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	
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) Accounting network – UK member firms	X

Question 1 (para 25)

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

Comments:

Our views, based on the views of our clients, are mixed. On the one hand our clients seek to minimise their regulatory and compliance cost base, but on the other complain when their debtors default on them and do not have the underlying protection of an audit process which is the historic reason for the UK audit requirement in the first place.

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 *Our conclusion, based on previous audit exemption changes together with current cost pressures arising from the wider economic position would lead us to conclude that 60% may be a lower, rather than a higher estimate.*

B *Our experience, based on our own practices and those of similar firms and networks known to us, leads us to conclude that many costs are described as "audit" which are accounting related.*

We certainly do not recognise an average cost saving of £9,500 per company – this would represent the whole of the audit ***and*** *statutory accounts preparation cost for a significant majority of our SME audit client base.*

Typically our experience would be that taking advantage of audit exemption produces a typical saving of £2,000 - £3,000 on average and would query the source of the data used to provide the estimate of £9,500.

C *Some of the partners in our member firms have previously worked as finance directors or in other senior financial positions in SME companies. This experience would lead us to conclude that it is not correct to assume that there is no saving of management time for companies taking up an audit exemption, but that this has no material marginal cost as the relevant costs are largely fixed costs.*

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:

Our experience is that the audit requirement for a balance sheet total of no more than £3.26million means that, as a result of UK property values, some quite small companies are caught by the audit requirement.

Our preference would be to raise the asset limit to be equivalent to that of the turnover limit, but we appreciate that the UK may be constrained by the terms of the EU Directives.

Other than this we have no specific comments to make.

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:

As described above, we do not recognise a cost saving of anything like £8,000 as being realistic in respect of small company accounts.

In particular we would note that for many groups efficiencies of scale are obtained as accounting functions are increasingly centralised and audit sampling covers the accounting records of all relevant subsidiaries at once. This significantly reduces the cost of auditing each individual subsidiary.

In addition, the abolition of an audit for each individual subsidiary would not eliminate the need for any audit procedures over subsidiary audit accounts, but would only partially reduce the extent of testing. This is because audit systems testing would still need to be carried out and because the testing of transactions and balances would be based on group rather than company materiality limits. Whilst these would be higher and testing would be reduced they would not be eliminated.

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:

On the presumption that all the EU required conditions are met we consider that some saving would be made. This would result from:

- *the preparation of formal financial statements for each entity; and*
- *some audit cost saving as described in our response to Question 4 above.*

We are not in a position to provide a robust or precise estimate of the saving involved, but would broadly estimate that this might save up to 20% of group audit and accounting costs.

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:
Our experience of dormant companies in SME groups is that most prepare DCA forms at Companies House. Even where this is not done, it is still a cheap and cost effective mechanism which ensures that confirmation is made of the relevant company's position on the public record.

We do not recognise a filing cost of £280 and would regard the cost saving made if this exemption is pursued would be marginal.

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 have no specific comment to make except that we do not consider that this would make any material difference to our business.

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:
We would be concerned, given the nature and status of financial services companies, if financial services subsidiaries were able to take advantage of this exemption, given their nature.

This is because of historic financial issues and scandals relating to such companies, given their focus on investments and deposits.

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 have no specific comments to make.

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:

Our experience of the audit cost of small companies would lead us to conclude that the average cost range of the audit is lower than £8,000 to £83,000.

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:

Whilst we agree that some management time will be saved, this will typically not save any cash cost as we would not expect this in itself to give rise to any reduction of management headcount or salaries.

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 do not recognise a filing cost of £280 and would regard the cost saving made if this exemption is pursued to be marginal.

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 have no specific comments to make.

Question 14 (para 49)

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

☐ Yes ☒ No ☐ Not sure

Comments:

We are not aware of any evidence that would indicate any change in the views of stakeholders expressed to the Company Law Review in 2000.

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:

We agree with the Government's conclusions.

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:

Inevitably a reduction in the number of audits will lead to a reduction in audit fees which is likely to have a significant impact on some firms and will cause some firms at the margin to discontinue maintaining their audit registration, a process that is costly in terms of both time and cost.

In passing we note that the consultation does not ask whether we agree that there will be a tax loss to the Exchequer. We consider that there will be and that this will be substantial. This is because:

- *Although HMRC can call for additional information, in our experience they are unlikely to do so for each relevant company; and*
- *The audit process currently reduces attempts to manipulate taxable profits in many cases.*

Question 17 (para 55)

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

☐ Yes ☒ No ☐ Not sure

Comments:

In our experience the safeguards in company law under S476 CA06 are seldom used, so in our view the limitation to risk to shareholders is not a material consideration.

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:

If the guarantee is to have any value to creditors it should be in the form proposed.

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 have no specific comments to make.

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:

We have no specific comments to make.

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:

We have no specific comments to make.

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:

Given that the new framework is based on IFRS with reduced disclosure we do not see any significant risks from removing restrictions on the ability of companies to move from IFRS to UK GAAP.

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:

We have no specific comments to make.

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:

Whilst we would generally expect the majority of companies to change to a reporting regime with reduced disclosure, we have no data or evidence that enables us to agree or disagree with the Government's 90% estimate.

A *We would note that many companies have an established routine for producing financial statements. To change these routines is likely to prove costly in terms of time and effort, so as a result we would expect the option to be taken up over a longer period of time than might first be envisaged.*

B *In terms of the cost saving, as already noted previously, we would not agree that any material saving is likely to arise as we consider it unlikely that the change will lead to a reduction in headcount and hence salary cost for relevant companies.*

Question 25 (para 82)

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

☐ Yes ☒ No ☐ Not sure

Comments:

We do not consider that there will be any material change in the cost of internal staff time as we consider it unlikely that the change will lead to an adjustment of headcount and hence salary cost for relevant companies.

In terms of audit cost, a cost of £250 is very much lower than our experience of the legal and advisory costs moving between UK GAAP and IFRS would lead us to expect.

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:

Given that UK GAAP will be based on IFRS principles we are not aware of any material risk that financial irregularities will increase.

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:

Given that both accounting frameworks will be based on IFRS principles we consider that there is a low risk that investors will be misled or confused by a company switching between accounting frameworks.

Question 28 (para 86)

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

☒ Yes ☐ No ☐ Not sure

Comments:

We have no specific comments to make.

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:

We have no specific comments to make.

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.

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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