

Change in company size thresholds (Lecture A863 – 12.40 minutes)

On 18 March 2024, the government announced its first set of planned regulatory changes that are designed to ease the burdens placed on businesses in respect of non-financial reporting.

Many would agree that regulation over financial reporting and auditing has increased significantly over the last few years. The government are conscious that increased regulation has a cost to it and given the challenging economic climate, increased costs are something which businesses are actively trying to avoid where possible.

The government intend to lay legislation in the summer of 2024 to increase the size thresholds which determine the size of a company. The 50% increase in the monetary thresholds aim to cut complexity and burden from legislative reporting requirements and it is expected that:

- 5,000 large companies will be reclassified as medium-sized to access more proportionate reporting;
- 13,000 medium-sized companies will fall into the small companies' regime enabling them to benefit from potential audit exemption and filing simpler accounts (see **7.3** below); and
- 113,000 small companies will fall into the micro-entities' regime to allow them to prepare simpler accounts.

If the new measures contained in The Companies (Non-financial Reporting) (Amendment) Regulations 2024 are implemented, the table below outlines the revised thresholds:

| Two out of three of: | | Micro | | Small | | Medium | | Large | |
|-----------------------------|--|---------------------|----------------------------|----------------------|----------------------------|--------------------|---------------------------|-------|--------------|
| | | Old | New | Old | New | Old | New | Old | New |
| Annual turnover | | Not more than £632k | Not more than £1m | Not more than £10.2m | Not more than £15m | Not more than £36m | Not more than £54m | £36m+ | £54m+ |
| Balance sheet total | | Not more than £316k | Not more than £500k | Not more than £5.1m | Not more than £7.5m | Not more than £18m | Not more than £27m | £18m+ | £27m+ |
| Average number of employees | | Not more than 10 | | Not more than 50 | | Not more than 250 | | 251+ | |

There are some technical points that are worth recapping on where these thresholds are concerned:

- Turnover is pro-rata'd for a short accounting period.
- Balance sheet total is fixed assets plus current assets (it is not net assets). This is a common misconception and the source of the authority clarifying this is found in the Companies Act 2006, s382(5).
- Employee headcount is based on the **average** number of employees employed under contracts of service by the company in that month (whether throughout the month or not).

Remember, a company's size is determined if it satisfies at least two out of the above three criteria. The thresholds above must be breached for two consecutive years for the classification to be applied.

Impact on audit exemption thresholds

The audit exemption thresholds track the small companies' thresholds and have done so since 2012 when they were both aligned. Hence, if there is a change to the small companies' thresholds, the audit exemption thresholds will automatically change as well.

Further consultation issued by the Department for Business and Trade

On 16 May 2024, the government issued a further Press Release titled *Brexit freedoms used to slash red tape for businesses*.

In that Press Release, the government confirmed that they will consult on raising the employee headcount threshold for medium-sized businesses from 250 to 500. In addition, the government is also consulting on providing an exemption from preparing a strategic report for medium-size companies, which is expected to be welcome.

If the proposals go through as planned, the only primary differences between a medium-sized company and a small company will be audit exemption (which can only be claimed by small companies); and the availability of a less onerous disclosure regime in FRS 102, Section 1A *Small Entities* (which, of course, would not be available to medium-sized entities).

Impact on filing requirements

As noted above, the government estimates that some 13,000 medium-sized companies will fall into the small companies' regime which will enable them to benefit from potential audit exemption and filing simpler accounts.

The filing requirements for small and micro-entities are, of course, going to change following the enactment of the Economic Crime and Corporate Transparency Act 2023 (ECCTA). Small companies will be required to file a directors' report and a profit and loss account; and

micro-entities will be required to file just the profit and loss account (a directors' report will still not be required in a micro-entity's annual accounts).

At the time of writing these notes, secondary legislation is awaited that will specify the form and content of the profit and loss account that will need to be filed at Companies House.

In addition, we are also waiting on confirmation as to whether, or not, the profit and loss account will be available for inspection on the public record. There are provisions in the ECCTA that provide the Registrar of Companies with the option of making the profit and loss account unavailable for inspection. Specifically, section 56 of the ECCTA states:

The Secretary of State may by regulations make provision requiring the registrar, on application or otherwise—

(a) not to make available for public inspection profit and loss accounts, or parts of them, delivered to the registrar under—

Section 443A (micro-entities), or

Section 444 (other small companies);

(b) to refrain from disclosing such accounts, or parts of them, except in specified circumstances.

This was a notable change from the original Bill which did not contain this provision. Hence, it would seem strange for the ECCTA to contain this provision and for the Registrar of Companies *not* to take advantage of it. Time will, of course, tell whether the Registrar decides, through secondary legislation, to make profit and loss accounts of micro-entities and small companies unavailable for inspection or not. Opinion on this is divided – some in the profession think they should be available for inspection on the grounds of the limited liability afforded to incorporated entities; whereas others disagree and state that the profit and loss should not be available for public inspection on the grounds that it may contain commercially sensitive information.

Also, at the time of writing these notes, we are still awaiting confirmation from the government as to when these new filing requirements will take effect. In any event, it is expected that an ample amount of time will be given by the government to transition to the new filing requirements because software providers will need time to update their software for the new filing regime and the systems at Companies House will also need to be changed.

Practical considerations

Many companies will be keen to take advantage of a reduced disclosure regime once they drop into medium-sized, small or micro territory. However, there may also be disadvantages to doing this and companies should consider the bigger picture before jumping ship.

Lenders and financiers may not look favourably on the entity including fewer disclosures in the financial statements just because they can. This may prevent useful information being

conveyed to them. In addition, parent entities may find the consolidation process more arduous if certain disclosures are not made in the financial statements.

Companies should therefore consider the practical pros and cons of preparing simpler financial statements to avoid any contentious issues being raised with interested stakeholders.

In most cases, there will be no issue in preparing financial statements under, say, FRS 102, Section 1A *Small Entities*, but in some cases there could be some issues to resolve first.