BIS | Department for Business Innovation & Skills

Consultation on audit exemptions and change of accounting framework

Response form

The Department may, in accordance with the Code of Practice on Access to Government Information, make available, on public request, individual responses.
The closing date for this consultation is 29 December 2011.

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Please state YES in the box from the list of options that best describes you as a respondent. This allows views to be presented by group type.

Preparer: Large business (over 250 staff)	
Preparer: Medium business (50 to 250 staff)	
Preparer: Small business (10 to 49 staff)	
Preparer: Micro business (up to 9 staff)	
Preparer representative body	
Accountants: over 500 UK Partners	
Accountants: 200 – 500 UK Partners	YES
Accountants: 100 – 199 UK Partners	
Accountants: 50 - 99 UK Partners	
Accountants: under 50 UK Partners	

Accounting bodies	
Legal representative or professional legal bodies	
User representative bodies	
Academics	
Regulators and Government bodies	
Individuals	
Other (please describe)	

Question 1 (para 25)

What are your views on the overall principle of reducing audit requirements for unlisted companies?
Comments:

Thank you for the opportunity to respond to the above Consultation Document. As auditors we have a direct interest in the proposals in relation to audit exemption as they will inevitably have an impact on our business, albeit one we are not able to quantify at this stage.

There are two specific points that we wish to highlight in relation to the proposals on audit exemptions. Firstly, whilst we can see value in the extension of the audit exemption, we are concerned that the consultation paper has not fully addressed the issue of the quality of financial information which will be on the public record following any widespread take up of the extended exemptions. Whilst the requirement on directors to prepare accounts which comply with the relevant standards and give a true and fair view will of course remain we have a concern that there may be a reduction in public confidence in the accounts. The extent of any such decline and whether there will be related costs we are unsure but we feel that it would have been helpful if BIS had consulted more specifically on this point, particularly with the users of such accounts.

We are also a little concerned about the proposals in relation to the extent of the guarantee to be provided by parent companies. We recognise that the proposals have been drafted so as to make the piercing of the corporate veil attractive to parent companies. However, we have a concern that the limited form of guarantee currently proposed, which may limit certain claims may not be in the wider public interest. Given the importance of this issue there may be value in BIS re-consulting specifically on this point if it concludes that there is support for the principle of extending the audit exemption.

Question 2 (para 29)

A Do you agree with the underlying assumptions in our Impact Assessment that at least 60% of small companies now eligible will take up the audit exemption?
B Do you agree that the whole of the audit fee will be saved?
C Do you agree that there is no saving of management time for small companies taking up the audit exemption?

A	☐ Yes	☐ No	x☐ Not sure
B	☐ Yes	☐ No	x☐ Not sure
C	☐ Yes	x☐ No	☐ Not sure

Comments:

Our experience is very limited in this area, therefore we do not feel we can help quantify the expected take up of the audit exemption or potential audit fee savings.

However, we note that, as highlighted in our response to question 1, costs may not be saved if users request an audit or additional assurance, and professional expenses may increase as a result of additional assistance needed to prepare the accounts.

Question 3 (para 33)

Do you agree that the audit and accounting exemption for small companies should be aligned and a small company should be able to obtain the audit exemption if it meets two out of the three criteria?

x☐ Yes ☐ No ☐ Not sure

Comments:

We note that this means companies with substantial gross assets, few employees and limited turnover (e.g. a start up organisation) or alternatively a company with no assets but significant turnover (e.g. Service organisations) could be exempt from an audit. However, the adverse impacts of omitting significant trading entities from the scope of audit is mitigated as the proposal is that public interest entities such as certain financial services entities are excluded from the scope of this exemption.

Our understanding of the proposal is that the change to the current requirements is that only two out of three of the small company criteria need to be met in any one year, i.e. there would be no changes to the other conditions around audit exemptions for small companies, in particular, the restriction on the use of the small company audit exemption for group companies.

Question 4 (para 36)

Do you agree with option B to exempt qualifying non-dormant subsidiaries from mandatory audit of their accounts?

☐ Yes ☐ No x☐ Not sure

Comments:

See our response to question 1.

Question 5 (para 36)

Under Option C, what would be the effect of exempting qualifying non-dormant subsidiaries from mandatory preparation of accounts, mandatory filing of accounts and mandatory audit of accounts?

Comments:

We would point out that the Companies Act 2006 does require the preparation of individual accounts for the purposes, inter alia, of distributions, financial assistance, tax and capital maintenance. If the requirement to prepare accounts is removed, consideration would need to be given to how this would be addressed in these related sections of the Companies Act 2006.

There is also a requirement for directors to ensure adequate accounting records are maintained at any given time. In the absence of an audit requirement, there are less checks on the accountability of directors in meeting their duties in this regard.

If option C were to be taken up, there would be a loss of all visibility over the financial position of the subsidiaries which have taken up this option. This would be detrimental for a wide range of users of the accounts, from creditors understanding the financial position of the entity they are undertaking business with, to rating agencies using the information for comparability. The absence of this publicly available financial information may result in additional costs of doing business e.g. to suppliers. In addition, some entities, which could be deemed to be in the public interest, for example utility companies, could be exempt from any public disclosure.

Question 6 (para 38)

Do you agree that the Government should exempt qualifying dormant subsidiaries of whatever size from mandatory preparation, mandatory filing and mandatory audit of accounts? What difference would this make to your business and to the wider economy?

x☐ Yes ☐ No ☐ Not sure

Comments:

As dormant subsidiaries are only permitted to undertake a very few types of transactions and are not trading, we do not envisage this having much impact on business and the wider economy. However, we suggest the annual return should require the directors to state the entity is dormant and has been since the date of the last filed accounts (stating the date).

Question 7 (para 40)

A Do you agree that in addition to the Article 57 exemptions, in order to qualify, a subsidiary company should be unquoted, not involved in financial services or insurance and not fall into the category of certain other companies under industrial relations legislation, in line with the existing exclusions from the audit exemption in UK company law?

B Why? What difference would this make to your business and to the wider economy?

A x☐ Yes ☐ No ☐ Not sure

B Comments:

Higher consumer protection is required for the companies excluded from the audit exemption proposals.

Question 8 (para 40)

What would be the consequences (e.g. to investors, depositors or lenders or to the wider economy) of allowing financial services subsidiaries to take advantage of this exemption?

Comments:

Whilst an audit is not designed to prevent or necessarily discover frauds, it does offer a level of protection against fraud and error and potentially acts as a deterrent to individuals considering fraud. Therefore, if the requirement to have an audit is removed, the regulator may feel it necessary to undertake additional reviews/non-statutory audits, or request independent reviews which could negate any potential saving in terms of management time and costs.
Overall, we consider the risk of fraud and error in this regulated area could increase in this sector.

Question 9 (para 41)

Do you agree that the same rules on exemptions for qualifying subsidiaries should broadly apply to Limited Liability Partnerships and unregistered companies?

x☐ Yes ☐ No ☐ Not sure

Comments:

No additional comments.

Question 10 (para 46)

Do you agree with our estimate of the savings of the cost of the audit as detailed in the impact assessment, and in particular the underlying assumptions:
A That the average cost of the audit is in the range of £8,000 to £83,000 per subsidiary?
B That 75% to 100% of qualifying subsidiaries will take up the exemption?
C That 10% to 25% of the audit cost of each qualifying subsidiary will be saved?

A	☐ Yes	☐ No	x☐ Not sure
B	☐ Yes	☐ No	x☐ Not sure
C	☐ Yes	☐ No	x☐ Not sure

Comments:

There is a wide range of subsidiaries by size that could be affected by the audit exemption, and the audit fees could be lower than that quoted, especially for small companies which may only undertake a small number of transactions in a year or the audit fees could be much higher for larger companies.

We are uncertain on what basis a take up of 75% to 100% has been predicted. Whilst clearly some companies would take up the audit exemption, we believe it is very difficult to assess the precise rate of take up. We are not convinced that experience in other jurisdictions is helpful in this regard given the differences in application. Ultimately we suspect the level of take-up will also be influenced by the precise nature of the guarantee required (see question 19).

Whilst a statutory audit may no longer be needed for the standalone company, an audit may still be required for the purposes of assisting the parent company auditor in issuing the group audit opinion. For this reason, we think it is unlikely the entire audit fee will be saved, however we do recognise that the overall fee should decrease. The audit fee saving would be dependent on the audit work needed for the purposes of the group audit and is dependent on audit matters arising; for this reason it is difficult to predict the savings.

Similarly, management will still need to be involved in the group audit, so whilst time will be saved it will not eliminate all of management's time in connection with the audit.

Question 11 (para 46)

Do you agree with our estimate of the saving of management time interacting with the auditor and in particular, with our underlying assumptions that for subsidiary companies the saving will be 5 hours of senior management time, which gives rise to £60 to £273 saving per company, depending on size of company?

☐ Yes ☐ No x☐ Not sure

Comments:

Senior management spend their time running the business primarily focusing on issues at a group level. The estimate above is presumably an estimate of the extra senior manager time for the purposes of the statutory accounts. We do not comment on the figures quoted.
However in our opinion this will not be a real saving of time or cost saving as directors will always spend the time needed to fulfil their duties as directors, eg by ensuring that they do not approve accounts that do not give a true and fair view.

Question 12 (para 46)

Do you agree with our estimate of the saving of the cost of management time to prepare and file qualifying dormant subsidiary accounts and in particular the underlying assumption of the £280 per dormant subsidiary?

☐ Yes ☐ No x☐ Not sure

Comments:

We have no involvement in the preparation and filing of dormant subsidiary accounts; for this reason we are unable to comment on the estimate.

Question 13 (para 47)

Do you agree with our estimate of the cost of taking legal advice of £110 per subsidiary in the first year only, but that if the Government provided guidance on an acceptable form of the guarantee, this cost of legal advice would be zero?

☐ Yes x☐ No ☐ Not sure

Comments:

In the absence of any legal advice from the government, this appears to be a low figure; if the government were to provide guidance on the acceptable form of the guarantee, this would spare a company from incurring this cost. However, if a company had further questions on amending the wording or the implications of the standard wording of their liability position, they could choose to obtain further legal advice which would incur a charge.

Question 14 (para 49)

Have views of stakeholders expressed to the Company Law Review changed since 2000?

☐ Yes x☐ No ☐ Not sure

Comments:

We are not aware of any changes.

Question 15 (para 49)

Do you agree with the Government's conclusions on the likely impacts that would have been involved in exempting non-dormant qualifying subsidiaries from either preparation or filing of accounts and that the costs of such a proposal would likely exceed the benefits?

☐ Yes ☐ No x☐ Not sure

Comments:

See response to question 5.

Question 16 (para 51)

Do you agree with the assumption that it is unlikely that the Government's proposals will have a significantly adverse impact on the number of small audit firms?

☐ Yes ☐ No x☐ Not sure

Comments:

The impact will be felt throughout the profession, as all audit firms audit subsidiaries, although some firms may be more adversely affected by aligning the audit exemption to the accounting definition of a small company.

Question 17 (para 55)

Do you agree with the Government's assessment of the risks of the proposal?

x☐ Yes ☐ No ☐ Not sure

Comments:

Logically, the parent guarantee should be legally effective regardless of the size of the subsidiary. What is critical to creditor protection, however, is that the guarantee is both legally effective and the parent has the resources to meet its obligations under the guarantee. Whilst we note that the government comments that the guarantees will be enforceable, there may be costs of pursuing an enforcement action against an EU parent. In addition, it is not clear how companies and directors can assess the parent company's ability to make the guarantee as the consolidated accounts may include a number of such guarantees covering other European subsidiaries (and the consolidated accounts may not include financial information about the extent of the debts/liabilities covered by the guarantees), the consolidated accounts may not be in English or readily available to an individual in the UK and may be prepared in accordance with local GAAP (which may differ significantly from UK GAAP or IFRS).

Question 18 (para 59)

Do you agree that the guarantee should be irrevocable and in respect of all debts in respect of that financial year? Until an audited set of accounts for the subsidiary is filed it will also be in respect of future debts incurred by the subsidiary

x☐ Yes ☐ No ☐ Not sure

Comments:

Whilst we agree that option (a) is better than (b) as, the paramount concern if the audit exemption is extended to subsidiaries is to protect creditors.

Whilst the form of the guarantee has not been set out, we appreciate that an effective guarantee offers better protection to the creditors of a subsidiary company than a set of audited accounts. See also our comments to question 17. However, it is also important for creditors to know when undertaking with a company whether they should consider the financial position of the entity they are engaging with or the group as a whole.
In addition, it would be helpful for auditors to know whether an entity is likely to require an audit for a particular financial period. For these reasons, we would like there to be some indication at the start of the relevant financial year as to whether the subsidiary will be taking up the audit exemption.

Question 19 (para 60)

Do you agree that the guarantee should cover the "debts" of the subsidiary and not extend to its "liabilities"?

☐ Yes ☐ No x☐ Not sure

Comments:

Whilst we accept that this is a matter of the interpretation of EU legislation, we are concerned that restricting the guarantee to debts may not be in the wider public interest. We would also note that there appears to be differences in the approach in other EU member states. If BIS conclude that it is appropriate to press ahead with these changes we believe it should produce further detailed papers on the nature and effect of the guarantee and consult further.

Question 20 (para 63)

A Do you agree with the proposals for the Guarantee?
B Do you think the form of the proposed guarantee will encourage its take-up in line with our assumptions above (75-90%)? If not, why not?
C Do you have alternative proposals that would not gold plate the Directive, provide adequate protection for those to whom the subsidiary owes a debt, but do not make it unlikely that the parent would issue such a guarantee?

A	☐ Yes	☐ No	x☐ Not sure
B	☐ Yes	☐ No	x☐ Not sure
C	☐ Yes	x☐ No	☐ Not sure

Comments:

A – see our comment on question 19
B – see our comment on question 10
C - The proposals imply that the parent guarantee may not need to be filed at Companies House, i.e. only a declaration that one has been obtained would need to be filed. We would prefer that the guarantee is filed. This will allow transparency as to the wording of the guarantee provided by the parent, which is particularly important if no standard wording is mandated. We cannot see how this would introduce significant regulatory burden or significant additional costs to the subsidiary.

Question 21 (para 65)

Do you agree that no new penalties should be proposed in conjunction with the introduction of these proposals?

x ☐ Yes ☐ No ☐ Not sure

Comments:

Question 22 (para 76)

Do you agree that the Government should impose restrictions on companies' ability to move from IFRS to UK GAAP?

x☐ Yes ☐ No ☐ Not sure

Comments:

In our view, there is a benefit from imposing some restrictions on the ability of companies to change their accounting basis. It is important that consistency be maintained from one period to the next to allow comparability. As assets, liabilities or profits may vary when computed under different GAAPs it is beneficial to minimise changes. In addition, the restrictions on changing financial reporting frameworks reduces the scope for tax arbitrage. However, we would support a relaxation in the current restrictions as explained in our response to Q26.

Question 23 (para 76)

How frequently should a company be able to move from IFRS to UK GAAP, unless there is a relevant change in circumstances?

☐ Every year ☐ Once every 3 years x☐Once every 5 years ☐ Never ☐ Not sure

Comments:

We would suggest that five years is appropriate; to change more frequently is likely to damage comparability. However, for the avoidance of doubt we would like to see a widening of the definition of a ‘relevant change in circumstances’ to include a delisting from AIM.

Question 24 (para 78)

A Do you agree with the Government’s estimate that 90% of eligible subsidiary companies will take up the option?

B Do you agree that the saving for each company will be £569?

A	☐ Yes	☐ No	x☐ Not sure
B	☐ Yes	☐ No	x☐ Not sure

Comments:

It is our expectation that a high percentage of eligible subsidiary companies currently reporting under IFRS will be interested in taking advantage of the reduced disclosures proposed by the ASB.

Question 25 (para 82)

Do you agree that the one-off cost per company will be £390?

☐ Yes ☐ No x☐ Not sure

Comments:

The cost will depend on the size and complexity of any GAAP adjustment; however a one-off cost of £390 does appear implausibly low.

Question 26 (para 86)

Do the proposed changes in any way increase the risk of financial irregularities? If so, what would you estimate the potential impact to be on investors?

☐ Yes x☐ No ☐ Not sure

Comments:

It is important for reasons of comparability and reducing the scope for accounting and tax arbitrage that there are restrictions over changing reporting frameworks, however we believe that changing once every 5 years manages those risks. UK GAAP and IFRS are both fit for purpose so we do not expect the risk of financial irregularities to increase.

While there is generally less disclosure under UK GAAP or the proposed FRSME compared to full EU adopted IFRS, the ASB has considered that issue in determining not to extend the mandatory scope of EU adopted IFRS to ‘publicly accountable entities as originally proposed in its Future of UK GAAP proposals, and by adding additional disclosure requirements for certain types of entities in the proposed FRSME.

Question 27 (para 27)

What is the risk that investors will be misled or confused by a company switching between accounting frameworks?

☐ High risk x☐ Low risk ☐ Not sure

Comments:

Under the future of UK GAAP proposals there will be fewer differences between the accounting frameworks and therefore less risk of confusion.

Question 28 (para 86)

Do you agree with the Government’s assessment of the risks of this proposal?

x☐ Yes ☐ No ☐ Not sure

Comments:

We agree with the Government’s assessment of the risks of this proposal. There should be restrictions on changing the financial reporting framework. However, there are some companies that are currently on IFRS but cannot revert to Companies Act accounts unless there is a relevant change in circumstances, even though there may be valid business reasons for doing so. In addition, many subsidiary companies may wish to apply Companies Act accounts when the new reduced disclosure framework becomes available. We note the risk of tax arbitrage but consider it managed by the restrictions proposed by the Government in its preferred option.

Question 29 (para 87)

Do you agree that the proposals should apply to entities for financial years ending on or after 1 October 2012?

☐ Yes ☐ No x☐ Not sure

Comments:

In respect of the proposed changes to restrictions over changing financial reporting framework we support the government’s proposed effective date. If the ASB issue their new standards by Autumn 2012 (allowing early adoption), companies may wish to take advantage particularly of the reduced disclosure available under IFRS.

In respect of the proposed changes to audit exemptions, whilst we understand the government’s wish to introduce the deregulatory changes as soon as possible, there is little time for any planning that may need to be undertaken: by companies and their management; auditors in respect of the impact to the accountancy profession; and creditors as to whether they should be looking at the entity they are trading with or the wider group in terms of deciding whether or on what basis they should be trading with a company. Therefore we would prefer a later implementation date.

Do you have any other comments that might aid the consultation process as a whole?

Please use this space for any general comments that you may have, comments on the layout of this consultation would also be welcomed.

No further comments

Thank you for taking the time to let us have your views. We do not intend to acknowledge receipt of individual responses unless you tick the box below.
Please acknowledge this reply ☐

At BIS we carry out our research on many different topics and consultations. As your views are valuable to us, could we contact you again from time to time either for research or to send through consultation documents?
☐ Yes ☐ No

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