The Hundred Group
of Finance Directors

Financial Reporting Committee

Rufus Rottenberg Esq
Audit & Accounting Team
Department of Business, Innovation & Skills
Spur 2, 3rd Floor
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Dear Mr Rottenberg

Consultation on Audit Exemptions and Change of Accounting Framework

We are pleased to submit our comments on this consultation which arises from the Government's commitment to remove regulatory burdens and improve corporate governance with a view to making the UK one of the best places in Europe to start, finance and grow a business.

We comment only on those aspects of the consultation that are relevant to our members' interests, i.e. the application of the audit and other exemptions to subsidiary companies and the ability of companies to change the accounting framework under which they prepare their financial statements.

We apologise for the lateness of our response and hope that this will not prevent the Government from taking our comments into account in its further deliberations.

Who we are

The Hundred Group is a non-political, not-for-profit organisation which represents the finance directors of the UK's largest companies, with membership drawn mainly, but not entirely, from the constituents of the UK FTSE100 Index. Our aim is to contribute positively to the development of UK and international policy and practice on matters that affect our businesses, including taxation, financial reporting, corporate governance and capital market regulation. Whilst this letter expresses the views of The Hundred Group of Finance Directors as a whole, they are not necessarily those of our individual Members or their respective employers.

Audit exemption

We welcome the proposals

We support the Government's initiatives to reduce the regulatory burden on British business. We therefore welcome the proposals:

a) to exempt all qualifying subsidiaries from mandatory statutory audit; and additionally

b) to exempt qualifying dormant subsidiaries from mandatory preparation and filing of accounts.

We support the protections that are contained within existing legislation for minority shareholders who wish the annual accounts to be audited and we agree that, if considered necessary in the public interest, companies involved in financial services or insurance should not qualify for these exemptions.

While our members would welcome having the option to exempt their UK subsidiaries from audit, it is possible that many of them will continue to have the accounts of some or all of their UK subsidiaries audited because:

a) they consider the audit to be an important aspect of their financial control environment; and

b) they may be required to present audited accounts when tendering for business, raising finance or for regulatory purposes.

Moreover, if a subsidiary is a material component of a group, auditing standards require it to be audited as part of the audit of the parent's consolidated accounts. While the level of materiality applied will usually be much lower than in the parent's consolidated accounts, the audit of the subsidiary's accounts does not usually involve significant incremental costs.

Qualifying conditions are a deterrent

We recognise that UK legislation must be consistent with the EU's Fourth Directive 78/660/EC which prescribes the conditions for subsidiaries to qualify for the proposed exemptions. We welcome the Government's intention to avoid any 'gold plating' of EU legislation but we are concerned that there are aspects of the qualifying conditions set out in Article 57 of the Directive that may deter some of our members from taking up the exemptions in respect of certain of their subsidiaries.

Parental guarantee

For a subsidiary to be exempt from audit the parent must declare that it "guarantees the commitments entered into by the subsidiary" and this declaration must be filed at Companies House. We welcome the Government's proposal that the guarantee itself would not need to be filed and that both the declaration of the guarantee and the declaration by the shareholders that they have agreed to the audit exemption would be included in the subsidiary's Annual Return.

We welcome the proposed interpretation of the term "commitments", i.e. that it means the subsidiary's debts (its liabilities in contract) and not its wider liabilities (including its liabilities in tort and contingent liabilities). However, we do not believe that the guarantee should be extended to cover all future debts incurred by the subsidiary until such time as an audited set of accounts is filed. We believe that such an open-ended guarantee would conflict with the principle of limited liability. We suggest that the nature and extent of the guarantee should be consistent with the commitments of support that are routinely given by a parent to where a subsidiary would not otherwise be able to prepare its accounts on a going concern basis. Generally, such support would extend for twelve months from the date of signing the accounts. In view of the fact that a qualifying dormant subsidiary would not prepare and file accounts, we suggest that a practical solution would be for the guarantee to be required to extend to the date on which the subsidiary files its next following Annual Return. For example, if the audit exemption is in respect of the year ending 31 December 2012, the guarantee would have to cover the period until the date of filing the subsidiary's Annual Return for the year ending 31 December 2013.

We believe that it should be stated explicitly in any eventual legislation that the guarantee must be effective, i.e. that the parent company must have sufficient resources or guarantees available to it to satisfy the guarantee given to the subsidiary.

Accounting for the parental guarantee

Parent companies that prepare IAS accounts would have to recognise and measure the parental guarantees as financial liabilities under IAS39 'Financial Instruments: Recognition and Measurement'. Such guarantees must be initially measured at fair value and subsequently measured at the higher of and the amount initially recognised (less, where appropriate, the cumulative recognition of revenue in accordance with IAS18 'Revenue') and the amount determined in accordance with IAS37 'Provisions, contingent Liabilities and Contingent Assets'

We believe that the costs of accounting for these guarantees may outweigh the benefits to users of the parent company's financial statements and represent an unnecessary burden for companies.

We suggest that users needs would be better served by disclosure in the parent company's accounts of the nature of the guarantees given and the total amount of the guarantees outstanding at the parent company's balance sheet date together with details of any material changes since that date. Where it is considered probable that the guarantee will be called upon, the parent company should provide for the expected future consequential out flows of resources.

We note that a financial guarantee issued between a parent and a subsidiary or issued by a parent of a subsidiary's debt to a third party are not subject to the recognition provisions of the equivalent US accounting standard, FASB Accounting Standards Codification Topic 460 'Guarantees'. We suggest that the Government draws the attention of the Accounting Standards Board to the possibility of modifying IFRS for use in the UK to exclude such guarantees from the scope of IAS39 (and its eventual successor standard, IFRS9 'Financial Instruments').

Disclosure requirements

We believe that the requirement to disclose the use of the exemption by each subsidiary in the parent's consolidated accounts will give rise to further clutter in the accounts that would be of little benefit to users. Such information is largely irrelevant in the parent's consolidated accounts which include the liabilities of the subsidiaries which are the subject of the guarantees.

In some groups, the number of subsidiaries that may be eligible for the audit exemption may run into the hundreds but that most of them are likely to be immaterial in the context of the parent's consolidated accounts. As the exemption will be relevant only to subsidiaries that are registered in the UK and a limited number of other EU countries, the disclosure is likely to confuse users of the consolidated accounts of international groups.

We recognise that the Government is restricted by the EU Directive but we suggest that a compromise may be to require disclosure of the existence of the guarantees in the parent's consolidated accounts with a reference to its Annual Return which would include a full list of the relevant subsidiaries.

Exemption from preparation and filing of accounts

We request that the Government reconsiders exempting non-dormant qualifying subsidiaries from the preparation and filing of accounts. While we acknowledge the arguments set out in paragraph 52 of the consultation, we note that this exemption is available in Germany. As such, the Government's proposals retain a degree of gold-plating of EU legislation which may adversely affect the attractiveness of Britain as a place to do business compared with one of its major European competitors.

Change of accounting framework

We believe that there should be no restrictions on the ability of a company to change accounting framework except that the directors of the company should have good reasons for the change that are disclosed in the company's financial statements.

We recognise that there is the possibility that companies will change their accounting framework to achieve tax arbitrage. However, given the cost and upheaval involved, we believe that in practice companies are unlikely to change accounting framework without a good reason that will generally be linked to a change in the company's circumstances. Moreover, we believe that investors and lenders would quickly lose confidence in companies that regularly change their accounting framework without good reason.

We believe that any concerns about companies achieving tax benefits by way of frequent changes of accounting framework should be dealt with through tax legislation.

Yours sincerely

Chris Lucas
Chairman
Hundred Group – Financial Reporting Committee