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SPOTLIGHT ON:

How to prepare for a business audit

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WHAT YOU NEED TO KNOW ABOUT COMPLIANCE

Preparing for an audit is rarely anyone's favourite task, but it is part of running a resilient business. HMRC is under pressure to close the tax gap, completing around 316,000 compliance checks in 2024/25 and continues to invest in new staff and technology.

Against this backdrop, audits and compliance checks are unlikely to fade away. This guide explains what "audit" means in practice, how the 2025 Autumn Budget and current tax rules shape the compliance environment, and what you can do to prepare your business so that any audit or review is as smooth as possible.

WHY AUDITS AND COMPLIANCE MATTER IN 2025/26

Government data shows that small businesses now account for the largest share of the tax gap by customer group, at 60% in 2023/24. Common reasons include errors, record-keeping problems and failure to take reasonable care. HMRC is responding with a mix of "upstream" measures, such as nudges and education, and traditional inquiries. Preventative measures now account for approximately 41% of HMRC's compliance yield, up from 29% in 2020/21.

Overall compliance yield reached an estimated £48bn in 2024/25, up from £41.8bn the previous year, with every £1 spent on compliance bringing in about £23 for the Exchequer. This level of return means HMRC is likely to maintain, and possibly increase, its focus on risk-based reviews, data matching and sector-specific campaigns.

For business owners, this does not only mean a higher chance of inquiry. It also highlights the value of strong internal controls, sound governance and up-to-date tax and accounting records.

WHAT WE MEAN BY A "BUSINESS AUDIT"

Clients often use "audit" to describe any deep review of their figures, but there are several distinct processes.

- **Statutory financial audit**
  This is a regulated review of your annual accounts under the Companies Act. Auditors test whether the accounts give a true and fair view and meet UK Generally Accepted Accounting Practice (UK GAAP) or International Financial Reporting Standards (IFRS) requirements.
- **HMRC compliance check or tax inquiry**
  This is a review of one or more taxes, such as corporation tax, VAT, PAYE or research and development (R&D) relief. HMRC may ask for explanations, source records and supporting documents, and can amend returns or raise assessments if it finds errors.
- **Other audits and reviews**
  Lenders, investors, regulators or group parents may request their own review, ranging from agreed-upon procedures to a full internal audit.

This guide focuses on statutory audits and HMRC compliance checks, as these affect most companies.

WHO NEEDS A STATUTORY AUDIT?

From financial years beginning on or after 6 April 2025, a private limited company may qualify for audit exemption if it meets at least two of the following criteria:

- annual turnover of **no more than £15m**
- assets worth **no more than £7.5m**
- **50 or fewer** employees on average.

If your company meets these thresholds, it is usually treated as "small" and may choose not to have a statutory audit. However, an audit is still compulsory if, at any time in the year, the company:

- is a public company
- is a subsidiary that does not qualify for a group exemption
- carries out regulated activities such as banking, insurance or certain investment services
- has shares traded on a regulated market
- is a master trust pension scheme funder or certain other specified bodies.

Even where an audit is not required by law, it can still be requested. Shareholders who hold at least 10% of the shares (by number or value) can insist on an audit if they make a written request at least one month before the year end. Lenders, investors or potential buyers may also require audited accounts as part of their due diligence.

HMRC COMPLIANCE CHECKS AND TAX INQUIRIES

HMRC compliance checks are an increasingly common part of the tax system. In 2024/25, HMRC completed about 316,000 compliance checks across all customer groups. These checks range from simple queries handled by letter to full records reviews.

Recent analysis shows the following.

- The overall tax gap in 2023/24 was 5.3% of theoretical liabilities, equal to £46.8bn.
- Corporation tax now accounts for about 40% of the tax gap by tax type, with the corporation tax gap percentage rising to 15.8% in 2023 to 2024.
- Small businesses are the largest contributor by customer group, at around 60% of the total tax gap.
- HMRC opened compliance checks into nearly 16% of R&D tax relief claims in 2023/24, underlining the level of scrutiny in this area.

HMRC uses data analytics, third-party information and cross-checks between taxes to identify apparent inconsistencies. Examples include:

- high director dividends compared with reported profits
- VAT returns that do not align with accounts or sector norms
- PAYE or Construction Industry Scheme (CIS) returns that suggest employment status risks
- large or unusual claims for reliefs, especially R&D and capital allowances.

For many businesses, a compliance check is not a sign of wrongdoing, but it still demands careful management.

HOW THE AUTUMN BUDGET SHAPES THE COMPLIANCE ENVIRONMENT

The Autumn Budget 2025 did not change headline rates of income tax, national insurance or VAT, and it left the main corporation tax rate at 25%, in line with the 2024 Corporate Tax Roadmap. The VAT registration threshold remains at £90,000 of taxable turnover (with a deregistration threshold of £88,000).

Key points for business owners include the following.

- **Higher tax on investment income from 2026/27**
  Ordinary and upper rates of dividend tax will increase by 2 percentage points from April 2026, which may influence profit extraction decisions and could feature in forward-looking audit and tax planning.

- **Tighter focus on avoidance and non-compliance**
  Budget and related HMRC reports highlight further work on promoters of tax avoidance schemes, anti-avoidance rules for company liquidations and strengthened action against directors who use phoenix arrangements or offshore structures to avoid tax.

- **Investment in HMRC compliance and debt collection**
  Additional funding for compliance teams and digital tools means more cases can be reviewed and debt followed up more quickly.

For audits and compliance checks, the message is straightforward: the rules around who must be audited and who must register for VAT are stable in 2025/26, but HMRC's capacity and willingness to enforce those rules is increasing.

GETTING AUDIT-READY: PRACTICAL STEPS BEFORE ANY REVIEW STARTS

Whether you expect a statutory audit, a lender review or a possible HMRC inquiry, good preparation makes a real difference. The following habits help your year-end process and reduce the risk of problems.

1. **Keep complete, timely records**
   - Use bookkeeping software that captures all sales, purchases and bank transactions.
   - Keep digital copies of key documents, including contracts, lease agreements, invoices and payroll reports.
   - Make sure you understand how your VAT, PAYE and CIS figures flow from the underlying records.

2. **Reconcile regularly**
   Monthly or quarterly reconciliations between the ledger and:
   - bank statements
   - supplier and customer balances
   - VAT and PAYE submissions
   - stock and work in progress.

3. **Document judgments and estimates**
   Areas such as revenue recognition, stock valuation, provisions and impairment require management judgment. Keep written explanations of the approach and assumptions used, as auditors and HMRC often ask for this supporting evidence.

4. **Review director remuneration and dividends**
   Check that directors' salaries, benefits and dividends are supported by board minutes, dividend vouchers and tax calculations. With higher future tax on dividends and close attention on profit extraction, clear documentation is important.

5. **Maintain clear tax working papers**
   For each tax return, retain schedules showing how figures were derived, including reconciliations from accounts profit to taxable profit, capital allowances computations and relief claims. This helps you respond quickly to queries and reduces the risk of misunderstanding.

WHAT TO EXPECT DURING A STATUTORY AUDIT

If your company requires, or chooses to have, a statutory audit for a period falling in 2025/26, the process usually follows these stages.

1. **Planning meeting**
   The audit team discusses your business model, key risks, systems and any changes since the prior year. They agree a timetable, key contacts and requested information.

2. **Information request**
   You receive a "prepared by client" (PBC) list of schedules and documents to provide before and during the audit, for example fixed asset registers, bank reconciliations, aged debtor and creditor reports and payroll summaries.

3. **Fieldwork and testing**
   Auditors test samples of transactions and balances, review controls and perform analytical procedures. They may attend stock counts or obtain confirmations from banks and major customers or suppliers.

4. **Discussion of findings**
   The audit team discusses any errors, adjustments or control observations with you. Many issues can be resolved through additional evidence or minor corrections.

5. **Audit report and management letter**
   Once the accounts are final, the auditors issue their opinion and, where appropriate, a separate letter setting out control recommendations.

You can make the audit more efficient by agreeing realistic deadlines, allocating an internal contact to co-ordinate responses and keeping communication open if issues arise.

WHAT TO EXPECT DURING AN HMRC COMPLIANCE CHECK

An HMRC compliance check normally starts with a letter. The letter explains which tax and period HMRC is looking at, what information it wants and the deadline for a response. In some cases, HMRC may phone first or request a meeting.

Typical features of a check include the following.

- **Scope**
  The check may be "aspect" based, limited to one issue or a full inquiry into an entire return.
- **Information requests**
  HMRC can ask for records it reasonably needs to check the position, such as invoices, bank statements, contracts, payroll data and supporting calculations. Where records are digital, HMRC may request data downloads.
- **Time limits**
  HMRC usually has four years to correct careless errors and up to 20 years in cases of deliberate behaviour, although exact limits depend on the tax and circumstances.
- **Outcome**
  The check may end with no change, an adjustment to tax due, penalties or agreement of a repayment. Penalties depend on behaviour (for example reasonable care, careless, deliberate) and whether you voluntarily disclose errors.
- **Rights of review and appeal**
  If you disagree with HMRC's conclusions, you can request an internal review or appeal to the tax tribunal.

Responding promptly, providing clear evidence and keeping a full record of correspondence helps to keep the process manageable and supports your position if there is any disagreement.

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ONGOING COMPLIANCE HABITS THAT REDUCE AUDIT RISK

The same habits that make your year end smoother also reduce the likelihood and impact of inquiries. Consider building the following into your regular operations.

- **Annual "health check" of accounts and tax**
  Review your trial balance, control accounts and tax workings before year end. Look for unusual trends, missing balances or old unreconciled items.
- **Review of high-risk areas**
  Pay particular attention to VAT treatment, employment status, director transactions, use of personal assets in the business and any relief claims such as R&D or capital allowances. HMRC sees these as higher risk and has dedicated teams reviewing them.
- **Up-to-date statutory books and filings**
  Maintain accurate Companies House filings, shareholder records and board minutes. Discrepancies between legal records, accounts and tax returns can raise questions during both audits and compliance checks.
- **Clear segregation of duties where possible**
  Even in smaller businesses, separating responsibilities for authorising payments, recording transactions and reconciling accounts can reduce error and fraud risk.
- **Training for finance and payroll staff**
  Make sure staff understand current VAT rules, PAYE reporting, national minimum wage and benefits reporting. HMRC uses educational campaigns and targeted checks in these areas.

CLOSING THOUGHTS

The 2025/26 tax year sits in a period of steady rules but rising scrutiny. Audit exemption thresholds have increased, yet many companies still need or choose an audit. HMRC's focus on the tax gap means more attention on small and mid-sized businesses, with compliance activity supported by better data and stronger technology.

You cannot remove the possibility of an audit or inquiry, but you can control how ready you are. Consistent records, clear documentation of decisions and regular reviews put you in a strong position if questions arise. If you are unsure how the current rules or Autumn Budget 2025 announcements affect your company, seek tailored advice before year end so that you can approach any future audit with confidence.

Preparing for an audit?
We can help.

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