

# 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:

Grant Thornton UK LLP is broadly supportive of the overall principle of reducing audit requirements for unlisted companies so that businesses in the UK have greater choice and are not placed at a disadvantage to their European competitors as a result of additional requirements.

### 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	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No	<input type="checkbox"/> Not sure
B	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No	<input type="checkbox"/> Not sure
C	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No	<input type="checkbox"/> Not sure

Comments:

In our view it is difficult to quantify the number of small companies that would take up the exemption and the savings that would be made where the exemption was taken. However, we believe that a number of stakeholders believe that an audit provides a level of assurance that they require. In some cases the option not to have an audit will be taken but a compilation report or an alternative will be requested.

We also believe that a number of lenders would require their clients to whom they provide finance to have an audit, or some form of alternative assurance, as part of the terms and conditions of the funding, which would potentially limit both the number of companies able to take the exemption and the savings made.

### 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:

We agree that this would remove some of the confusion that currently exists in practice with regard to application of the different exemptions for small companies. However, we note that

some substantially larger businesses would become exempt from audit, for example a company could have significant turnover but low assets and a small number of employees, and not require an audit, or a company that was previously small could achieve significant growth and remain exempt from audit for a further year.

We welcome the intention to retain the safeguards in company law allowing shareholders holding at least 10% of the share capital to require an 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:

In principle we agree with this proposal, which will give UK businesses greater choice. However, we have some reservations about how the proposal will work in practice, principally in relation to the requirement for the parent company to provide a guarantee. Our views in relation to the requirement for a guarantee are given in our responses to questions 18 to 20.

#### **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 our view, providing an exemption for qualifying non-dormant subsidiaries from mandatory preparation and filing of accounts would be harmful to businesses, as we believe it is important that financial information is publicly available to assist stakeholders in their dealings or potential dealings with the individual entities.

#### **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 do not believe that providing these exemptions to qualifying dormant subsidiaries would make a significant difference either to our business or the wider economy.

#### **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 agree that this should be consistent with existing exclusions from audit exemptions.

The impact is difficult to assess but in the interests of wider stakeholders we agree with the approach.

### 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:

Such stakeholders may lose confidence in the subsidiary if it does not obtain an audit.

### 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:

We agree that these should be consistent.

### 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:

In our view, the number of qualifying subsidiaries that will take up the exemption is dependent on the requirement for the parent company to guarantee the commitments entered into by the subsidiary undertaking. It is not clear what form this guarantee would need to take in practice in order for the subsidiary to qualify for the exemption. This is considered further in questions 18 to 20.

### 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 will depend on the size and complexity of the companies involved. We note that some audit work will still need to be performed on subsidiaries for the purposes of auditing the consolidated accounts, although this may be to a higher materiality, therefore reducing the audit work to some degree.

#### 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:

In our view this is difficult to quantify.

#### 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:

In our view the cost of obtaining legal advice is difficult to quantify. Some companies may wish to take legal advice even if the Government were to provide guidance on an acceptable form of the guarantee.

#### Question 14 (para 49)

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

☐ Yes ☒ No ☐ Not sure

Comments:

We do not believe that the views of stakeholders have changed with regard to the points mentioned in paragraph 52b. of the consultation.

#### 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:

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#### 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:

-

### Question 17 (para 55)

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

☒ Yes ☐ No ☐ Not sure

Comments:

-

### 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:

We agree that, in order for the guarantee to be meaningful to the creditors of the subsidiary, it should be irrevocable and in respect of all debts in respect of the financial year, as well as future debts incurred by the subsidiary, although, as explained under question 20, we do have reservations about how such a guarantee would work in practice.

### 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:

We believe that the scope of the guarantee would need to be extensive in order not to disadvantage third parties who would otherwise trade with the subsidiary.

### 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	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<input checked="" type="checkbox"/> Not sure
B	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No	<input type="checkbox"/> Not sure
C	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No	<input type="checkbox"/> Not sure

Comments:

Whilst we agree that a guarantee is necessary in order to protect creditors, in our view, the requirement for a guarantee will deter businesses from taking this exemption. Principally this is due to concerns that providing a guarantee will increase risk to the business due to this impacting on the limited liability status which is achieved through setting up a separate subsidiary company. In addition, the fact that a company has obtained a guarantee from its

parent may give the impression to third parties that the subsidiary is in financial difficulty and cannot meet its debts, which in turn would act as a deterrent for those third parties from doing business with the subsidiary in question.

There may also be accounting implications of the guarantee in the parent company financial statements. If the parent company applies IFRS or UK GAAP with FRS 26, the guarantee may need to be recognised on the balance sheet at fair value. This may also be the case under the ASB's proposals for the future of UK GAAP. The need to obtain a valuation would give rise to an additional cost.

### 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:

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### 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:

While we agree that some restrictions should be imposed, we believe it is important that the law in this area is changed, to address, for example, the issue that a company which delists from AIM must continue to prepare group accounts under IFRS as delisting from AIM is not considered to be a relevant change in circumstances.

### 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 our view, 3 years would be an appropriate time period.

We would not agree with options (b), (d) or (e) set out in paragraph 79 of the consultation paper.

### 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:

Whether a subsidiary company currently applying IFRS would take up the option to change to UK GAAP would depend on the circumstances of the group, and in particular why the subsidiary had initially chosen to apply IFRS. Currently there are significant differences between UK GAAP and IFRS and therefore, where the consolidated accounts are prepared under IFRS, there may be cost-savings and other benefits to the group if the subsidiaries report under IFRS.

Under the ASB's current proposals for the future of UK GAAP, UK GAAP would include applying IFRS with reduced disclosures. If these proposals come in, we would expect more subsidiaries currently applying IFRS to take up the option to move to UK GAAP.

In our view it is difficult to quantify the saving for each company.

#### **Question 25 (para 82)**

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

☐ Yes ☐ No ☒ Not sure

Comments:

In our view this is difficult to quantify.

#### **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:

-

#### **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:

-

#### **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:

As the proposals all provide UK businesses with additional choice, we believe that they should be brought in as soon as possible.

**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 look forward to a draft of proposed regulations being made available for comment prior to being laid before parliament.

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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