



# PREPARING AN AUDIT REPORT FOR MICRO-ENTITIES

GUIDE

September 2018

Audit and Assurance Faculty Helpsheets are now known as 'Guides'. This Guide was last updated in September 2018 and is based on the relevant laws and regulations that apply as at 1 September 2018. The only changes since the last version of the Guide are to the use of the audit report section to reflect the release of Technical Release 01/03AAF (Revised).

## Introduction

This Guide is designed to explain the main changes that are needed to the audit report of a company preparing its financial statements under the micro-entities regime compared to that of a company preparing its financial statements under FRS 102. It does not seek to explain every difference, just the key areas to consider as a result of the differing legal and regulatory requirements.

The micro-entities regime consists of FRS 105 The Financial Reporting Standard applicable to the Micro-entities Regime and The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409) amended by The Small Companies (Micro-Entities' Accounts) Regulations 2013 (SI 2013/3008) and The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015 (SI 2015/980).

Entities eligible to prepare financial statements in accordance with the micro-entities regime are not required by UK legislation to have those financial statements audited and it is expected that the majority of such entities will not require an audit. However, where an audit of such financial statements is requested or required for some other reason, the auditor is required by law to state in their audit report whether the financial statements give a true and fair view.

The financial statements of micro-entities are presumed in law to give a true and fair view even though Section 495(3A) of the Companies Act 2006 expressly prohibits the auditor from requiring additional disclosures that would normally be considered necessary to give a true and fair view where these go beyond the minimum disclosures required by the Companies Act 2006.

The FRC acknowledges this contradiction in the ISAs (UK) and notes that it may lead to a risk that the 'true and fair' audit report may be misunderstood by users as it may not include additional disclosures that would normally be required for the auditor to give a true and fair view. To deal with this matter, auditors have the option of following the guidance in ISA (UK) 210<sup>1</sup> which states that in such circumstances the auditor may include an 'other matter' paragraph highlighting the limitations on the true and fair view.

The example wording in this Guide has been adapted from the company examples in the [FRC's Compendium of illustrative auditor's reports](#).

The guidance in this Guide suggests options for how micro entity audit reports can comply with the requirements of the Companies Act 2006 and International Standards on Auditing (UK).

However, provided that the audit report complies with the applicable requirements, audit firms may prefer alternative ways of presenting the required information.

<sup>1</sup> ISA (UK) 210 (Revised June 2016), paragraph A38-2

## Pervasive changes to the audit report

Certain references to the 'Companies Act 2006' need to be amended to 'Companies Act 2006 as applied to micro-entities'.

## Addressee of the report

The audit report is addressed to its members, the same as for all companies.

## Opinion

The opinion paragraph describes the financial statements, including specifying the titles of the primary statements. However, it is important that the titles of the primary statements precisely match those used by the entity. For a micro-entity, there may not be any notes to reference.

The opening paragraph of the 'opinion' section needs to reflect that the financial reporting framework is UK GAAP (including FRS 105):

The financial reporting framework that has been applied in their preparation is applicable law, and United Kingdom Accounting Standards, Financial Reporting Standard (FRS) 105 The Financial Reporting Standard applicable to the Micro-entities Regime (United Kingdom Generally Accepted Accounting Practice).

The actual audit opinion needs to be amended to reflect that it is a compliance framework not a fair presentation framework. Notwithstanding this change, the auditor is still required by the Companies Act 2006 to state that the financial statements give a true and fair view.

In our opinion, the financial statements are in all material respects:

- properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, specifically FRS 105; and
- prepared in accordance with the requirements of the Companies Act 2006 as applied to micro-entities.

Therefore under section 495(3A) of the Companies Act 2006, in our opinion the financial statements give a true and fair view of the state of the company's affairs as at [date] and of its [profit / loss] for the [year / period] then ended.

## Basis for opinion

Where the auditor has taken advantage of an exemption provided in paragraphs 6.11, 6.12 or 6.13 of the FRC's Ethical Standard for the audits of 'small entities'<sup>2</sup> in relation to non-audit services or partners/statutory auditors joining the entity, the auditor is required to disclose this in the 'basis for opinion' section of the audit report:

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and the provisions available for small entities, in the circumstances set out in note [X] to the financial statements, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## Other matter paragraph

As there is a risk that the audit report using the words 'true and fair' may be misunderstood by users, ISA (UK) 210 states that it may be possible for the auditor to mitigate the potential

misunderstanding through the prominent inclusion of an 'other matter' paragraph addressing this issue.

It is recommended that the following paragraph go immediately after the basis for opinion paragraph:

#### **Other matter – application of true and fair view**

The financial statements have been prepared under the micro-entities regime which does not require the directors or the auditor to consider the inclusion of any disclosures necessary to give a true and fair view where these go beyond the minimum disclosures required by the Companies Act 2006 as applied to micro-entities.

#### **Conclusions relating to going concern**

No specific changes are needed as FRS 105 contains the same requirements in respect of going concern as under FRS 102 and IFRS.

However, where there is a material uncertainty in relation to going concern, while the minimum disclosures required by the Companies Act 2006 as applied to micro-entities do not appear to require specific disclosure of the material uncertainty, this disclosure would still be required by ISA (UK) 570. Therefore, for an unmodified audit report, the financial statements need to disclose adequately the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions.

#### **Other information**

There is no requirement for a micro-entity to prepare a directors' report or a strategic report.

Where there is no other information published with the financial statements of the company, then there is no need for an 'other information' section of the audit report.

If however, other information is published with the financial statements, then the 'other information' section set out in Appendix 1 of the FRC Bulletin needs to be included. The reference to 'except to the extent otherwise explicitly stated in our report' is only required when a voluntary directors' report (or strategic report) has been prepared.

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and **[include this wording only when a voluntary directors' report or strategic report has been prepared: , except to the extent otherwise explicitly stated in our report,]** we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

#### **Opinions on other matters prescribed by the Companies Act 2006**

As discussed above, there is no requirement for micro-entities to prepare either a directors' report or a strategic report.

This means that if no directors' report or strategic report is prepared, the section on 'opinions on other matters prescribed by the Companies Act 2006' is not required.

However, if the micro-entity voluntarily chooses to prepare a directors' report or strategic report, the provisions in section 496 of the Companies Act 2006 still apply. Therefore, the section on 'opinions on other matters prescribed by the Companies Act 2006' set out in Appendix 1 (where just a directors' report) or Appendix 2 (if also a voluntary strategic report) of the FRC Bulletin should be included in the audit report. This includes reporting as to whether the directors' report and/or strategic report have been prepared in accordance with applicable legal requirements even though there are no such legal requirements for micro-entities.

### **Matters on which the auditor is required to report by exception**

If no voluntary directors' report or strategic report is prepared, the following wording should be deleted:

~~In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified material misstatements in [the strategic report or] the directors' report.~~

The auditor's responsibilities for certain other matters we report on by exception in section 498 of the Companies Act have not been amended to reflect the requirements of the micro-entities regime.

There are no disclosure requirements for directors' benefits (remuneration, pensions and compensation for loss of office) for micro-entities. However, the Companies Act duty for the auditor to report on this matter by exception still applies for micro-entities.

Technically the Companies Act 2006 still requires the auditor of micro-entities to report on whether the financial statements were inappropriately prepared in accordance with the small companies regime or whether the directors took small company exemptions the company was not entitled to in relation to the directors' report and strategic report. There is no amended duty for micro-entities.

However, by definition if there were no issues with a company reporting in accordance with the micro-entities regime there would have been no issue if the company had instead taken the exemptions available to small companies.

Where the company has prepared a voluntary directors' report and a strategic report, but not included all of the information that would be required for large and medium-sized entities, the following wording can be used:

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit; or
- the directors were not entitled to prepare the financial statements in accordance with the small companies micro-entities regime and take advantage of the small companies' micro-entities' exemptions in preparing the directors' report and ~~from the requirement to prepare a~~ strategic report.

Where the company has prepared a voluntary directors' report only, but not included all of the information that would be required for large and medium-sized entities, the following wording can be used:

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or

- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit; or
- the directors were not entitled to prepare the financial statements in accordance with the ~~small companies~~ micro-entities regime and take advantage of the ~~small companies'~~ micro-entities' exemptions in preparing the directors' report and from the requirement to prepare a strategic report.

Where the company has neither prepared a voluntary directors' report nor strategic report, the following wording can be used:

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit; or
- the directors were not entitled to prepare the financial statements in accordance with the ~~small companies~~ micro-entities regime and take advantage of the micro-entities' exemptions ~~in preparing the directors' report and~~ from the requirements ~~to~~ to prepare a directors' report and strategic report.

### Responsibilities of directors

No changes are needed.

### Auditor's responsibilities for the audit of the financial statements

ISA (UK) 700 includes a detailed description of the responsibilities of the auditor and the wording to use varies depending on whether the entity is listed, applies a fair presentation framework, the auditor reports key audit matters in accordance with ISA (UK) 701 or where there is a group audit.

An auditor has three choices in relation to the more detailed description of the auditors' responsibilities:

- to include within the audit report directly;
- to include within an appendix to the audit report; or
- to include a reference to a more detailed description on the FRC's website.

#### 1. Include within the audit report directly

An example of how this would look is given in Appendix 2 of the FRC Bulletin.

The following bullet point needs to be deleted because, as discussed above, the micro-entities regime is not a fair presentation framework:

- ...
- ~~Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.~~

In addition, the example in that Appendix is for a group and all references to 'group' need to be removed or amended to refer to the company. The last bullet point in that example needs to be deleted as that responsibility only applies to group auditors:

- ...
- ~~Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.~~

## 2. Include within an appendix to the audit report

Where the more detailed description is included in an appendix, the audit report needs to indicate the page number or other specific reference to the location of the more detailed description. An example of how this would look is given in Appendix 6 of the FRC Bulletin

The following bullet point needs to be deleted from the detailed description because, as discussed above, the micro-entities regime is not a fair presentation framework:

- ...
- ~~Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.~~

In addition, the example in that Appendix is for a listed group and all references to 'group' need to be removed or amended to refer to the company. The following further changes are needed to remove responsibilities that only apply for listed entities or groups:

- ...
- ~~Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express an opinion on the group financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.~~

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

~~We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.~~

- ~~From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.~~

## 3. Include a reference to a more detailed description on the FRC's website

Where the auditor chooses to refer to the description of the auditor's responsibilities on the FRC website, the audit report needs to refer to [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities).

An example of how this would look is given in Appendix 1 of the FRC Bulletin.

### Use of the audit report

ICAEW guidance within Technical Release 01/03AAF (Revised), The Audit Report and Auditors' Duty of Care to Third Parties, includes clarification language stating that the audit is performed for

the benefit of the members, as a body, in accordance with the Companies Act 2006 and case law. This wording is also referred to as 'Bannerman ' wording.

The guidance in Technical Release 01/03AAF (Revised) states that this paragraph is suitably placed as the final section of the audit report with a heading 'Use of our report '.

The typical company wording needs to be amended to read as follows:

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 as applied to micro-entities. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

It will remain for each firm to decide its own individual approach to the management of audit risk, whether to include the above wording and if so, in which section of the audit report. However, as the guidance in Technical Release 01/03AAF (Revised) makes clear, while a third party's use of an audit report presents uncertainty for auditors, the best risk management policy is for firms to take the steps that are necessary to carry out quality audits.

### Signature on the audit report

The same requirements for all companies apply and the audit report is required to be signed by the senior statutory auditor, for and on behalf of the audit firm:

[Signature]  
John Smith (Senior Statutory Auditor)  
For and on behalf of ABC LLP, Statutory Auditor  
[Address]  
[Date]

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