AUDIT EXEMPTION - WHAT THE LATEST CHANGES MEAN

Changes have been introduced to the rules on audit exemption by the Companies and Limited Liability Partnerships (Accounts and Audit Exemptions and Change of Accounting Framework) Regulations 2012.

Applicable date

These Regulations came into force on 1 October 2012 and apply to financial years ending on or after that date. Companies will be able to extend their financial year ends to take advantage of the change in the rules to audit exemption provided they satisfy the conditions contained within section 392 of the Companies Act 2006 eg they have not extended their accounting reference period in the previous 5 years. More information at: www.legislation.gov.uk/ukpga/2006/46/section/392.

Audit exemption – Small company test applies

The change from 1 October widens the exemption from audit for private companies to provide that a non-group company must only meet the general small company definition for accounts and reports to qualify for the exemption. Prior to that date, the company had to also separately satisfy additional turnover and balance sheet total criteria. The need to separately meet those two other criteria has been removed.

Small company definition

This definition is contained in section 382 of the Companies Act 2006. This states:

1. A company qualifies as small in relation to its first financial year if the qualifying conditions are met in that year.
2. A company qualifies as small in relation to a subsequent financial year:
   a) if the qualifying conditions are met in that year and the preceding financial year;
   b) if the qualifying conditions are met in that year and the company qualified as small in relation to the preceding financial year;
   c) if the qualifying conditions were met in the preceding financial year and the company qualified as small in relation to that year.
3. The qualifying conditions are met by a company in a year in which it satisfies two or more of the following requirements:
   (i) Turnover - Not more than £6.5 million
   (ii) Balance sheet total - Not more than £3.26 million
   (iii) Number of employees - Not more than 50.

The maximum figure for turnover must be proportionately adjusted where the period is not a year. The balance sheet total means the total of fixed and current assets in the company’s balance sheet (total assets with no account taken of liabilities). The number of employees means the average number of persons employed by the company in the year, determined as follows:

a) find for each month in the financial year the number of persons employed under contracts of service by the company in that month (whether throughout the month or not),
   b) add together the monthly totals, and
   c) divide by the number of months in the financial year.
A parent company qualifies as a small company in relation to a financial year only if the group headed by it qualifies as a small group. Therefore, for a company which is a parent undertaking, it must also head up a small group in order to take advantage of audit exemption. The small group criteria are as follows:

(i) Aggregate turnover - Not more than £6.5 million net (or £7.8 million gross)
(ii) Aggregate balance sheet total - Not more than £3.26 million net (or £3.9 million gross)
(iii) Aggregate number of employees - Not more than 50.

Likewise, where a small company is a subsidiary company then it must also be part of a group which is small and not ineligible in order to be able to take advantage of audit exemption. (However, please also refer to details of the new exemption for subsidiary companies which has been included below.) The aggregate figures are ascertained by aggregating the relevant figures determined in accordance with section 382 for each member of the group. In relation to the aggregate figures for turnover and balance sheet total - “net” means after any set-offs and other adjustments made to eliminate group transactions.

a) in the case of Companies Act accounts, in accordance with regulations under section 404,
b) in the case of IAS accounts, in accordance with international accounting standards; and
“gross” means without those set-offs and other adjustments.

A company may satisfy any relevant requirement on the basis of either the net or the gross figure.

The figures for each subsidiary undertaking shall be those included in its individual accounts for the relevant financial year, that is:

a) if its financial year ends with that of the parent company, that financial year; and
b) if not, its financial year ending last before the end of the financial year of the parent company.

If those figures cannot be obtained without disproportionate expense or undue delay, the latest available figures shall be taken.

The accounting and auditing queries in Issues 116 and 118 of Technical Bulletin feature several examples on audit exemption to illustrate the above changes.

A company cannot be small if it is ineligible or a member of an ineligible group.

**New provision to allow subsidiary undertakings to take advantage of audit exemption**

A new exemption is created from audit for subsidiary companies whose parent undertaking is established under the law of a European Economic Area (EEA) state. Please note however that various conditions must be satisfied in order for the subsidiary company to qualify for the exemption. Principally, the parent company must declare that it guarantees all outstanding liabilities to which the subsidiary company is subject at the end of the financial year to which the guarantee relates, until they are satisfied in full. Various categories of company are excluded from the exemption including quoted companies, some financial services companies and trade unions and employers’ associations.

The parent undertaking must be established under the law of an EEA State and all members of the company must agree to the exemption in respect of the financial year in question. The subsidiary must be included in the consolidated accounts drawn up for that year or to an earlier date in that year by the parent undertaking in accordance with the provisions of the Seventh Directive or International Financial Reporting Standards (IFRS). The parent undertaking must disclose in the notes to the consolidated accounts that the company is exempt from the requirements of this Act relating to the audit of accounts by virtue of this section, and the directors of the company must deliver to the registrar on or before the date that they file the accounts for that year the relevant supporting documents.