

# Small and audit exempt companies and groups

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## Introduction

This factsheet aims to summarise the requirements for:

- 1 qualification as a small or medium company
- 2 qualification for the audit exemption.

### 1 Qualification as a small or medium company

In order to qualify as small a company must meet both the eligibility criteria and qualifying (size) criteria and comply with certain other requirements.

#### Eligibility criteria

A company will not qualify as small if, at the time of approval of the accounts or, at any time within the financial year (even just a part of one day) to which the accounts relate, the company was:

- a public company
- a banking or insurance company.

A group is an ineligible group if any of its members is:

- a public company
- a body corporate (other than a company incorporated in Great Britain) which has power under its constitution to offer its shares or debentures to the public
- an authorised institution under the Banking Act 1987
- an insurance company to which Part II of the Insurance Companies Act 1982 applies.

Companies which would otherwise qualify as small but which are members of ineligible groups can still take advantage of the exemption from including a business review in the directors' report prepared for members and from filing the directors' report at Companies House.

There are now separate and more detailed rules for FSA regulated entities.

A group comprises a parent undertaking and all its subsidiary undertakings determined using Companies Act rules. For eligibility purposes a group therefore comprises the group as a whole, it cannot be restricted to a sub-group headed by an intermediate holding company.

#### Qualifying criteria

The qualifying criteria relate to both the size of the reporting company and the number of financial years for which the size limits are met, or treated as being met.

An individual company qualifies as small in relation to a financial year if it meets the qualifying conditions in that year and in the preceding year.

## Qualifying conditions

An individual company must meet at least two of the following three limits:

- 1 Turnover £6.5m (was £5.6m for p/c prior to 5 April 2008)
- 2 Gross assets £3.26m (was £2.8m)
- 3 Number of employees 50

The number of employees means the average number of persons employed by the company in the year, determined as follows:

- 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)
- add together the monthly totals, and
- divide by the number of months in the financial year.

Where the financial year of a company is shorter or longer than 12 months the amount for turnover is adjusted proportionately.

Once the new size limits apply (periods commencing on or after 5 April 2008), the new size limits are treated as though they have always been in place and the thresholds should be accordingly re-tested in the prior year.

A company is also treated as qualifying as small in the following two situations:

- 1 it qualified as such in the previous financial year or was treated as so qualifying under (2) below
- 2 it was treated as qualifying by virtue of (1) above in the previous year and the qualifying conditions are met in the year in question.

In addition, a company qualifies in respect of its first financial year if it meets the conditions in that year.

The rules can produce some unusual results. In particular, it is important to look at the actual limits each year rather than simply whether 'small company' accounts were prepared. The following example demonstrates how changes in the financial size of a company affect its status.

### Year Size Qualifies as

- |   |       |  |
|---|-------|--|
| 1 | Small | Small (first year)   |
| 2 | Med   | Small (qualified as small in PY)   |
| 3 | Small | Small (was treated as qualifying as small in PY & meets the qualifying conditions in CY) |
| 4 | Med   | Small (qualified as small in PY)   |
| 5 | Med   | Medium (did not meet criteria for CY and PY)   |
| 6 | Small | Medium (did not meet criteria for CY and PY)   |
| 7 | Small | Small (criteria met in CY and PY)  |

(CY = current year, PY = prior year)

## Groups

### Eligibility criteria

A group is an ineligible group if any of its members is:

- a public company
- a body corporate (other than a company incorporated in Great Britain) which has power under its constitution to offer its shares or debentures to the public
- an authorised institution under the Banking Act 1987; or
- an insurance company to which Part II of the Insurance Companies Act 1982 applies.

Companies which would otherwise qualify as small but which are members of ineligible groups can still take advantage of the exemption from including a business review in the directors' report prepared for members and from filing the directors' report at Companies House.

### Qualifying criteria

The qualifying criteria work in a different way. The qualifying conditions apply to a group headed by a parent company, not the wider group. Therefore, the general rule is that a group qualifies as small in relation to a financial year if the group headed by it meets the qualifying conditions in that year and the preceding year.

### Qualifying conditions

The financial conditions for a group are set out below. A group must meet at least two of the following three limits:

1	Turnover	- net:	£6.5m (was £5.6m for p/c prior to 5 April 2008)
		- gross:	£7.8m (was £6.72m)
2	Gross assets	- net:	£3.26m (was £2.8m)
		- gross:	£3.9m (was £3.36m)
3	Number of employees		50

'Net' means after consolidation adjustments. A group can satisfy the relevant requirements on either a net or gross basis or a combination of the two.

The figures taken into account for a subsidiary should be those for the same financial year as the parent. Where the year-ends are not coterminous the figures for the year-end preceding the parent should be used.

A group is also treated as qualifying as small in the following two situations:

- 1 it qualified as such in the previous financial year or was treated as so qualifying under (2) below; or
- 2 it was treated as qualifying by virtue of (1) above in the previous year and the qualifying conditions are met in the year in question.

A group also qualifies in respect of its first financial year if it meets the conditions in that year.

## Qualification for audit exemption

An individual company qualifies for audit exemption in a financial year if it meets all of the following conditions:

- the company qualifies as small in relation to that year for the purposes of section 382(1) to (6) of the Companies Act 2006 (see above)
- the turnover in that year is £6.5m or less (£5.6m for periods commencing before 6 April 2008)
- its balance sheet total for that year (that is, gross assets) is not more than £3.26m (£2.8m for periods commencing before 6 April 2008)
- an audit has not been requested in writing by 10% or more of the members.

Where the financial year is not a year the qualifying threshold for turnover is adjusted proportionately. An effect of requiring a company to qualify as small is that it must meet all the section 382 criteria for two consecutive years as well as the audit exemption criteria (i.e. turnover and gross assets) for the year of the accounts. If a company does not qualify as small then it is not eligible for the audit exemption. There are some other cases where the exemption is not available. In addition to the 'small company' eligibility criteria a company does not qualify for the audit exemption if:

- it is a special register body or an employer's association as defined under the Trade Union & Labour Relations (Consolidation Act) 1992.
- it is permitted by its Articles to take advantage of the audit exemption.
- There are now separate and more detailed rules for FSA regulated entities.

## Groups

A trading company is not automatically disqualified from taking advantage of the audit exemption on the grounds that it was a parent or subsidiary undertaking for all or part of a year. However, the following conditions must be met during the part of the financial year in which it was a member of a group:

- The group as a whole must qualify as a small group and not at any time during the year be an ineligible group (see above);
- The aggregate group turnover in the year is not more than £6.5m net or £7.8m gross (£5.6m net or £6.72m gross for periods commencing before 6 April 2008); and
- The group's aggregate gross assets for the year did not exceed £3.26m net or £3.9m gross (£2.8m net or £3.36m gross for periods commencing before 6 April 2008).

NB: associates are ignored when considering the size limits, other than the inclusion of the cost of the investment in the parent's balance sheet.

When assessing the above criteria the following points should be noted:

- it is the group as a whole that must be considered and not merely a group headed by an intermediate holding company. All UK companies in a group qualify for exemption or none of them. As already noted above the criteria for determining qualification as small are applied differently
- a group can qualify on the basis of the net or gross criteria or a combination of the two
- UK subsidiaries of an overseas parent may take advantage of the exemption in the same way as wholly UK groups (that is the whole group including overseas companies must meet the exemption criteria – not just the UK companies).

## Year ends

The turnover criteria for audit exemption, and for qualification as small, are adjusted proportionately if the accounting period is not one year.

Examples:

### **A small company is a UK registered subsidiary of a US holding company. Is it possible for the UK company to qualify for the audit exemption?**

The short answer is yes, it is possible for the UK company to qualify for the audit exemption. However, both the following conditions would have to be met:

- The whole group of which the UK subsidiary is a part (that is including overseas companies) meets the financial criteria for the audit exemption.
- There are no ineligible companies in the group.
- Both the above points relate to the whole group, not just the group headed by the immediate parent.

### **A group has the following structure:**

Holding Company (Very large)

100% Subsidiary

The subsidiary meets the financial criteria for qualification for the audit exemption. Can the company apply the exemption? Can the company apply the FRSSE and file abbreviated accounts?

The subsidiary cannot apply the audit exemption as the group as a whole does not qualify. However, assuming that the group is not an ineligible group, the subsidiary qualifies as small and may apply the FRSSE and file abbreviated accounts.

### **A group has the following structure:**

Holding Company (Very large)

100% Subsidiary A

100% Subsidiary B

100% Subsidiary C

The group is not an ineligible group. All the subsidiaries individually meet the financial criteria for qualification as small. Are the subsidiaries able to take advantage of the FRSSE and file abbreviated accounts?

Subsidiary C is able to take advantage of the FRSSE and file abbreviated accounts. The example does not provide sufficient information to determine the position for subsidiaries A and B, but Subsidiary B will be able to take advantage of the FRSSE and file abbreviated accounts if the group headed by it (ie subsidiaries B & C) qualifies as small. The same would apply for Subsidiary A, and the A, B, & C group.