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	
Accountants: 100 – 199 UK Partners	
Accountants: 50 - 99 UK Partners	YES
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:

Overall, we agree in principle to reducing the audit requirement for unlisted companies although there must be provisions to enable shareholders who are not involved in management of companies to be able to require an audit. One also needs to consider the integrity of corporate reporting as a whole and the audit plays a significant role in providing confidence to other stakeholders including providers of finance. In the current climate where banks appear unwilling to lend, extending the audit exemption limits too far may not be conducive to encouraging a change in behaviour.

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	☐ Not sure
B	☐ Yes	☒ No	☐ Not sure
C	☐ Yes	☐ No	☒ Not sure

Comments:

A The take up to this degree may not be immediate as directors will need to consider the interests and attitudes of shareholders, creditors and lenders. They will also wish to consider alternative assurance reviews that are available.

B The majority of small companies have assistance from the auditors in preparing statutory financial statements. Given that there is no proposal to change the overall financial reporting regime then this assistance will need to continue. Audit fees for small companies very often include this assistance and for that reason we disagree that the whole of the audit fee will be saved.

C We believe there will be some saving of management time but do not necessarily believe it will be significant. In a small company audit, much of the time spent by management is in connection with the preparation of statutory financial statements, i.e. the determination of appropriate accounting treatments and proper disclosure and we believe this will need to continue.

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?

☒ Yes ☐ No ☐ Not sure

Comments:

Overall we agree with the proposition although we do believe that this will mean that certain types of company, for example property companies, that can have substantial levels of both assets and borrowings but relatively modest income and low levels of staff could fall within the audit exemption regime. It may be appropriate not to permit audit exemption if one of the qualifying measures exceeded that for a medium-sized company.

Currently, the audit exemption rules not only require that the turnover and gross asset tests are both met but also that they are met in the financial reporting period under review. If the audit exemption proposals are to be aligned properly with the small company limits then this should include the provision that a company might not meet the limits in a year after the limits have been met without losing the ability to be exempt from audit.

Question 4 (para 36)

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

☐ Yes ☐ No ☒ Not sure

Comments:

Overall we have reservations as to the appropriateness of this proposition.

Although a similar approach is used in the United States, in the US there is no filing requirement for such subsidiaries and, accordingly, the results and financial position of qualifying subsidiary companies is not on the public record.

Our comments under question 1 are also relevant to this question. There is a need to maintain confidence in the UK financial reporting regime and we question whether exempting qualifying non-dormant companies would support this need. In the current proposals there are no size limits on subsidiaries that would fall under this regime and we do not believe that is appropriate. We question whether it is appropriate to exempt companies from audit where the management and operations could be separate from its parent notwithstanding the guarantee of borrowings.

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:

In the UK there is a strong link between statutory financial statements and tax filings, particularly given the calculation of taxable profits starts with accounting profits produced in accordance with an appropriate set of accounting standards (i.e. either IFRS or UK GAAP). If, for qualifying non-dormant subsidiaries, the need to produce statutory financial statements that give a true and fair view was removed, we are concerned that the quality of tax filings might decrease which could lead to an adverse impact on the tax-take. For many companies, this might then require increased management time on the production of tax filings as well as additional external cost from external advisers.

Again, our comments under question 1 are relevant where financial institutions and lenders, notwithstanding the requirement for a guarantee, as well as other stakeholders (e.g. customers and suppliers) need to have confidence in the integrity of financial control and reporting. We believe that removing the requirement for financial statements and audit will have a negative impact on confidence which will not support growth in the UK economy.

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?

☐ Yes ☒ No ☐ Not sure

Comments:

We support exemption from audit (which is available already) but we do not support exemption from preparation and filing of financial statements. At the very least, the preparation and filing of accounts require the directors to state their assertion that the company has been dormant through the period.

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 ☒ Yes ☐ No ☐ Not sure

B Comments:

We concur companies should not be listed but question whether it is appropriate to include all financial services and insurance companies; there can be similar risks to companies in other sectors not covered by financial services legislation. There should continue to be a requirement for audits of entities that are, effectively, custodians of third party assets.

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:

Overall, we believe there could be a reduction in the confidence of the public, particularly the individual investor/depositor. As mentioned earlier, in the current economic environment it is not desirable to introduce any measures that will damage public confidence in the security of savings and investments.

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?

☒ Yes ☐ No ☐ Not sure

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	☒ Not sure
B	☐ Yes	☒ No	☐ Not sure
C	☒ Yes	☐ No	☐ Not sure

Comments:

A Although this range appears reasonable, we are not convinced that it provides any meaningful analysis.

B We believe that the requirement for parent undertakings to provide the appropriate guarantees in respect of the subsidiary may mean that the take up is less than 75%.

C If the cost benefit to qualifying subsidiaries is only 10% to 25% of the audit cost, we question whether that 'benefit' justifies the potential threat to the impact on confidence in the integrity of the financial reporting environment.

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 ☒ Not sure

Comments:

This appears to us to be extremely subjective and we do not believe that this gives any meaningful measure of the potential financial effects of saving in management time that might be achieved.

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 ☒ Not sure

Comments:

We believe the cost of preparing and filing dormant company accounts is minimal although recognise that there is also the cost of a tax filing for dormant parent companies.

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 ☐ No ☒ Not sure

Comments:

We do not believe it is necessarily appropriate to measure this cost on a per subsidiary basis. A more appropriate measure would be 'per parent company' as it is the parent that would be required to provide the appropriate guarantee. Arguably, the cost of legal advice will be the same for a parent with one subsidiary as for one with say ten subsidiaries.

Even if the Government provided guidance, we believe most parent companies would still want to take independent legal advice.

Question 14 (para 49)

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

☐ Yes ☒ No ☐ Not sure

Comments:

We believe stakeholders still require access to appropriate corporate financial information which for companies is generally via filed financial statements.

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 ☐ Not sure

Comments:

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 ☐ Not sure

Comments:

Although we note the comments that small firms would still be required to provide accountancy and taxation advice, we believe that should such firms decide to deregister as audit firms then they would be open to greater competition from 'unqualified' firms and also might find it more difficult to attract and retain staff who wish to have exposure to audit assignments.

Question 17 (para 55)

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

☐ Yes ☐ No ☒ Not sure

Comments:

We disagree with the comment in relation to dormant accounts filing. Dormant companies can contain significant assets and liabilities yet still be dormant if these have not moved. Such financial statements could be of interest to the public.

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

☐ Yes ☐ No ☒ Not sure

Comments:

An important question will be whether the parent company has the ability or means to provide such a guarantee.

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 ☒ Not sure

Comments:

Although we understand the desire not to gold-plate, if appropriate protection is going to be afforded to stakeholders of subsidiaries that are exempt from audit then there should be proper consideration of whether other liabilities, including contingent liabilities, should be covered by the guarantee.

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	☒ Not sure
B	☐ Yes	☐ No	☒ Not sure
C	☒ Yes	☐ No	☐ Not sure

Comments:

C To ensure there is appropriate transparency, where the guarantee is given by a foreign parent, the consolidated audited accounts of the parent should be filed at Companies House along with the declaration.

Question 21 (para 65)

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

☒ Yes ☐ No ☐ Not sure

Comments:

If a new regime is to be effective, especially where the consequences are potentially far-reaching, then there have to be appropriate sanctions for individuals and entities that fail to comply.

Question 22 (para 76)

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

☒ Yes ☐ No ☐ Not sure

Comments:

Although the 'Future of UK GAAP' project does propose a framework based on IFRS, the proposed regime will not mean that there are not differences in measurement between UK GAAP in the future and IFRS. Further, currently the proposal is for small companies to continue to apply the Financial Reporting Standard for Smaller Entities (FRSSE) where there are more significant differences with IFRS.

Where there is a legitimate business reason for moving from one financial reporting framework to another then this should be permitted. There is a risk, however, that companies might seek to move frameworks as a means of manipulating results where there are differences in accounting treatments between the two frameworks. This could be a particular issue for the tax-take given the move over recent years to align the calculation of taxable profits with that of accounting profits.

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 ☒ Once every 5 years ☐ Never ☐ Not sure

Comments:

In UK GAAP there is currently no guidance on how a company should present its results when moving from one reporting framework to another (i.e. IFRS to UK GAAP) and we believe that this should be developed to ensure that stakeholders have a clear view of the impact of the change in framework on the results of the entity. The movement from UK GAAP to IFRS is covered through IFRS 1, First time adoption of International Financial Reporting Standards.

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	☐ Not sure
B	☐ Yes	☐ No	☒ Not sure

Comments:

A Company law currently requires directors of UK parent companies preparing group accounts to use a consistent framework across all group companies but s407 does permit all subsidiary entities to use a consistent framework which is different to the parent (i.e. the parent could adopt IFRS and all the subsidiaries UK GAAP). We believe that significant number of the companies preparing financial statements under IFRS will be doing so because of the ease of using a single framework for all group companies, particularly where it is a multi-national group.

Question 25 (para 82)

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

☐ Yes ☒ No ☐ Not sure

Comments:

Our experience of companies moving from UK GAAP to IFRS is that there is a considerable amount of time required to assess the differences in accounting treatments and disclosures. We believe the four hours of internal staff time quoted may be too 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 ☐ No ☒ Not sure

Comments:

We do not believe changing from one accounting framework to another necessarily increases the risk of financial irregularities but we believe this risk will increase given the proposal to exempt qualifying subsidiaries from the audit regime on an entity basis.

Question 27 (para 27)

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

☐ High risk ☐ Low risk ☒ Not sure

Comments:

This risk will be dependent on the degree of understanding that investors have on the differences between financial reporting frameworks and what impact so doing has on an entity's financial results.

As noted above, there should be transitional arrangements that apply when companies move between accounting frameworks that include full and clear disclosure of the effects. We suggest this should also include narrative disclosure of the reasons for making the change.

Question 28 (para 86)

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

☐ Yes ☐ No ☒ Not sure

Comments:

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 ☐ Not sure

Comments:

It does not seem appropriate to us to introduce changes for a financial year that might already have started. Given that some of the arguments for change in the consultation paper are based on the ASB's 'Future of UK GAAP' project, it does not seem appropriate to us to introduce changes to company law before that project has been finalised. A new exposure draft from that project is due imminently but we understand that an effective date for the new standard is unlikely to be before 1 January 2015.

Secondly, the proposals for the reform of the audit market in Europe have also not yet been finalised and we believe that an effective date of 1 October 2012 is too early given the progress of those proposals.

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.

We believe having a robust financial reporting regime is essential for the UK. Currently there are consultations taking place on UK GAAP, acceptable accounting frameworks, audit exemption and potential reform of the Financial Reporting Council, all against the backdrop of the debate on audit reform taking place in the European Union. We are concerned that this piecemeal approach may not deliver the cohesive and coherent response that is required.

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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