to show the nature of the professional accountant's involvement whether in the form of an audit, the cross-profession compilation report or no report.

To help achieve such arrangements at Companies House, the bodies would need to develop the existing joint register of audit firms to include non-audit practices.

Recommendation 6: The bodies should consider how, on an ongoing basis, users of the accounts of non-audited companies could be given a clear explanation of the extent and relevance of the involvement of professional accountants in the preparation of those accounts. For this purpose, the bodies should consider the use of a cross-profession compilation report that includes a very broad description of the scope of engagement of the professional accountant together with a positive description of professional accountants' obligations.

Recommendation 7: The bodies should consider taking up the offer from Companies House to work with the profession to achieve greater clarity and security over reporting the involvement of professional accountants when accounts are, in future, filed electronically.

Annex A – Introduction to POBA

The Professional Oversight Board for Accountancy (POBA) contributes to confidence in corporate reporting and governance by strengthening the independence and transparency of the regulatory regime for auditing and for the accountancy profession.

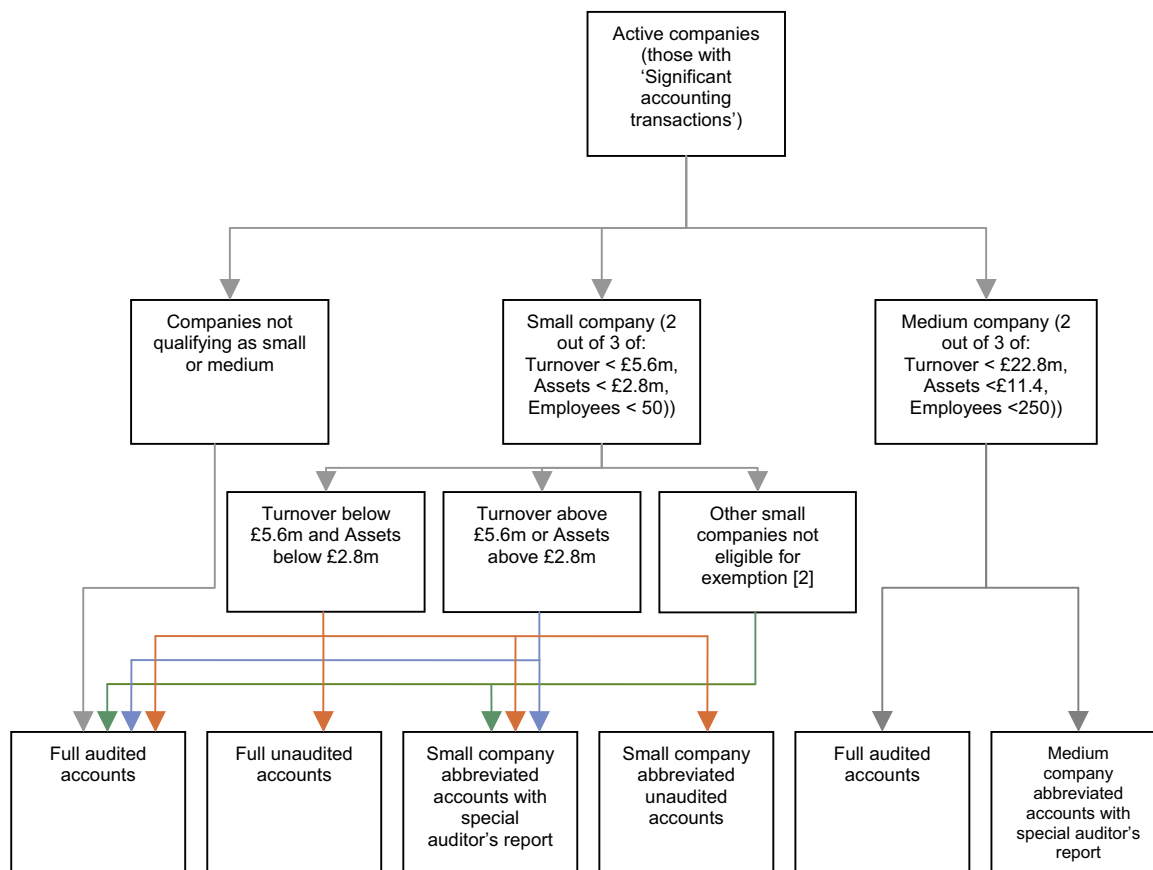
POBA's functions are to:

- Discharge the statutory responsibilities delegated by the Secretary of State for authorising professional accountancy bodies to act as supervisory bodies and/or to offer a recognised professional qualification.
- Monitor the quality of the auditing function in relation to listed companies and any other entity in whose financial condition there is a major public interest.
- Review the regulatory activities of the professional accountancy bodies in relation to their members, including education, training, continuing professional development, standards, ethical matters (except those which are the responsibility of the APB), professional conduct and discipline, registration and monitoring, including making recommendations on how these activities might be improved.

With effect from April 2006, POBA's oversight responsibilities will include actuaries.

In respect of POBA's independent oversight of the regulation of the accountancy profession by the professional accountancy bodies, the CCAB bodies have accepted a commitment to consider carefully POBA recommendations, implement them within a reasonable period or give reasons in writing for not doing so.

Annex B – Companies Act accounting and auditing options for non-dormant small and medium-sized companies (excluding Northern Ireland)



Notes:

1. Companies must be:
 - a. Small or medium-sized in the current year and (if appropriate) the previous year **and/or** the year before that, **or** if not small this year, have been small in the previous year **and** (if appropriate) the year before that.
 - b. If part of a group, the group must also be small or medium-sized as appropriate (special exemption limits apply to groups).
2. Various categories of small companies are not eligible for audit exemption, including:
 - a. Where the company's articles of association require audited accounts.
 - b. Various categories of companies subject to financial services or charities regulation.
 - c. Quoted and other public companies.
 - d. A company where an audit is required by members holding 10 per cent of the issued share capital or 10 per cent of any class of shares.
3. Companies reporting under International Accounting Standards cannot have abbreviated accounts.
4. Diagram excludes dormant companies for which special rules apply.

Annex C - Summary of previous research

The most relevant findings from previously published research are summarised below. Summaries marked with an asterisk are taken with permission from the ICAS publication, *Getting in Shape*, June 1999.

Small Company Financial Reporting, B.V. Carsberg, M.J. Page, A.J. Sindall, I.D. Waring, 1985, Prentice-Hall International

Considered whether accounting standards should apply equally to large and small companies. Found that preparation of accounts was normally left to the auditors. Management, not external users, found to be the most important user of the accounts of small companies, with no practical need for comparability. Companies and their accountants found to be ignoring some reporting standards.

**** Financial Measurement of Small Firms: An Alternative Perspective, Jarvis R et al (ACCA Research Report No. 49, 1996)***

Survey of small firms found that survival and stability were their main objectives: they were more interested in cash flow than profitability measures, and therefore the performance measures used by large firms were irrelevant to them. Cash flow information is easier to obtain and important to third parties.

**** The Uses of the Accounts of Small and Medium-Sized Companies and the Effects of the Audit Exemption Regime, Cliff Pratten (ICAEW, 1997)***

Generally, the effects of audit exemption seem to have been benign for venture capitalists and bankers. Any increase in the threshold for qualifying for audit exemption could be significant as most of the companies backed by venture capitalists are too large to qualify for audit exemption. Credit managers were the group that were most concerned by audit exemption and the use of provisions for submitting abbreviated accounts.

Breaking the Code... A Better Reporting Framework for Small Companies (1998)

Consultation paper from the ICAS Small Companies Working Party, identified key information needs in order to provide assurance to users of small company accounts, taking into account the ability of different user groups to obtain information above and beyond that in the published accounts.

Accounting for Growth: Ways Accountants Can Add Value to Small Businesses, David Kirkby et al (1998)

Small business owner-managers saw little opportunity, in general, for their external accountant to add value by helping to develop the business. This could be because they perceive some inadequacy in the accountancy services they receive or, perhaps more likely, they are content with their existing level of support.

** The Provision of Financial Information to Smaller Companies by Small Accounting Practitioners: a Survey, Marriott N & Marriott P (ICAEW, 1999)*

Many owner-managers of smaller companies have limited financial awareness. As they do not understand all the financial information they receive, they are reluctant to request any more than the minimum necessary to comply with the statutory requirements. These companies are not prepared to pay for additional financial information.

How owner-managers use accounts, Jill Collis & Robin Jarvis (ICAEW, 2000)

Statutory accounts of small companies are not considered to be particularly useful for managing the company, but the majority of directors receive management advice or further analysis at the same time. The majority of small companies have a computerised or partly computerised accounting system and this is positively associated with the frequency or availability of management information.

The Financial Management of the Small Enterprise, David Deakins et al (ACCA, 2001)

External advice is sought in response to problems rather than as a balanced development of financial management capability. Larger and older firms showed more use of financial management, suggesting that necessity or 'shock' may be a more likely explanation for take-up of such techniques than conviction by reason.

The Demand for the UK Small Company Audit, Jean-Lin Seow (International Small Business Journal, 2001)

Companies that had non-director shareholders, remote from the day-to-day operations of the company, were more inclined to choose to be audited. The majority of company directors made the decision engage / disengage auditing jointly with their auditors.

Financial Management Practice Amongst SMEs, Tony Berry et al (Manchester Metropolitan University, 2002)

There is considerably variety in financial management practices in small firms, with some owner-managers capable of adopting sophisticated approaches, including full strategic and financial planning methods. The relationships between owner-managers and external advisers are important factors behind these capabilities.

Financial information and the management of small private companies, Jill Collis and Robin Jarvis (Journal of Small Business and Enterprise Development, 2002)

There is a strong emphasis on controlling cash and monitoring performance in the context of maintaining relationships with the bank. The most widely used and most useful sources of financial information are the monthly/quarterly management accounts and cash flow information in various forms.

The Development of Little Gaap in the UK - Evidence from the Directors of Small Companies, Jill Collis & Robin Jarvis (Kingston University/ ACCA, 2002)

There are a range of reasons for the financial reporting choices made by small companies and the accountant plays an important role in influencing the decision in connection with the type of accounts filed

and whether to adopt the FRSSE. However, professional advice plays a minor role with regard to the audit decision.

Accounting and financial reporting guidance for small enterprises, S. Sian & C. Roberts (University of Aberdeen, 2003)

SMEs do maintain accounting records, with many using computerised packages or spreadsheets. However, financial awareness of owner-managers varies significantly, and most rely upon their accountants to provide financial services and commonly to prepare their financial statements.

Directors' Views on Exemption from the Statutory Audit, Jill Collis (DTI, October 2003)

The main reason for filing unaudited accounts was lower accountancy fees, but very few directors were able to report the specific amount saved. Of those that did, the typical reduction in fees was £1,000. The main reason for voluntary audit was that it provides a check/assurance for third parties.

Barriers and catalysts to sound financial management systems in small sized companies, S. McChlery et al (CIMA, 2004)

The accounting profession was not scored highly by companies in relation to adding value, with an apparent over-emphasis on financial reporting and year-end accounts and little assistance on management accounting information, systems and business strategy development. There was a high preponderance of financial accounting systems but less uptake of management accounting systems, particularly among smaller businesses.

Annex D – History of development of relevant policy and regulation

1967	Companies Act requires small companies to file audited accounts at Companies House.
1979	Qualified audit opinion for small companies (“Example 6”) introduced. This allowed auditors to refer to their reliance on management assurances where internal controls were not present, making a less serious qualification (a “subject to” true and fair opinion, rather than a disclaimer of opinion). Abolished by Auditing Practices Committee in 1989.
1981	EEC Fourth Directive allows member states to exempt all “small” companies from audit. Government decided to retain the audit requirement.
1981	Companies Act permits small companies to file abbreviated accounts at Companies House
1994	Introduction of audit exemption (turnover test £90,000). Companies with a turnover between £90,000 and £350,000 were given the option of filing a simpler audit exemption report (AER) in place of the full audit report.
1997	Audit exemption turnover test increased to £350,000; audit exemption report abolished.
1997	Introduction of Financial Reporting Standard for Smaller Entities (FRSSE)
1998	Financial Management Working Group, which included accountancy bodies and firms, banks and HM Treasury, reported that business owners were unaware of the value of improving their financial management. It recommended the development of financial ‘health checks’ designed to assist businesses to assess their financial management skills and the provision of a wide range of business services by accountants including training.
2000	Audit exemption turnover test raised to £1 million
2000	Auditing Practices Board trials Independent Professional Review as an alternative, less costly, form of assurance to the audit.
2000	As part of Company Law Review, Government consults over simplified format and content requirements for small company accounts.
2004	UK audit exemption turnover test raised to £5.6 million
2004	Government and Accountants’ Working Group recommended more specific ‘health checks’ to help businesses to assess their financial requirements and strategies, and the introduction of a ‘SME Funding Adviser identifier’ to help SMEs and funding providers to identify appropriately skilled accountants and other advisers.
Dec 2005	European Parliament votes to increase maximum possible audit exemption thresholds by 20%. Small companies would be defined as having turnover of up to €8.8m, up from €7.3m. The figures for medium sized companies are €35m, an increase from €29.2m.

Annex E –Individuals and organisations involved in the review

In addition to those responding to our survey and participating in interviews, we acknowledge with thanks the input of the following:

2020 Innovation Group Ltd
ABA Limited
Association of International Accountants
The Association of Chartered Certified Accountants
Association of Accounting Technicians
British Bankers Association
The Chartered Institute of Management Accountants
Companies House
Digita International Ltd
FD Solutions Limited
Financial Services Authority
Graydon UK Limited
Grant Thornton
HM Revenue and Customs
David Hunt
Institute of Business Advisers
Institute of Certified Bookkeepers
Institute of Chartered Accountants in England and Wales
Institute of Chartered Accountants in Ireland
Institute of Chartered Accountants of Scotland
Institute of Credit Management
Institute of Financial Accountants
Insolvency Practices Council
International Federation of Accountants
Dr Julia Smith, Cardiff University
Julian Spencer-Wood, University of Greenwich
Mercia Group Limited
MYOB UK Limited
Nottingham University Business School UK Business Adviser Barometer
Office of Government Commerce
Professor Mike Page, University of Portsmouth
Professor Ian Percy
Sage (UK) Limited
Small Enterprise Research Team, Open University Business School
Society of Professional Accountants
SWAT Limited
Professor Stuart Turley, University of Manchester

Annex F - Glossary of key terms and abbreviations

Abbreviated accounts	For a small company, includes an abbreviated balance sheet and notes, and a special auditor's report (if appropriate). For a medium-sized company, includes the abbreviated profit and loss account, full balance sheet, special auditor's report, directors' report and notes to the accounts.
ACCA	Association of Chartered Certified Accountants
Accounting technicians	Members of the Association of Accounting Technicians who provide support to companies in general accountancy services.
Bookkeepers	Individuals who provide support to companies in keeping accounting records.
CCAB	Consultative Committee of Accountancy Bodies
Companies House	Executive Agency of the Department of Trade and Industry that incorporates and dissolves limited companies in England, Scotland and Wales, examines and stores company information delivered under the Companies Act and related legislation, and make this information available to the public.
Companies Registry	Part of the Department of Enterprise, Trade and Investment in Northern Ireland. Registers, maintains and provides information on companies.
Dormant companies	A company is dormant if it has had no 'significant accounting transactions' during the period, which means no entries in the company's accounting records.
FAME	A database that contains information for companies in the UK and Ireland.
Full set of accounts	Includes a profit and loss account, a balance sheet, and auditor's report (if appropriate), a directors' report, notes to the accounts, and group accounts (if appropriate).
HMRC	HM Revenue and Customs, the UK's tax authority formed following the merger in 2005 of Inland Revenue and HM Customs and Excise Departments.
ICAEW	Institute of Chartered Accountants in England and Wales
ICAI	Institute of Chartered Accountants in Ireland
ICAS	Institute of Chartered Accountants of Scotland
Medium-sized companies	To be a small company, at least two of the following conditions must be met: Annual turnover must be £22.8 million or less; the balance sheet total must be £11.4 million or less; the average number of employees must be 250 or fewer. See also Annex B.
Small companies	To be a small company, at least two of the following conditions must be met: Annual turnover must be £5.6 million or less; the balance sheet total must be £2.8 million or less; the average number of employees must be 50 or fewer. See also Annex B.



FINANCIAL REPORTING COUNCIL

5TH FLOOR

ALDWYCH HOUSE

71-91 ALDWYCH

LONDON WC2B 4HN

TEL: +44 (0)20 7492 2300

FAX: +44 (0)20 7492 2301

WEBSITE: www.frc.org.uk