



BIS CONSULTATION ON AUDIT EXEMPTIONS AND CHANGE OF ACCOUNTING FRAMEWORK

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CA House 21 Haymarket Yards Edinburgh EH12 5BH
enquiries@icas.org.uk +44 (0)131 347 0100 icas.org.uk

Direct: +44 (0)131 347 0234 Email: jbarbour@icas.org.uk

I refer to the above BIS Consultation Paper and I am pleased to provide the comments of ICAS below.

As the Institute's Charter requires, ICAS must act primarily in the public interest, and responses to consultation documents etc. are predicated on the essential premise that their conclusions must be consistent with the public interest. Our Charter also requires us to represent our members' views and protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

General Comments

ICAS welcomes each of the various proposals contained in the consultation paper. We would however caution that we do have concerns that the benefit of audit to the economy is not fully recognised by the Government. Whilst we are supportive of the proposed measures on this occasion we would not be supportive of any plans to significantly increase the audit exemption thresholds in the near future e.g. to the medium company criteria level.

We also harbour doubts as to whether there will be a large take up by business of the subsidiary exemption proposals.

Comments on the Questions Posed in the Consultation Paper

Question 1

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

We are supportive of the proposals contained in the consultation paper in relation to simplifying the criteria for small companies to qualify for audit exemption and for relaxing the requirements for subsidiaries where creditors are protected via a parent company guarantee. However, we believe that in general, great care should be taken when considering whether to reduce the audit requirements for unlisted companies especially in the current economic environment. The high level of uncertainty that is prevalent in the economic environment means that businesses are very wary when dealing with suppliers and customers. An unqualified audit report can also provide assurance to a lender. Reducing assurance in this way may increase reluctance for lending which is not a desirable outcome in the current market. In the wake of 2008, banks are increasing their balance sheet substantiation efforts as part of strengthening their financial control, a clean audit report could help to inform this element of their financial control (although if a parent guarantees the debt this reduces the risk). We are however aware that banks can make audit a condition of lending to businesses but this very much depends on the approach taken by individual banks. We would emphasise that audit can serve a very valuable purpose and companies which have been audited provide greater assurance to the marketplace on their financial viability although we do appreciate that the information in many cases is not current.

Question 2

A. Do you agree about the underlying assumptions in our Impact Assessment that at least 60% of small companies now eligible will take up the audit exemption?

We agree that a substantial proportion of those small companies affected are likely to take advantage of this proposed exemption. We are not in a position to specifically provide a figure but do believe that the minimum expected uptake of 60% is reasonable in this context.

B. Do you agree that the whole of the audit fee will be saved?

No, we do not agree that the whole of the audit fee will be saved. Where the auditors of a small company assist in the preparation of the statutory accounts of a small company, one will sometimes find that it is difficult to ascertain whether certain costs pertain to the accounting or to the audit work. We would therefore anticipate that the proposed saving will be less than that anticipated.

C. Do you agree that there is no saving of management time for small companies taking up the audit exemption?

We agree.

Question 3

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, this removes an unnecessary complication.

Question 4

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

Yes, we agree in principle with this proposal subject to the safeguards which the Government intends to put in place. We would however add that even if the companies may be entitled to audit exemption under the legislation they may still require to be audited e.g. the Group auditors needs to obtain comfort over a certain percentage of the Group and there is therefore a strong possibility that certain entities will be subject to audit.

Question 5

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?

We believe that the impact might be a lack of transparency in relation to the financial viability of subsidiary companies. We do not support such a proposal.

Question 6

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.

This proposal would make no difference to our business but will reduce the annual management and administration costs associated with the preparation, audit (where applicable) and filing of dormant company accounts.

Question 7

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?

Yes,

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

We believe that there is a need for appropriate safeguards to ensure that there is still appropriate protection for stakeholders.

This proposal would make no difference to our business.

Question 8

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?

We do not believe in the current economic environment that such a move would be appropriate as there is already considerable uncertainty over certain areas of the financial sector without taking steps which could be seen to add further to this.

Question 9

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

Yes.

Question 10

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. We are not in a position to comment on this.
- B. We do not believe that the take-up will be as high as that suggested.
- C. We believe that the figures quoted are reasonable.

Question 11

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?

We believe the reported saving is likely to be less in practice.

Question 12

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?

This appears reasonable.

Question 13

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?

We believe the cost of taking legal advice will be higher than that stated. If the Government was to produce guidance then this would reduce the associated costs but is unlikely to be zero in all cases.

Question 14***Have views of stakeholders expressed to the Company Law Review changed since 2000?***

We do not believe that the views of stakeholders have changed in relation to whether qualifying subsidiaries should be exempt from either the preparation or filing of accounts.

Question 15***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, we agree.

Question 16***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?***

The Government's proposals are likely to lead to at least some small audit firms leaving the marketplace and might have an adverse impact on audit firms which have a number of group audits. We therefore believe that this assumption is somewhat underestimating the potential impact on audit firms.

Question 17***Do you agree with the Government's assessment of the risks of the proposal?***

We believe there are other areas of risk not commented on in the consultation paper e.g. risks such as money laundering and fraud. Such risks may be more prevalent in (larger) international organisations although we do appreciate that such entities will have internal audit departments who will seek to mitigate such risks. Without a company auditor flagging attention to any potential weaknesses the non audited subsidiaries may be more exposed to risks of this nature.

Additionally, financial services is not the only complex industry or the only area which has experienced a negative event which has triggered a major reassessment of current practice e.g. the collapse of Enron which traded in commodities –and Worldcom (telecommunications) – the largest corporate insolvency ever as at 2002; both were complex groups.

Secondly, publicly funded companies which may have a significant impact on the local economy are not considered because they are not quoted companies. There are a number of local authorities who deliver services through other entities (including subsidiary companies). This practice would also appear to be on the increase.

Question 18***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.

Question 19***Do you agree that the guarantee should cover the "debts" of the subsidiary and not extend to its "liabilities"?***

Yes.

Question 20**A. Do you agree with the proposals for the Guarantee?**

Yes.

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?

We remain to be convinced that the take-up will be as high as that which is anticipated. Businesses operate group structures for various reasons but one of the main ones is that this restricts the liability of each of the individual businesses and therefore protects the other members of the group. We are not convinced therefore that groups will readily give up this benefit.

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?

We have no alternative proposals.

Question 21**Do you agree that no new penalties should be proposed in conjunction with the introduction of these proposals?**

We agree.

Question 22**Do you agree that the Government should impose restrictions on companies' ability to move from IFRS to UK GAAP?**

Yes, and also from UK GAAP to IFRS.

Question 23**How frequently should a company be able to move from IFRS to UK GAAP, unless there is a relevant change in circumstances? Every year, every 3 years, every 5 years, or never?**

Every five years appears a reasonable timeframe. We do however hope that the UK becomes more aligned with IFRS in the coming years.

Question 24**A. Do you agree with the Government's estimate that 90% of eligible subsidiary companies will take up the option?**

We are not convinced that the take-up will be as high as that suggested for various reasons including the current uncertainty over the future of UK GAAP.

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

We are not in a position to comment on this.

Question 25**Do you agree that the one-off cost per company will be £390?**

We are not in a position to comment on this.

Question 26

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?

There is a slight increase in the risk of financial irregularities but this is significantly reduced if the period is not made shorter than five years.

Question 27

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

Companies which do this should explain properly in their accounts the reasons for doing so. Where considered necessary, investors should enquire further of the company's directors the reasons behind their decision to switch accounting frameworks.

Question 28

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

Yes.

Question 29

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

In order to give companies and stakeholders sufficient time to prepare for these proposals we consider that their implementation should be delayed until financial years ending on or after 31 December 2012.