Department for Business Innovation & Skills

AUDIT EXEMPTIONS AND CHANGE OF ACCOUNTING FRAMEWORK

Summary of Responses to Consultation

02 MARCH 2012

Contents

1. Introduction

Background

1. On 6 October 2011 BIS published a consultation paper Consultation on Audit Exemptions and Change of Accounting Framework together with an Impact Assessment, outlining proposed changes to audit exemptions and to the ability of companies to change their accounting framework.

2. The consultation on increasing audit exemptions concerned the proposal to give more SMEs and subsidiary companies the ability to make a commercial decision about whether or not to have an audit. It was estimated that removing this EU gold plating would save UK businesses £612m per year, but as a result of the consultation, this amount will reduce. Every company requires robust financial controls and appropriate governance and for many companies audit will be a vital part of this. However it is well established in the UK that the requirement for audit should not be imposed by law on all companies.

3. The Audit Exemption policy options considered were:

- Option A: take advantage of some of the exemptions available under Articles 51(2) and 57 of the 4th Company Law Directive to reduce the mandatory audit, preparation and publication of accounts (the Government's preferred option)
- Option B: take advantage of all of the exemptions available under the above articles.
- Option C: do nothing

4. Under the Government's preferred option, mandatory audit thresholds for small companies would be aligned with accounting thresholds for small companies; also a subsidiary company would be exempt from mandatory statutory audit where it fulfils all of the following conditions:

- the subsidiary's parent company is registered in the EU;
- the parent has declared that it guarantees the debts of the subsidiary and this declaration must be published by the subsidiary in Companies House ;
- the subsidiary's shareholders unanimously must have declared each year to dispense with an audit and this declaration must be published by Companies House;
- the subsidiary must be included in the consolidated accounts drawn up by the parent undertaking; these consolidated accounts and the consolidated annual report must be audited and filed in the company registry;
- the use of the exemption by the subsidiary must be disclosed in the notes on the consolidated accounts drawn up by the parent;
- the subsidiary is unquoted;
- the subsidiary is not in the banking or finance sector.

The final two conditions above were ones that the Government proposed to add in addition to those imposed by the Directive in order to reduce the potential risks of not mandating an audit. The changes would also apply to subsidiary Limited Liability Partnerships and it was estimated that the change to the audit exemption for subsidiaries would result in a net benefit to businesses of £406m per year, although this amount is likely to reduce in the final Impact Assessment.

5. In light of the consultation by the Accounting Standards Board on changes to UK GAAP, the Government also sought views on whether to allow companies who currently prepare accounts under IFRS, as adopted in the EU, more flexibility to change their accounting framework to UK GAAP. This would permit subsidiaries to take advantage of reduced disclosures under UK GAAP.

6. The Change of Accounting Framework policy options considered were:

- Option A: permit companies to change their accounting framework no more than once every 5 years (the Government's preferred option)
- Option B: add a change in the accounting standards to the list of relevant reasons for a permitted change in companies' accounting framework
- Option C: permit companies to change their accounting framework no more than once every 3 years
- Option D: permit companies to change their accounting framework every year
- Option E: do nothing/status quo

It was estimated that the Government's preferred option would result in a net benefit of £2m per year.

7. For both audit exemptions and a change in accounting framework, it was proposed that the changes would apply for accounting years ending on or after 1 October 2012.

8. The consultation sought views on form, scope and implementation of the proposed changes.

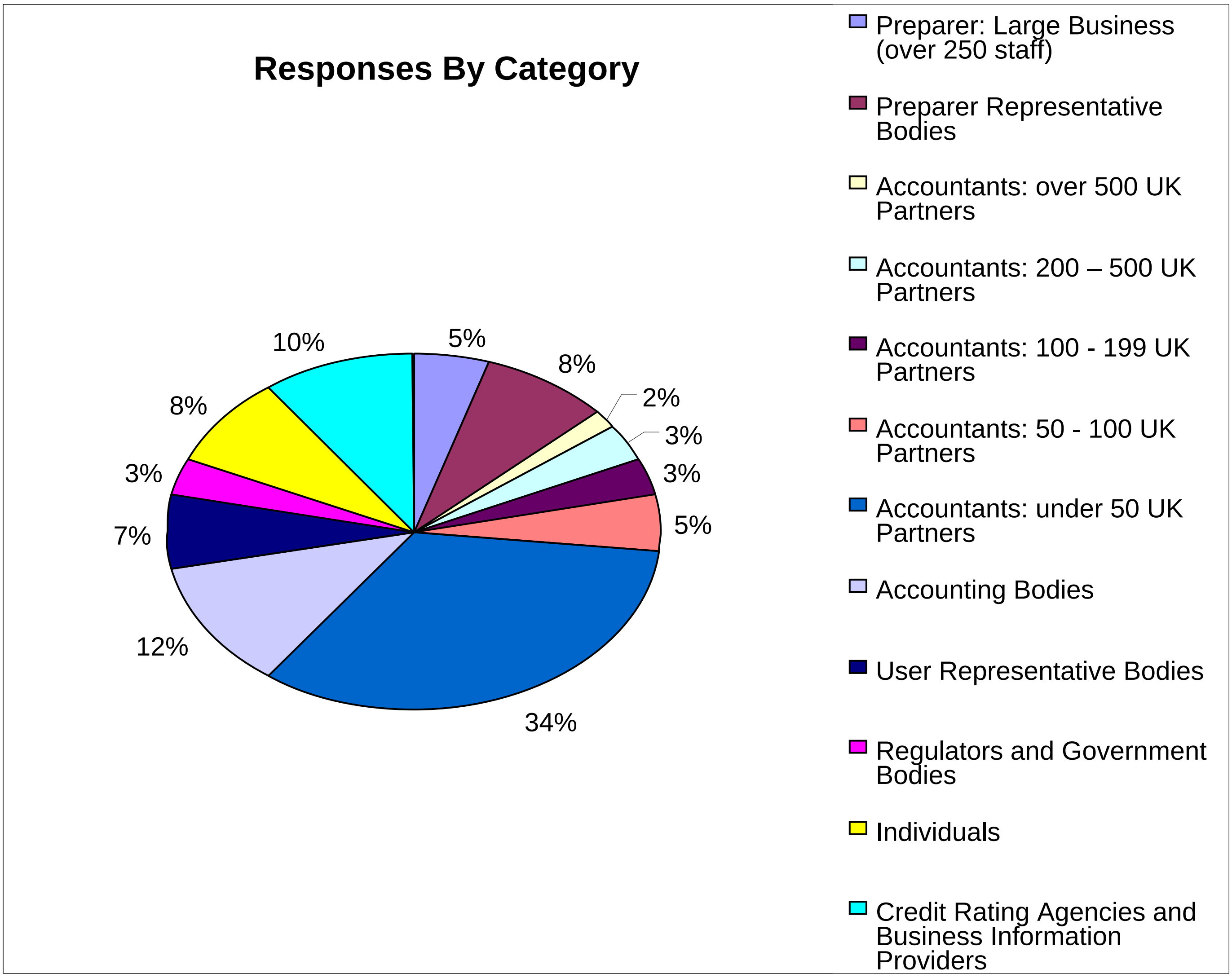
Consultation Process

9. The consultation covered the whole of the UK. It began on 6 October 2011 and ran for twelve weeks, closing on 29 December 2011. Respondents are listed in 'Annex A'.

10. Following receipt of the consultation responses, further discussions with several stakeholders were held.

Responses to the Consultation

11. 60 responses were received. The chart below sets out the distribution of responses received according to the consultation document categories. A tabular version of this chart is at Annex A.



2. Key Themes Arising in the Consultation Responses

- Clear support for the proposals from the companies who see themselves benefitting from the audit exemptions and ability to change accounting framework.
- Need to protect users of accounts and creditors.
- Uncertainty about the level of take up of the audit exemption for subsidiaries with a parent company guarantee and the resulting cost savings.

3. Next steps

12. The Government will now consider its own response to these responses, which it intends to publish, together with a final impact assessment and any draft legislation, in the Spring.

4. Summary of Responses to Questions 1-29

Q1. What are your views on the overall principle of reducing audit requirements for unlisted companies?

13. The principle was broadly supported by a majority of respondents including accounting firms of varying size, the majority of accounting bodies, and all industry respondents. Changes which encourage economic growth and reduce costs through the reduction in the audit and regulatory requirements on small businesses were welcomed by accounting firms, user representative bodies and industry respondents alike, with a number of accounting bodies agreeing that the benefit of audit varies with company size. One industry respondent commented that the proposals would allow large corporations to focus on more critical issues.

14. Several respondents, including a large corporate firm, were in favour of proposals which prevent UK businesses from being at a disadvantage to their EU competitors.

15. One large accounting firm commented that a reduction in audit requirements would allow companies to seek assurance that suits their strategic position and needs, and others believed that companies would welcome the opportunity to decide themselves whether to have an audit or not. It was noted that the current restrictions do not promote flexibility and inclusivity. A preparer representative body commented that while members would welcome the option to avail themselves of audit exemptions, many would still continue to audit their accounts for the purposes of financial control and satisfying third parties such as potential trading partners.

16. Approximately 10% of respondents, primarily individuals, were strongly opposed to the principle because they believed that all businesses should be subject to an external audit to ensure accounts are correct and not misleading, user needs are met and the interests of stakeholders are protected.

17. Concerns were raised by several accounting firms, individuals and business information providers over the possible negative impacts of a reduction in audit requirements on the availability, quality and reliability of financial information. They were particularly concerned that this would lead to loss in public confidence in financial information, which in turn may lead to difficulties for companies seeking to obtain credit or overdraft facilities, difficulties in assessing credit worthiness, creditors being placed in a vulnerable position, further costs and a negative impact on business overall. One accounting body believes that many small companies and subsidiaries will continue to have audit in order to maintain confidence. They also expressed concern over the loss of an independent and objective view on the financial status of a company, and the consequent possible increase in the risk of corporate fraud and fraudulent disclosure at Companies House.

18. However the British Bankers Association stated that the requirements of banks needs not get in the way of deregulation, but that there will be instances where banks will recommend that companies have their accounts audited and instances where companies themselves choose to do so in support of the track record needed if they wish to raise capital in the markets.

19. Clarification was sought by several respondents on the impact of any reduction in audit requirements on charities

Q2.

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?

Of those who responded, 59% agreed with this estimate, 6% disagreed and 35% were unsure.

20. Members of one accounting body believed that take up rate would be higher than 75%, while another firm believed the take up rate will be higher than estimated based on the impact of previous changes to audit exemptions and the cost pressures companies are currently facing. Two accounting firms commented that independent audit is not of as much benefit to shareholder actively involved in company affairs, which is often the case for shareholders of small companies.

21. The few who did not agree with this estimate felt that an audit was likely to be still required by creditors, shareholders, lenders and potential investors.

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

Of those who responded, 23% agreed, 54% disagreed and 23% were unsure.

22. The majority of respondents felt that the whole audit fee would not be saved. Almost a quarter of responding accounting firms believed only a partial saving is likely as companies will still require assistance in the preparation and filing of accounts, and other assurance services may be required. Other accounting firms and bodies commented on the difficulty to distinguish between costs relating to accounting and auditing work, and so the saving is most likely overestimated.

23. A number of respondents also believed the estimated cost of £9,500 for an audit of a small company or subsidiary to be too high, with one accounting body proposing an alternative estimate of less than £4,000.

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

Of those who responded, 18% agreed, 64% disagreed, and 18% were unsure.

24. The majority of respondents, which included over 80% of responding accounting firms, felt that some savings in management time could be made, largely in the preparation and

provision of information to auditors. Others noted that directors would still need to adhere to the Companies Act 2006 with respect to the preparation and filing of financial statements, and so any saving of management time would be limited.

25. One industry respondent commented that additional internal review procedures would take place and require management time.

Q3. 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?

Of those who responded, 73% agreed, 19% in disagreement and 8% unsure.

26. The proposals to align audit and accounting exemptions for small businesses were supported by the majority of respondents. There was consensus between the majority of accounting bodies, accounting firms, and respondents from industry. Two accounting firms commented that the alignment would provide simplification, and one industry respondent asserted that the alignment would not result in a significant deterioration of the quality of financial information as information will still be consolidated at group level. Concerns however were expressed by a business information provider over the potential negative impacts on company growth arising from a loss in the amount and quality of publicly available financial information.

27. An accounting body expressed strong disagreement with the alignment on the basis that the thresholds for auditing and accounting serve different purposes and therefore may need to move independently. They also suggested reducing the accounting thresholds to levels that currently define a micro-company in order to meet user requirements.

28. Concerns were primarily raised by accounting firms over the nature and scale of companies that would now be exempt from audit under the proposed alignment, (for example, companies with few employees, low turnover but high gross assets such as property investment companies or start-up companies) and the risks arising from such companies availing of the exemption. One large accounting firm commented that the risks of allowing significant trading entities to be exempt from audit are mitigated by the exclusion of public interest entities from the scope of the exemptions.

Q4. Do you agree that qualifying non-dormant subsidiaries should be exempted from mandatory audit of their accounts?

Of those who responded, 52% agreed, 31% in disagreement and 17% unsure.

29. Opinion on this proposal was divided, with a wide range of views being expressed. All respondents from industry agreed with this proposal. One of these respondents commented that the cost and time spent preparing for a subsidiary audit outweighs the benefits to stakeholders, while the other stated that the proposed exemptions would remedy inefficiencies within the system and that a risk-based management approach focusing on the group would be more appropriate. One preparer representative body commented that mandatory audit does not provide investors with significant additional protection, and that,

provided stakeholders would not be exposed to any extra risk, proposals which reduce the costs of doing business in the UK would be welcomed

30. Concerns were raised over the nature of subsidiaries potentially eligible to use the exemptions. An accounting body believed that a subsidiary should be wholly-owned in order to be eligible.

31. Several respondents called the proposed level of savings into question. One accounting body commented that the proposed savings were unlikely to materialise in practice due to an increase in the workload and hence costs of the group auditor, and due to a reluctance of parent companies to increase their risk exposure thereby reducing the take-up rate. Another raised concern over the enforceability of a parent company guarantee overseas, the potential costs to consumers of enforcing a guarantee, with the issue of translation costs being raised by a user representative body.

32. Concerns were expressed by several accounting firms and business information providers over the potential reduction in the quality of publicly available financial information. An accounting firm also suggested the inclusion of an upper size limit for subsidiaries to prevent large trading subsidiaries of considerable public interest from availing of audit exemptions.

33. A respondent from industry was strongly in favour of the audit exemptions for subsidiaries being extended to UK companies with non-EU parents.

Q5. 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?

34. The consensus among correspondents was that, although there could be significant cost savings for companies under this option, the risks associated with it were significant. The majority of accounting firms, accounting bodies and business information providers felt that this option would result in a significant loss of financial information and a lack of financial transparency for credit and risk decision makers, with a respondent noting that consequently the cost of capital may increase. One accounting body commented that accounts prepared outside the UK may not be readily accessible to the public, and so UK companies should not be exempt from filing accounts at Companies House if group accounts are prepared outside the UK.

35. One representative body commented that audit exemption proposals will be of limited application to company charities as a parent company charity could only guarantee the debts, commitments or liabilities of a non-charitable subsidiary in the case of the guarantee furthering the charity's charitable objectives. Further guidance on the circumstances in which company charities can offer a guarantee was requested.

Q6. 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?

Of those who responded, 54% agreed, 26% in disagreement and 20% unsure.

36. An accounting body and two accounting firms believed that the proposed exemption would have little impact on business and the wider economy, and that a significant loss of publicly available information was unlikely. Another body commented that the exemptions would reduce annual administration and managerial costs.

37. Concerns were mainly raised over declarations of dormancy and the ability of dormant subsidiaries to hold significant assets and/or liabilities. Two accounting firms suggested that a declaration of dormancy should be included in the annual return, while another firm felt that filing dormant company accounts forms at Companies House was a cost effective way of declaring the state of a subsidiary. One accounting body suggested that a state of dormancy should be disclosed in the group accounts.

38. With respect to the balance sheet of dormant subsidiaries, an accounting body asserted that dormant subsidiary accounts should still be reviewed by the group auditor and filed at Companies House as such subsidiaries may still have significant assets or liabilities on their balance sheet. A user representative body believed that any movement of assets or liabilities, since the last accounts had been filed should not be permitted, and that a declaration to that effect should be required.

Q7.

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 for the audit exemption in UK company law?

Of those who responded, 70% agreed, 17% in disagreement and 13% unsure.

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

39. Approximately three quarters of responding accounting firms and all responding accounting bodies were in favour of the proposed exclusions from the exemptions largely on the basis that they were required for the benefit of public interest and transparency, as more creditor and consumer protection is required for such companies. Two respondents commented that such companies were systemically more important, and an accounting firm also noted that the provision of a parent company guarantee might not mitigate the risks associated with such companies.

40. Several accounting firms sought clarity on definitions of affected entities and on the scope of the exclusions.

Q8. 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?

41. Slightly over a third of those responding to this question, which included several accounting bodies, accounting firms, and user representative bodies believed that allowing financial services subsidiaries to avail of this exemption would result in a threat to user confidence.

Further concerns were raised over the possible increase in the risk of fraud and error, and over the adverse impacts, particularly on investors and lenders, resulting from a decline in the quality and reliability of financial information. One respondent believed it could increase the cost of borrowing.

42. Two respondents commented that such a change would run contrary to initiatives encouraging stricter regulation and reporting in the financial services industry.

43. A small number of respondents suggested the use of alternative criteria in determining whether a subsidiary should qualify for exemptions, such as company size

Q9. Should the same rules on exemptions for qualifying subsidiaries should broadly apply to LLPs and unregistered companies?

Of those who responded, 73% agreed, 13% in disagreement and 14% unsure.

Q10. 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 audit is in the range of £8,000 to £83,000 per subsidiary?

Of those who responded, 28% agreed, 24% disagreed and 48% were unsure of the estimate.

44. Several accounting firms commented that they were unable to provide a judgement of the estimate as the stated range of the estimate was too broad, and two respondents commented that some companies would incur audit costs outside of this range. A cost of less than £4,000 was proposed by an accounting body, while another accounting firm proposed a cost range of £3,000-£6.000.

45. A respondent from the accounting profession questioned the estimate on the basis that a parent company would be more likely to provide a guarantee for smaller subsidiaries, while larger subsidiaries were likely to undergo detailed examination as part of the group audit.

B. That 75% to 100% of qualifying subsidiaries will take up the exemption?

Of those who responded, 25% agreed, 36% in disagreement and 39% were unsure.

46. Agreeing respondents included a large corporate.

47. The majority of concerns with respect to this estimate arose from issues surrounding the provision of a parent company guarantee. Several accounting firms believed that significant uncertainty exists over the willingness of parent companies to provide a guarantee, and felt that the take-up rate would be highly dependent on the nature of the guarantee. The possible unwillingness of companies to relinquish the limited liability status of subsidiaries in favour of audit exemptions was highlighted by a small number of other respondents. One accounting body felt that the take-up rate would be lower than proposed as subsidiaries would still be subject to the mandatory filing of accounts.

48. Views were mixed on the potential audit savings. A large accounting firm commented that

potential audit savings may not be significant in the eyes of a parent company given the work still required by larger subsidiaries for the consolidated accounts. Another firm felt that the potential savings would not outweigh the costs and risks associated with the proposals.

C. That 10 to 25% of the audit cost of each qualifying subsidiary will be saved?

Of those who responded, 43% agreed, 11% in disagreement and 46% unsure.

49. A large corporate suggested that these savings would be significant where these subsidiaries already had a US GAAP audit. In this instance almost the whole UK statutory audit fee for each of these subsidiaries that were neither regulated, nor had employees, could be saved. One respondent commented that whole audit fee might be saved if audit costs could be differentiated from accounting costs.

50. A small number of respondents felt that, as savings would vary from company to company, it was impossible to generalize the level of savings.

51. The estimate was questioned primarily owing to concerns of an increase in costs and audit work at group level. It was suggested that an audit may still be required by a parent company auditor in forming an opinion on the group, while an accounting firm asserted that significant subsidiaries would still be subject to audit testing as part of a group audit.

Q11. 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?

Of those who responded, 15% agreed, 33% disagreed and 52% were unsure with the estimate and the underlying assumptions.

52. There was a substantial level of uncertainty among respondents, with over half of all respondents indicating that they were unsure about the proposed estimate and underlying assumptions.

53. Several respondents felt that savings in management time would vary widely with the size and complexity of a company. While an industry respondent recognised that the proposals would result in the saving of management time, they felt it was not possible to quantify the savings. One respondent also commented that the estimate was too subjective to give a meaningful measure of time savings.

54. Large accounting firms asserted that savings of management time may not be significant. It was noted that junior members of staff rather than senior management often carry out the majority of audit work, that significant subsidiaries will still require substantial interaction with the group auditor and that directors will still need to ensure that accounts give a true and fair view of the company.

Q12. Do you agree with our estimate of the saving of the cost of management time to prepare and file dormant subsidiary accounts and in particular the underlying assumption of £280 per dormant subsidiary?

Of those who responded, 19% agreed, 32% disagreed and 49% were unsure.

55. Again there was quite a large degree of uncertainty among respondents. There was no consensus here, some feeling that savings would be greater and some that they would be smaller.

Q13. Do you agree with our estimate of the cost of 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?

Of those who responded, 11% agreed, 59% in disagreement and 30% were unsure.

56. The majority of respondents thought that the cost of legal advice on the form of the guarantee and the extent of the company's liability under it would be higher than the Government's estimate, and disagreed that if Government provided guidance on an acceptable form of guarantee, that the cost of legal advice would be zero.

57. It was pointed out that the cost was dependent on the number of subsidiaries in a group taking advantage of the exemption and that the legal costs would be spread across all the subsidiaries in a group taking advantage of the exemption. However no respondent provided alternative estimate of the number of hours of legal advice that would be required.

Q14. Have views of stakeholders expressed to the Company Law Review changed since 2000?

Of those who responded, 74% believed the views of stakeholders expressed to the Company Law Review have not changed since 2000. 26% of respondents were unsure, and no respondents believed the views had changed.

58. The majority of respondents felt that the views expressed by stakeholders in 2000 still hold today. Concerns were raised over that the potential loss of public information, should non-dormant subsidiaries be exempt from the preparation and filing of accounts, still exist with one respondent commenting that the cost to the economy of such an exemption would still exceed the marginal cost savings to the individual company. A respondent from industry believed that, in the context of wholly owned subsidiaries, the lack of such an exemption provides transparency.

Q15. 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 to exceed the benefits?

Of those who responded, 59% agreed, 22% disagreed and 19% were unsure.

59. The majority of respondents from all sectors, agreed with the overall conclusion that qualifying non-dormant subsidiaries should continue to prepare and file individual accounts,

because of the impact of a potential loss of financial information, an increased risk of fraud and error, a reduction in business confidence and potential difficulties for users interpreting consolidated accounts.

Q16. 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?

Of those who responded, 25% agreed, 54% disagreed and 21% were unsure.

60. Opinion on the impact of the proposals was quite divided, however a majority of respondents believed the impact of the proposals on the number of small audit firms had been underestimated by Government. Included in this majority were all responding accounting bodies, and 50% of responding accounting firms with fewer than 50 partners.

61. Several accounting firms and an accounting body were concerned that the costs incurred by small firms in maintaining audit registration would outweigh the benefits given a decrease in the number of businesses requiring an audit, thereby reducing the number of small firms.

62. The potential negative impact of the proposals on the level of competition in the audit market was raised by a number of accounting firms. Further to this, an accounting body and several individuals felt that a reduction in both the competition and the number of small and medium audit practitioners could lead to adverse cost effects for SMEs and charities.

63. 30% of responding accounting firms with fewer than 50 partners commented that the level of audit expertise could be adversely affected insofar as a reduction in audit work could lead to difficulties in maintaining expertise and in training new auditors and accountants.

64. Contrary to these views was the opinion held by a large accounting firm that there would be no significant effect on the overall number of small accounting firms if such firms had the opportunity to redeploy audit staff to other accounting work. Several accounting firms also commented that such firms may now be able to offer value-added non-audit services which they would have not been able to offer in their role as auditor owing to issues of independence and objectivity.

Q17. Do you agree with Government's assessment of the risks of the proposal?

Of those who responded, an equal percentage (42%) were in agreement as in disagreement, and 16% were unsure.

65. Respondents were evenly divided in their opinion of the Government's assessment of the risks of the proposals. A large accounting firm believed the proposals offered small entities a greater choice in the level of assurance they would prefer, and that risks arising from the exemption of significant, complex trading subsidiaries from audit would be mitigated through the guarantee and audit requirements at group level.

66. Half of those who disagreed expressed concern over the impacts of a reduction in the amount and quality of financial information available. Respondents felt this could lead to a reduction in confidence, an increase in the risk of fraud, an increase in the failure to recognise and report financial crime, and less informed, poor decision making by directors.

67. Respondents also raised concern over effectiveness of a guarantee, namely that the guarantee should be legally effective regardless of the size of subsidiary, and over the costs of enforcing a guarantee. One highlighted the potential difficulties in assessing the value of a guarantee, as the consolidated accounts may include guarantees covering several European subsidiaries and may not be readily accessible UK companies and individuals owing to differences in language and in the preparation of accounts.

Q18. 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.

Of those who responded, 62% agreed, 15% disagreed and 23% were unsure.

68. The majority of respondents agreed that a guarantee should include the elements stated above. Included in this majority were all responding accounting bodies, all respondents from industry and over half of responding accounting firms.

69. With regard to public benefit and the protection of creditors differing views were expressed. One accounting firm asserted that an effective guarantee offers creditors more protection that an audited set of accounts, while another firm commented that the proposed form of guarantee was required to protect creditors. Several respondents were concerned that a lack of information and transparency may leave creditors financially exposed. An accounting body felt that those with third party claims may be left exposed if liabilities were not covered by the guarantee, and that further legislation was required to ensure all claimants were treated fairly in the case of insolvency. Concern was also raised over the practical enforceability of a guarantee, particularly in the case of a non-UK parent.

70. Further clarity was called for on the definition of “debts”, “financial year” and “liabilities”.

71. It was also suggested that the guarantee should be renewed annually, and that the subsidiary should indicate at the beginning of the financial year whether they would be availing themselves of the audit exemption.

72. A preparer representative body did not believe the guarantee should cover future debts until such time as an audited set of accounts for the subsidiary is filed on the basis that this would conflict with the principle of limited liability. They suggested an alternative proposal of requiring the guarantee to cover future debts until such time as the subsidiary files its next annual return.

Q19. Do you agree that the guarantee should cover “debts” of the subsidiary and not extend to its “liabilities”?

Of those who responded, 23% agreed, 44% disagreed and 33% were unsure.

73. Opinion on this issue what quite evenly divided with almost a third of respondents expressing uncertainty on the matter. However a preparer representative body agreed with the proposal.

74. Further clarity on the restriction was called for, and particularly on the definition of “debt”. One respondent questioned whether limiting the guarantee to “debts”, when the directive

refers to “commitments” is consistent with EU law.

75. 40% of those who disagreed with the restriction believed the guarantee should extend to contingent liabilities. One respondent commented that contingent liabilities could constitute debts as a matter of contract and thus should be covered by a guarantee of debts, while others felt their inclusion was necessary to protect stakeholders. A small number of respondents felt that all liabilities should be covered by the guarantee, largely to protect the interests of creditors.

76. The public benefit of the restricting the guarantee to debts was also questioned by a significant number of respondents. One respondent believed that the restriction would leave those without a contractual agreement with a company lacking assurance, and this risk would outweigh the benefits of any increase in take up rates facilitated by the restriction.

77. Concern was also expressed that the proposals may undermine existing cross-guarantees, which in turn would lead to companies seeking legal advice when considering offering a guarantee.

78. It was also noted that the audit exemption proposals would have limited application to company charities as a parent company charity could only guarantee the debts, commitments or liabilities of a non-charitable subsidiary if it was in furtherance of the charity’s charitable objectives.

Q20.

A. Do you agree with the proposals for the Guarantee?

Of those who responded, an equal percentage (38%) was in agreement as in disagreement, and 24% were unsure.

79. Respondents were evenly divided in their views on the proposals for the guarantee. Those who disagreed with the proposals raised concerns largely over the effectiveness of the proposals and their benefit to the public. A preparer representative body suggested that the Accounting Standards Board should modify UK GAAP to exclude a guarantee between a parent and a subsidiary from the requirement of IAS39 on recognition, in line with the equivalent US accounting standard. They also believe that, in order to avoid additional clutter in the accounts, the Directive requirement to disclose the existence of the guarantees in the parent’s consolidated accounts could be met by a reference to its annual return, which would include a full list of the relevant subsidiaries.

80. A small number of respondents believed creditors were afforded better protection through the provision of a guarantee, but expressed concern at how a guarantee could be legally implemented. Government guidance on the wording of the guarantee would be welcomed. It was suggested that the annual return should include a declaration of agreement by shareholders to the exemption, and that a copy of the guarantee should be filed with Companies House to prevent a lack of user information. Others suggested a solvency declaration should also be required of the parent company or at least a requirement in the legislation that the guarantee should be effective.

81. Further guidance was also called for in ensuring directors of company charities understand

the circumstances in which a guarantee can be offered.

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?

Of those who responded, 15% believed the form of the proposed guarantee would encourage a take up rate of 75-90%, 44% disagreed and 41% were unsure.

82. The majority of respondents did not support the above claim. Following consultation with its members, one accounting body expected the take up rate to be less than 75% and following initial discussion with a number of clients, an accounting firm suggested the take up rate would be significantly lower due to unwillingness among clients to provide the proposed guarantee.

83. Respondents who disagreed largely felt that the costs and risks associated with the provision of such a guarantee may outweigh the benefits in terms of the loss of the limited liability status of a subsidiary availing of the exemption, the need for legal advice, and the marginal level of savings. An accounting firm commented that the savings achieved through use of the exemption, would be exceeded by the additional costs of providing financial information sufficient to maintain trade credit and costs of capital.

84. One respondent commented that a company's distributable reserves and dividend payments could be affected, as a parent company providing the guarantee would need to prepare financial statements under IFRS reflecting the fair value of the guarantee in financial statements.

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?

Of those who responded, 11% had an alternative proposal to offer, 68% did not, and 21% were unsure.

85. An industry respondent suggested the use of a non-legally binding letter of support from the parent company expressing the intention to financially support the subsidiary through the foreseeable future

86. It was suggested that, in the interest of transparency, the parent company guarantee should be filed at Companies House.

87. It was also suggested that the guarantee should cover all debts, including contingent liabilities, incurred until such time as audited financial statements are filed.

Q21. Do you agree that no new penalties should be proposed in conjunction with the introduction of these proposals?

Of those who responded, 74% agreed, 19% disagreed and 7% were unsure.

88. The majority of respondents believed that no new penalties should be proposed in conjunction with the introduction of the proposals.

Q22. Do you agree that the Government should impose restrictions on companies' ability to move from IFRS to UK GAAP?

Of those who responded, 53% agreed, 41% disagreed and 6% were unsure.

89. Opinion was quite evenly divided on this issue, with a majority of respondents in favour of imposing restrictions. Reasons given for requiring restrictions were to ensure the reliability of financial information, and to maintain consistency and comparability, and to reduce the risk of tax arbitrage.

90. A variety of views were expressed in opposition to any restrictions. Several respondents, including a preparer representative group, believed companies should be afforded the flexibility to decide themselves on which framework to use. One accounting body asserted that the only restriction should be the requirement for directors to have a good reason for change, and that this reason should be disclosed in the accounts. An industry respondent believed companies should possess the flexibility to align new subsidiaries, who previously reported under IFRS, with the group reporting policy of UK GAAP. Support was also received for the removal of this restriction, which would prevent AIM companies moving from IFRS to UK GAAP upon de-listing.

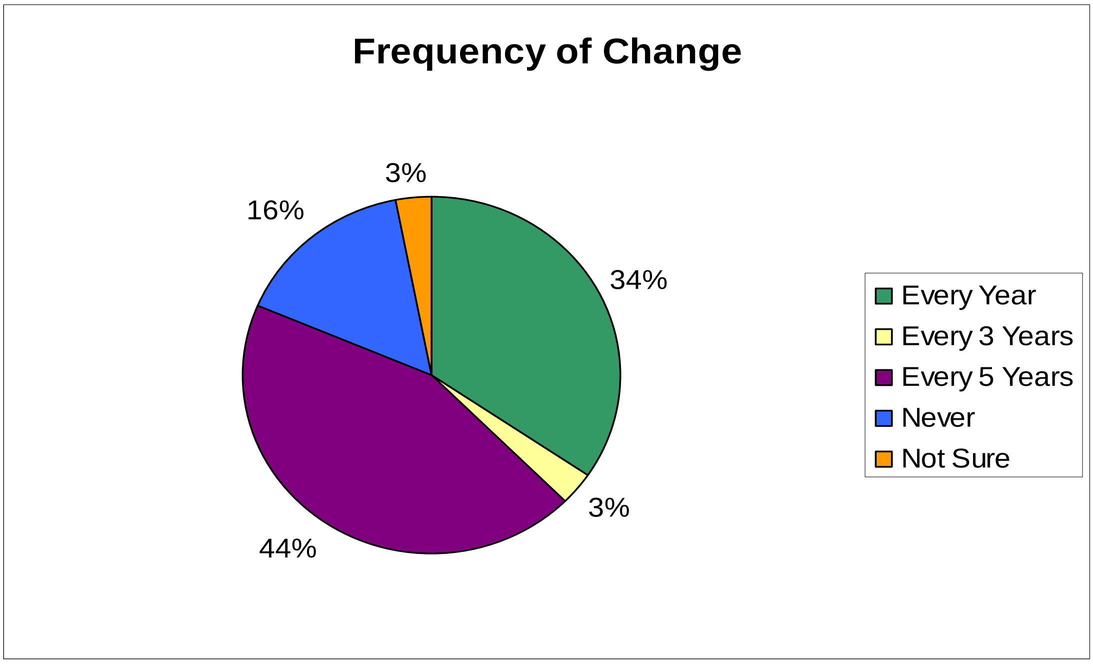
91. A number of respondents disagreed that companies would benefit from being able to move regularly between IFRS and UK GAAP (as stated in the line preceding paragraph 83 of the consultation document) as such movement is costly. It was also suggested that restrictions are unnecessary as the time, cost and complexity of switching between frameworks will discourage companies from doing so.

92. Approximately 10% of respondents commented that the risk of misrepresentation when moving between frameworks will be mitigated by the similarities between IFRS and UK GAAP under the ASB proposals.

93. Further clarity was sought by a preparer representative body on the position of the Companies Act requirement for consistency of reporting framework in a group.

Q23. How frequently should a company be able to move from IFRS to UK GAAP, unless there is a relevant change of circumstances? Every year, every 3 years, every 5 years, or never?

The beliefs of those who responded were distributed as follows:



94. The majority of respondents were in favour of permitting a company to move from IFRS to UK GAAP once every 5 years unless there is a relevant change in circumstances. Over half of those in favour of this timescale believed such a timescale was necessary to maintain consistency and comparability with respect to the preparation and filing of accounts. A business information provider also commented that this timescale would allow the construction of a historical financial profile, thereby facilitating more informed decision making by creditors.

95. Several respondents did not agree with the use of time-based criterion. One accounting firm felt the list of relevant changes in circumstances should be replaced by the requirement that a change in framework is permitted if the company directors believe there is a good reason for doing so, and this reason is disclosed in the accounts. An industry respondent commented that a change in framework should only be permitted if there is a relevant change in the business.

96. It was also suggested that guidance be provided on how a company should present its results when moving from reporting under IFRS to reporting under UK GAAP, in particular for the benefit of stakeholders.

Q24.

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

Of those who responded, an equal percentage (24%) was in agreement as in disagreement, and 52% were unsure.

97. There was no consensus, with over half of all respondents indicating uncertainty over the proposed take up rate of 90%.

98. Several accounting firms commented that they expect a high take up rate, with one firm

having received indications of strong support from its clients. It was also noted that the take up rate would be dependent on the form of the final ASB proposals.

99. Half of those in disagreement believed that companies would be unwilling to change frameworks on the basis that subsidiaries will have good reasons for preparing accounts under IFRS and the consolidation process may be easier under IFRS.

100. A respondent questioned whether companies would revert to UK GAAP only to have switch again to FRSME with transitional effect from 1 January 2014

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

Of those who responded, 13% agreed, 29% disagreed and 58% were unsure.

101. Opinion on the estimate was uncertain, with 58% of respondents unsure of proposed level of saving. Almost a fifth of respondents believed that savings would be greater than £569 for some companies. Although uncertain of the estimate, another respondent felt that the saving would be sufficient to warrant a change in framework.

Q25. Do you agree that the one-off cost per company will be £390?

Of those who responded, 4% agreed, 25% disagreed and 71% were unsure.

102. Respondents were unable to reach a consensus on this estimate. Several accounting firms commented that the cost would depend on the size and complexity of the company in question and on the differences between IFRS and the amended UK GAAP as applied to that company.

103. Almost a fifth of respondents felt that the cost may have been underestimated. Attention was drawn to costs arising from a possible required increase in management and auditor time, additional audit costs for subsidiary not exempt from audit and the preparation of information required for group accounts.

104. A respondent also commented that the estimate in the Impact Assessment (page 15) of internal staff costs of four hours per company was too low.

Q26. 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?

Of those who responded, 24% believed the proposed changes would increase the risk of financial irregularities, 55% believed they would not and 21% were unsure.

105. A fifth of respondents commented that any increase in the risk of financial irregularities would be mitigated, through the similarities between the frameworks and the transitional costs of changing frameworks. A large accounting firm noted that both frameworks are fit for purpose, and that risks associated with reduced disclosure have already been considered by the ASB in their proposals.

106. Those who felt the proposed changes would increase the risk of financial irregularities expressed concern over a possible increase in the risk of concealment of financial

irregularities and in the levels of fraud.

Q27. What is the risk that investors will be misled or confused by a company switching between accounting frameworks?

Of those who responded, 53% believed there was a low risk that investors will be misled or confused by a company switching between frameworks, 14% believed the risk was high, and 33% were unsure.

107. The majority of respondents, which included slightly over two thirds of responding accounting firms, believed the risk level to be low. Two large accounting firms noted the existence of sufficient disclosure requirement in UK GAAP and IFRS to ensure clarity and continuity. A number of other firms commented that the risk of confusion would be mitigated by similarities between the frameworks.

108. Several respondents felt that a switch between frameworks would increase the risk of confusion for investors, and concern was also expressed over a reduction in comparability. Approximately 10% of respondents, including one from industry, suggested the reasons for a change in framework and the effects of the change should be fully disclosed.

Q28. Do you agree with the Government's assessment of the risks of the proposal?

Of those who responded, 66% agreed, 21% disagreed and 13% were unsure.

109. The majority of respondents believed the Government had adequately assessed the risks of the proposal, and respondents had few further comments to offer.

110. An accounting firm believed the risk of tax arbitrage had been successfully managed by the restrictions of the proposal, while another firm commented that, if change of framework can be make regularly and unnecessarily, the risk of arbitrage may increase and there may be a reduction in the quality of financial information.

Q29. Do you agree that the proposals should apply to entities for financial years ending on or after 1 October 2012?

Of those who responded, 52% agreed, 36% disagreed and 12% were unsure.

111. The majority of respondents agreed with the proposed implementation date of the proposals, however a substantial number of respondents disagreed. Just over 10% of respondents would prefer an earlier implementation date if possible, while approximately half of those in disagreement commented that the proposed implementation date of 1 October 2012 was too early.

112. Several accounting firms believed the proposed date was too early on the basis that the proposals should not apply to financial years already begun. One respondent suggested the proposals should apply to entities beginning on or after 1 October 2012. A respondent from industry commented that the timeframe with respect to the introduction of audit exemptions for qualifying subsidiaries was not sufficient to allow companies to make a decision on

whether to avail of the exemptions. This wish for further planning time was shared by a large accounting firm, and accounting representative body. A suggestion was put forward to delay implementation until financial years ending on or after 31 December 2012.

113. A respondent noted that clarity over the form and scope of the guarantee was required in sufficient time to allow companies to consider their position with respect to availing of audit exemptions for subsidiaries.

5. Annex A: List of Respondents

1. Abell Morliss International
2. Asset Based Finance Association (ABFA)
3. Association of Accounting Technicians
4. Association of Chartered Certified Accountants
5. Association of Investment Companies (AIC)
6. Baker Tilly Tax and Accounting Limited
7. Barnley & Rotherham Chamber of Commerce Ltd
8. Bill Hicks
9. British Bankers' Association
10. BT Group PLC
11. Business Information Providers Association (BIPA)
12. Certified Public Accountants Association
13. Charity Commission
14. Chartered Institute of Management Accountants (CIMA)
15. Connelly & Co Ltd
16. Creditsafe Business Solutions Ltd
17. Crowe Clark Whitehill LLP
18. Deloitte LLP
19. DeLonga Chartered Accountants
20. Equifax Ltd
21. Ernst & Young
22. Experian
23. FBR McGarry Harvey
24. Federation of Private Residents Associations Ltd
25. Forum of Private Business
26. Fraud Advisory Panel
27. Garbetts CCA
28. GE Corporate
29. Geoffrey Rogers Chartered Accountants
30. Grant Thornton UK LLP
31. Graydon UK Ltd

32. Institute of Chartered Accountants in England and Wales (ICAEW)

33. Institute of Chartered Accountants of Scotland (ICAS)

34. Institute of Credit Management (ICM)

35. Johnston Carmichael LLP

36. KingstonSmith LLP

37. K M Business Solutions Ltd

38. Kreston International

39. Lane, Farrand & Co

40. Legislation Monitoring Service for Charities

41. Lewis & Co

42. Lindsay & Co

43. Michael Rigby

44. Nabarro Poole Ltd

45. NWN Blue Squared Ltd

46. PKF UK

47. Price Waterhouse Cooper (PWC)

48. Quoted Companies Alliance

49. R Pert

50. Raymond Patterson

51. Robert Thompson

52. Rowleys Partnership Ltd

53. Saffery Champness

54. Semperian PPP Investment Partners Group Limited

55. Sugarwhite Associates

56. The Hundred Group of Finance Directors

57. Try Lunn & Co

58. Unilever UK

59. V J Patel & Co

60. Wheeler & Co Chartered Accountants

Responses by Category

Category	Total	Total (% of responses)
Preparer: Large Business (over 250 staff)	3	5%
Preparer Representative Bodies	5	8%
Accountants: over 500 UK Partners	1	2%
Accountants: 200 – 500 UK Partners	2	3%
Accountants: 100 - 199 UK Partners	2	3%
Accountants: 50 - 100 UK Partners	3	5%
Accountants: under 50 UK Partners	20	34%
Accounting Bodies	7	12%
User representative Bodies	4	7%
Regulators and Government Bodies	2	3%
Individuals	5	8%
Credit Rating Agencies and Business Information Providers	6	10%
Total	60	100%

6. Annex B: List of principal studies or sources cited by respondents or referred to during the consultation

- **Annual Fraud Indicator 2011 (National Fraud Authority)**
  http://www.homeoffice.gov.uk/publications/agencies-public-bodies/nfa/annual-fraud-indicator/

- **ASB Accounting Standards Board**
  See Financial Reporting Council FRC http://www.frc.org.uk/asb/

- **Charities Act 1993**
  http://www.legislation.gov.uk/ukpga/1993/10/contents

- **Companies Act 2006**
  http://www.legislation.gov.uk/ukpga/2006/46/contents

- **Companies House**
  http://www.companieshouse.gov.uk/

- **Modern company law for a competitive economy: completing the structure Consultation (2000)**

http://webarchive.nationalarchives.gov.uk/+/http://www.berr.gov.uk/whatwedo/businesslaw/co-act-2006/clr-review/page25080.html

- **Fourth Council Directive 78/660/EC**
  http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31978L0660:en:HTML

- **Ethical Standards for Auditors see FRC**
  http://www.frc.org.uk/apb/publications/ethical.cfm

- **Financial Reporting Council**
  http://www.frc.org.uk/asb/about/

- **Financial Reporting Exposure Draft 44 (Proposal) 'Financial Reporting Standard for Medium-sized Entities' FRSME**
  http://www.frc.org.uk/documents/pagemanager/asb/Case_Studies/AR%2012%20Transition%20FRSME.pdf

- **HM Revenue & Customs HMRC**
  http://www.hmrc.gov.uk/

- **International Financial Reporting Standards IFRS**
  http://www.ifrs.org/Home.htm

- **International Standards on Auditing (ISA)**
  http://www.financialstabilityboard.org/cos/cos_021001b.htm

- **KPMG Fraud Barometer 2011**
  http://www.kpmg.com/uk/en/issuesandinsights/articlespublications/newsreleases/pages/business-under-threat-as-uk-fraud-exceeds-%C2%A31bn.aspx

- **Proceeds of Crime Act 2002**
  http://www.legislation.gov.uk/ukpga/2002/29/contents

- **SORP (AIC Statement Of Recommended Practice)**
  http://www.theaic.co.uk/handbook/Print/?print=4872

- **TECH 3/01 (2001) ICAEW memorandum**
  http://www.ion.icaew.com/.../ICAEW%20representation%20124-11.docx

- **The IASB (International Accounting Standards Board) consultation on Investment Entities ED/2011/4**
  http://www.ifrs.org/News/Press+Releases/ED+investment+entities+aug+2011.htm

- **UK GAAP (Accounting Standards Board)**
  http://www.frc.org.uk/asb/

This publication is also available on our website at www.bis.gov.uk

Any enquiries regarding this publication should be sent to:

Department for Business, Innovation and Skills
1 Victoria Street
London SW1H 0ET
Tel: 020 7215 5000

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