Department for
Business, Energy
& Industrial Strategy

THE IMPACT OF EXEMPTING SMALL COMPANIES FROM STATUTORY AUDIT

BEIS Research Paper

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This report was prepared by ICF International, in collaboration with BMG Research, on behalf of the Department for Business, Energy and Industrial Strategy.

Contents

Executive summary

Key findings:

- Up to 90 per cent of all UK registered companies – especially smaller companies without shareholders – were likely to have benefited from the Government's small company audit exemptions in 2015, and this figure is expected to grow in the future.
- Audit exemptions are a valuable resource in helping to reduce burdens for small companies but some companies are concerned about the risk of negative impacts for the confidence of lenders and stakeholders.
- The key motivation for taking up audit exemptions is to save money and time – but, for some, these savings are insufficient to offset potential negative consequences – while inertia and a lack of awareness can also be barriers to take-up for companies that have always undergone audits and/or are unaware that they are eligible for audit exemptions.
- Audit exemptions were expected to benefit UK companies by at least £4.6 billion in 2015 (these estimated savings are for the total population of small companies in the UK, based on the findings of this research).
- Most companies have benefited or expect to benefit from taking up audit exemptions, although perceived savings are significantly higher than actual savings.
- There is strong support for audit exemptions to continue with similar eligibility criteria, although thresholds should be monitored over time and increase in line with inflation.

Introduction to audit exemptions

Most private limited companies in the UK are able to take advantage of small company audit exemptions and therefore do not need to undergo an audit of their annual accounts. To be eligible for audit exemptions, companies need to meet certain criteria. These eligibility criteria were changed in October 2012 such that companies qualified for an audit exemption (until January 2016) if they met at least two of the following three criteria:

- an annual turnover of no more than £6.5 million;
- assets worth no more than £3.26 million; and
- 50 or fewer employees on average.

Companies had previously been eligible if they met the two criteria relating to turnover and asset values. The thresholds have since increased for accounting years beginning in 2016, although this research focused on the above thresholds that applied between October 2012 and December 2015.

Study objectives

The aim of this study was to assess the scale of take-up of audit exemptions and provide the Department for Business, Energy and Industrial Strategy (BEIS) with a better understanding of the reasons behind – and the implications of – the take-up or otherwise of audit exemptions. It also made comparisons between companies that were eligible for audit exemptions before the eligibility criteria were changed in 2012 and those that became eligible as a result of those changes.

The study involved three main research methods: desk-based research; a quantitative telephone survey of 410 UK companies; and semi-structured depth interviews with 17 companies that responded to the survey.

Take-up of audit exemptions

The study estimated that between 62 and 90 per cent of all UK registered companies were likely to have taken up audit exemptions in 2015. This is a wide range, although the findings from this study suggest that the higher estimate of 90 per cent, based on Companies House data, is likely to be the most robust.

These estimates of take-up of audit exemptions are broadly consistent with the range provided in the Department for Business, Innovation and Skills (BIS) impact assessment of the 2012 audit exemption changes, which estimated take-up of between 60 and 85 per cent[1]. The small increase in the latest estimates produced for this study seems sensible given the changes in the eligibility criteria in 2012, which increased the number and proportion of companies that are now eligible for the audit exemption.

This research project provided a more in-depth analysis than BIS' impact assessment of the 2012 audit exemption changes and the survey responses suggest that take-up of audit exemptions is likely to continue to increase over time. The large majority (84 per cent) of companies that had already taken up audit exemptions expected to continue to do so, while fewer than 1 per cent of companies reported that they were unlikely to continue taking up audit exemptions. There were more mixed views amongst those that were still undergoing audits. Around half of these companies (52 per cent) expected to continue to undergo audits but 30 per cent reported that they expected to take up audit exemptions in the future and most of these (70 per cent) expected to do so for their next set of accounts. Take-up is also expected to increase as a result of the increased eligibility thresholds that have since been introduced for accounting years beginning on or after 1 January 2016.

The survey findings suggest that those taking up audit exemptions were typically smaller, with fewer employees and a smaller turnover, than those continuing to undergo audits. Similarly, those taking up audit exemptions were less likely to expect that they might exceed the 2015 eligibility thresholds within the next three years. These findings suggest that larger companies that are closer to the eligibility thresholds, and more likely to exceed them in the future, may be less likely to take up audit exemptions if this option is only likely to be available in the short-term. The survey findings also suggest that the take-up of audit exemptions is generally lower for companies that reported having shareholders, lenders and/or external investors, suggesting that these companies may be more likely to undergo audits to satisfy and provide confidence to these external parties.

[1] BIS, 2014. 'Impact assessment: audit exemptions'

Awareness of the eligibility criteria also appears to be a key factor affecting take-up of audit exemptions. For example, companies that became eligible for the audit exemption in 2012 were far more likely to have taken up audit exemptions in the last few years if they were aware of the changes to the eligibility criteria (87 per cent of those that had taken up audit exemptions were aware of the changes in 2012 compared to just 63 per cent of those that continued to undergo audits). Awareness was also an issue more broadly as one-in-three respondents either thought they were ineligible for the exemption or did not know if they were eligible. While some of these companies had valid reasons for being ineligible, such as being a public company, a financial services provider, or because of requirements placed on the company by other parties, most had mistakenly thought they exceeded the eligibility thresholds.

To inform this study, BEIS undertook analysis to estimate that there are around 44,700 companies in the UK that became eligible as a result of the 2012 changes to the eligibility criteria for audit exemptions, having previously been ineligible. This figure is also slightly larger than the 36,300 additional companies that were estimated in the impact assessment of the 2012 audit exemption changes. Most of the additional 44,700 companies (70 per cent) had still undergone an audit despite becoming eligible for the audit exemption. This suggests a relatively low take-up rate of 30 per cent amongst this population.

General views on audit exemptions

The survey found high levels of support for audit exemptions amongst those continuing to undergo audits as well as those that had taken up audit exemptions. Overall, 80 per cent of respondents agreed or strongly agreed that audit exemptions help to reduce burdens for small businesses. Most respondents (two-thirds) felt that audit exemptions were fair and did not offer an unfair advantage to small businesses. In fact, respondents were more likely to feel it was unfair for small businesses to undergo audits as the costs of doing so are disproportionately large for small business and the potential benefits are relatively low.

Views were more mixed in relation to the potential disadvantages of audit exemptions. The main risks of not having audited accounts were the associated impacts on confidence and uncertainty for individuals and organisations with a financial interest in the company, particularly lenders and shareholders. However, most respondents were less concerned about these risks and some suggested that the perceived importance of having audited accounts was diminishing over time for these external parties.

The research also explored the extent to which audit exemptions had led to changes in the market for audits. Respondents generally felt that any impacts had been minimal, although there were some suggestions that the market was becoming more competitive, resulting in audits becoming cheaper and more cost-effective. There were also some suggestions that audit exemptions had helped create alternative solutions and were encouraging greater innovation and development of tailored services in the market. Examples included streamlined or partial audits where companies can prioritise the audit of particular high-risk activities, or areas that are of particular concern to investors and other external parties.

Reasons for taking up audit exemptions

The survey found that of those taking up audit exemptions, 98 per cent had taken up the small companies audit exemption, while 1 per cent were exempt because of a parent company guarantee. The findings suggest companies that are eligible for audit exemptions through multiple means are most likely to use the small companies audit exemption.

The principal reason for taking up audit exemptions was to save money spent on audits. Other important reasons included the time saved from not having to interact with auditors and simply not seeing any value in having audits, which was particularly common amongst micro companies. Other common reasons included finding the audit process overly complicated and confusing, and following the advice of their accountant.

Reasons for not taking up audit exemptions

The most common reasons for companies continuing to undergo audits were:

- To meet the requirements imposed by lenders (cited by 17 per cent of those not taking up audit exemptions). Respondents provided examples of these requirements being used as preconditions for loans or investments, but also where companies were choosing to undergo audits because they perceived this to provide comfort and confidence to shareholders, investors, suppliers, etc.
- Because companies had not realised they were eligible for audit exemptions (cited by 16 per cent of those not taking up audit exemptions).

These results suggest there were almost as many respondents that did not know they were eligible for the audit exemption as there were companies saying they use audits to meet the actual or perceived requirements of lenders. There was also a relatively large proportion of respondents who did not know why they undergo audits.

Other reasons for undergoing audits and not taking up audit exemptions included: meeting the requirements of trustees, shareholders, directors, funders or regulators; group level decisions that audits should be undertaken by all businesses in the group; perceptions that audits add credibility to a company and improve its reputation; following the advice of accountants; perceptions that audits represent good financial practice; and inertia (i.e. companies with a history of always undergoing audits). More broadly, the survey findings suggest that companies are unlikely to switch between audits and audit exemptions from year to year. This also relates to companies that have decided to take up audit exemptions, as they are unlikely to switch back to audits unless they grow and are no longer eligible for audit exemptions.

Impacts of taking up audit exemptions

Two-thirds (65 per cent) of the respondents taking up audit exemptions felt that they had benefited from doing so. These benefits were particularly prevalent for respondents that had only become eligible in 2012, perhaps because these companies had, on average, more recent experience of undergoing audits and greater clarity on the savings of not undergoing audits. In contrast, 17 per cent of those taking up audit exemptions felt that they had not benefited, and 16 per cent said they did not know whether they had benefited.

Almost all of those that felt they had benefited from audit exemptions had reported saving money (98 per cent), while 83 per cent reported also saving time from not having to deal with auditors. These findings were broadly consistent across different types of businesses, although the survey evidence did suggest that savings can be less significant amongst larger companies.

The average saving reported by those who experienced benefits was £3,960 per company per annum. The average savings were slightly higher amongst those who were ineligible before 2012 (£4,500 per annum) compared to those that were eligible before and after 2012 (£3,600 per annum). However, these savings appear relatively low compared to the average audit fees reported by respondents still undergoing audits of £7,470 per annum. This appears to suggest that the perceived benefits of not paying for an audit (among those taking up audit exemptions) are lower than the perceived costs of the latest audit (among those continuing to undergo audits).

It is possible to use these findings to estimate the overall savings associated with audit exemptions in the UK in 2015. If we assume that 65 per cent of the 1,815,000 UK companies taking up audit exemptions in 2015 (based on Companies House data) had experienced benefits and 98 per cent of those companies had saved money, this suggests that 1,156,000 companies saved money from audit exemptions in 2015. If these companies are assumed to have each saved £3,960 per annum, this suggests that audit exemptions may have saved UK companies £4.6 billion in 2015. This is likely to be a conservative estimate as this is based on perceptions of savings rather than the actual money saved from not undergoing audits. An alternative, higher estimate based on the actual audit fees reported by survey respondents suggests that audit exemptions could have saved UK companies as much as £8.6 billion in 2015.

The survey respondents reported a range of different uses for the savings around some key themes including reinvesting in the business, increasing cashflow or working capital, repaying debts, providing a boost to other savings and investments and improving the profitability of the business. However, one-in-three respondents who reported making savings reported not doing anything with the savings or not knowing what they had done with the savings, which suggests that the savings were sometimes not considered to be of a significant scale.

The research found only limited evidence of perceived impacts of audit exemptions on business growth. The survey also found that 78 per cent of companies taking up audit exemptions reported that it had had no impact on their growth (and a further 11 per cent did not know if it had had an impact). A minority of respondents (11 per cent) reported a positive impact on growth, of which 4 per cent reported a significant positive impact.

The research also identified very little evidence of negative impacts on the confidence of lenders, shareholders and other investors. Only two respondents reported any negative or unintended consequences from taking up audit exemptions. One suggested it had negatively impacted on their credit scores, while another suggested that lenders had required audits to meet their lending criteria.

Most companies taking up audit exemptions had not taken on any alternative forms of assurance or scrutiny for their accounting processes. The majority (70 per cent) of those that did introduce further measures reported that they had still made overall savings, while only 1 per cent reported that these costs had exceeded the savings from not undergoing audits. However, it is likely that these additional costs have influenced the above perceptions of savings associated with audit exemptions and to some extent explain the differences between the perceived savings and the actual cost of audits.

Impacts of not taking up audit exemptions

Companies undergoing audits also reported expecting to make time savings and cost savings (50 and 67 per cent of respondents respectively) from taking up audit exemptions. Only one-in-four companies undergoing audits did not feel they would benefit from audit exemptions. These findings are very similar to the actual incidence of benefits cited by those that had taken up audit exemptions, although those undergoing audits were found to be more concerned about the potential negative impacts on their business and future growth.

However, there were significant differences in the perceived and experienced scale of savings. Respondents undergoing audits at the time of interview reported expected average savings from taking up audit exemptions of £8,680 per annum. This is more than double the scale of savings reported by those that had taken up audit exemptions. It is also higher than the reported cost of audits amongst this group of £7,470 per annum, which is likely to show that respondents are including time savings in addition to the cost of the audit.

Implications for future policy development

The survey identified strong levels of support for audit exemptions, even amongst companies that were concerned about potential impacts on investor and shareholder confidence and/or those that continued to undergo audits. Overall, audit exemptions were widely considered to be a valuable resource in helping to reduce burdens for small businesses. The findings also suggest that take-up is likely to continue to increase over time. These research findings therefore provide strong support for audit exemptions to continue in the UK.

Respondents were also asked about the 2015 thresholds for the eligibility criteria for audit exemptions and whether they felt that these should be changed. There was strong agreement that the thresholds should not be decreased but there were mixed views about whether the thresholds should be increased with a similar number of respondents agreeing and disagreeing that thresholds should be increased. In conclusion, the evidence suggests that the eligibility thresholds in 2015 were generally considered appropriate and relevant, according to the majority of surveyed companies, although there were calls for these thresholds to be monitored over time and adjusted periodically to account for inflation.

1 Introduction

This Final Report has been prepared by ICF International (ICF), in collaboration with BMG Research (BMG), for a Department for Business, Energy and Industrial Strategy (BEIS) study to better understand the reasons behind, and implications of, the take-up or otherwise of audit exemptions. This report describes the role of the research, the study methodology, the headline findings from the research and conclusions.

1.1 Introduction to the study

Most small private limited companies in the UK are able to take advantage of an exemption from statutory annual audit (an “audit exemption”)[2]. This means that they do not need to undergo an audit of their annual accounts (i.e. have their annual accounts reviewed and confirmed by an independent accountant).

For company financial years ending on or before 30 September 2012, companies qualified for an audit exemption if they had both:

- an annual turnover of no more than £6.5 million; and
- assets worth no more than £3.26 million.

These eligibility criteria were then changed such that, from 1 October 2012, companies qualified for an audit exemption if they met at least two of the following three criteria:

- an annual turnover of no more than £6.5 million;
- assets worth no more than £3.26 million; and
- 50 or fewer employees on average.

The above thresholds for turnover and asset values were increased in 2016 such that, for accounting years beginning on or after 1 January 2016, companies qualified for an audit exemption if they met two of the following three criteria: an annual turnover of no more than £10.2 million; assets worth no more than £5.1 million; and 50 or fewer employees.

It should be noted, however, that the fieldwork for this study was undertaken in 2015 and this research report focuses on the thresholds that operated between 1 October 2012 and 31 December 2015.

[2] There are exceptions to this rule. Companies must undergo an audit if at any time in the financial year it has been: a public company (unless it’s dormant); a subsidiary company (unless it qualifies for an exception); an authorised insurance company or carrying out insurance market activity; involved in banking or issuing e-money; a Markets in Financial Instruments Directive (MiFID) investment firm or an Undertakings for Collective Investment in Transferable Securities (UCITS) management company; and/or a corporate body and its shares have been traded on a regulated market in a European state.

1.2 Purpose of the study

The aim of this study was to assess the scale of take-up of audit exemptions and provide BEIS with a better understanding of the reasons behind – and the implications of – the take-up or otherwise of audit exemptions. It also aimed to help build a wider understanding of the factors that influence decision-making around exemptions to inform future policy development, in particular government policies in relation to small companies' audit exemptions and the transparency of financial information that businesses are required to provide to the market.

The specific objectives of the project included:

- assessing the take-up of audit exemptions over time, exploring trends in take-up between different types of businesses and between those that were eligible and ineligible for audit exemptions before the eligibility criteria were changed in 2012;
- exploring the views of different types of businesses regarding audit exemptions, including comparisons between those that took up an exemption and those that did not, and between those that were eligible and ineligible for audit exemptions before the changes in 2012;
- assessing the reasons companies chose, or did not choose, to take up audit exemptions; and
- assessing the impacts of company decisions to adopt, or not to adopt, audit exemptions.

1.3 Methodology

The study involved three main research methods:

- desk-based research;
- a quantitative CATI (computer-assisted telephone interviewing) survey of 410 UK companies; and
- semi-structured depth interviews with 17 companies that responded to the survey.

The approach to the quantitative telephone survey and the qualitative depth interviews is summarised below. Further detail on the methodological approach is set out in Annex 1.

1.3.1 Quantitative telephone survey

The quantitative survey was designed to explore company views and decisions relating to audit exemptions. The survey included questions on the factors that influence company decisions about whether or not to take up audit exemptions, the impact of these decisions and what more the Government can do to improve the effectiveness of audit exemptions and reduce burdens for businesses. The survey questionnaire is provided in Annex 2.

The survey was targeted at UK companies that were eligible for the small companies audit exemption at the time of the survey. An overall sample size of 400 was selected, targeting 200 companies that had taken up audit exemptions and 200 that had not. Business contacts were sourced by BEIS from the Financial Analysis Made Easy (FAME) database[3]. The original approach intended to focus the survey exclusively on companies that were ineligible for audit exemptions prior to 2012 but then became eligible when new criteria were introduced in 2012. However a pilot of the survey found that it was not possible to accurately identify these companies from the available data. It was therefore agreed that the approach would be revised and the sample would be split into four groups, depending on eligibility for audit exemptions prior to 2012 and whether or not eligible companies had taken up audit exemptions. The four groups are defined in Figure 1 below.

Figure 1: Defining the four sub-groups of the sample

Group A companies were ineligible for exemption from statutory audit before 2012 and took up the exemptions after the 2012 reforms. Group B were also ineligible before 2012, but after the 2012 regulations were introduced, continued to undergo audits. Group C were eligible for audit exemptions before 2012 and took up the option of exemption from audit. Group D companies were eligible for audit exemption before 2012, but continue to undergo audits.

The target and achieved number of interviews for each of the four groups are presented in Table 1 below. A total of 410 interviews were undertaken. These were split relatively evenly between those that were ineligible for audit exemptions before 2012 (197 interviews) and those that were eligible before 2012 (213 interviews). However, the interviewed sample was more focused on those that had not taken up audit exemptions (243 interviews) compared to those that had taken up audit exemptions (167 interviews). This was due to difficulties in predicting whether companies had undergone an audit. As a result the sample was slightly skewed towards those that did not take up audit exemptions.

The final column in the table below includes the total number of competed interviews after excluding charities. An initial analysis of the survey results showed a relatively large number of charities in the sample and, since charities are subject to additional audit requirements in charity law with their own more limited audit exemptions, it was decided that they should be

[3] FAME – Financial Analysis Made Easy – Database of company information (www.bvd.co.uk)

removed from the sample prior to the analysis. The analysis included in this report is therefore based on the 361 interviews undertaken with companies and organisations that did not hold charitable status at the time of interview.

Table 1: Target sample structure and achieved interviews, by group

Group	Eligible pre-2012	Eligible post-2012	Took up exemption?	Target	Total Achieved	Achieved (excluding charities)
A	No	Yes	Yes	100	68	66
B	No	Yes	No	100	129	102
C	Yes	Yes	Yes	100	99	98
D	Yes	Yes	No	100	114	95
TOTAL				400	410	361

The overall response rate to the survey was 14 per cent in terms of the number of achieved interviews as a percentage of those who were interviewed or refused/quit. The reasons for the low response rate are not known although feedback from interviewers suggested that the subject matter was a key reason as many contacts were simply not interested in undertaking a survey about audits and exemptions. In other cases it was not possible to speak to someone in the finance team of the company because the company was using an external accountant who could not be interviewed because they are not decision-makers for the companies.

Finally, given the significant differences in the size of the wider populations of groups A and B and groups C and D, it was decided that the datasets should be separated into two parts. Groups A and B were weighted against the characteristics of the 44,700 companies that became eligible as a result of the changes introduced in 2012[4], and groups C and D were weighted against the population of companies that were eligible for audit exemptions before and after 2012[5].

Further details on the methodology for the quantitative survey are included in Annex 1.

[4] The survey data for groups A and B were weighted against profiles of the size and sector characteristics of companies that had, or had not, taken up audit exemptions. These profiles were based on analysis of FAME and IDBR data, undertaken by BIS to inform this study, which identified companies that became eligible as a result of the changes introduced in 2012.

[5] The weighting process was more complicated for groups C and D. The profiles for companies that were eligible for audit exemptions before and after 2012 were estimated, using the same BIS analysis of FAME and IDBR data, as the difference between all eligible companies and those that only became eligible after the changes in 2012. However, it was not possible to use the data to create separate size and sector profiles for groups C and D (i.e. separate profiles for companies that had, and those that had not, taken up audit exemptions). Random Iterative Method (RIM) weights were therefore used to weight the survey data for groups C and D. RIM weighting is a statistical technique used when some characteristics of the target population are known, but the relationship between the characteristics is unknown (e.g. when the disaggregation of companies between groups C and D was known, but size and sector profiles could not be disaggregated between the two groups). RIM weighting allowed size and sector profiles to be estimated for each group using a statistical approach that aims to distort each variable as little as possible. Two separate RIM weights were applied to groups C and D: one based on calculated targets for size and sector, the other on whether the company had undergone an audit or not. The survey data for groups C and D were then weighted against the respective size and sector profiles.

1.3.2 Qualitative depth interviews

Qualitative semi-structured depth interviews were designed to unpack individual responses to the telephone survey and explore in more detail some of the key issues, which included:

- company views of audits and audit exemptions;
- company awareness and take-up of audit exemptions;
- the reasons and motivations for company decisions to take up or not take up audit exemptions; and
- the impacts of company decisions to take up or not take up audit exemptions.

The qualitative interviews were undertaken with companies that had already participated in the CATI survey and had agreed to participate in further research. The sample for the qualitative interviews focused exclusively on companies that were ineligible for audit exemptions before 2012 but became eligible when the criteria were changed in 2012 (i.e. companies in groups A and B). Having only recently become eligible for audit exemptions, these companies were considered likely to have a better awareness of their motivations and decisions about whether to take up audit exemptions and the resulting impacts. A total of 17 interviews were undertaken and included:

- 9 interviews with companies that had taken up audit exemptions; and
- 8 interviews with companies that had not taken up audit exemptions.

The interviewees were randomly selected from those that had and had not taken up audit exemptions and had agreed to be re-contacted. The interviews were conducted by telephone and lasted around 30 minutes on average. The interview topic guide is provided in Annex 3.

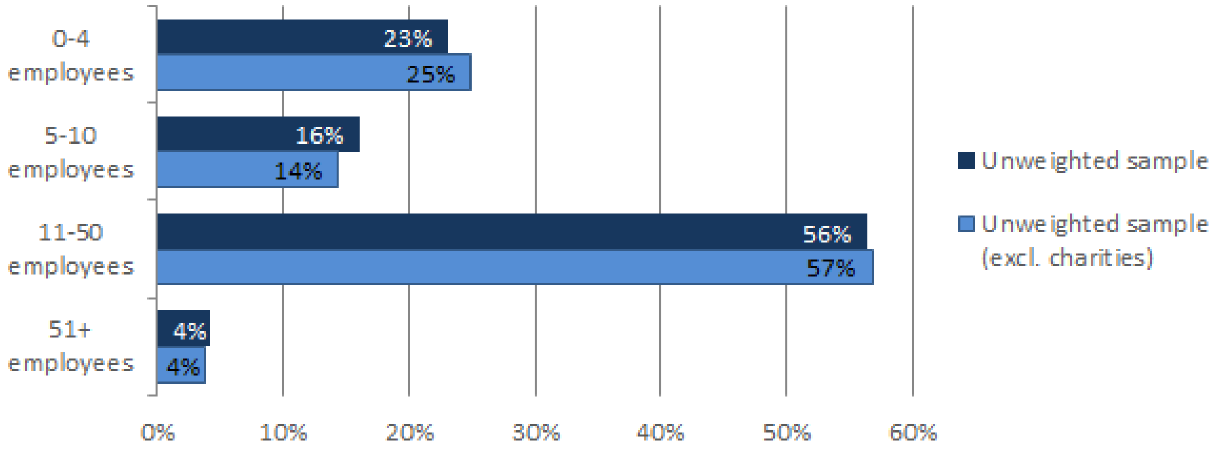
1.4 Profile of companies surveyed and interviewed

1.4.1 Profile of companies surveyed

1.4.1.1 Size of companies surveyed

In total, 410 companies were surveyed, including 361 that did not hold charitable status. The sample provided good coverage of micro companies (with 0 to 10 employees) and small companies (with 11 to 50 employees). Figure 2 shows that the sample included a concentration of small companies. This was the result of over-sampling companies that were ineligible before 2012 which would, by definition, be close to the 50 employee threshold for the eligibility criteria. The relatively small number of medium sized companies with more than 50 employees is again due to the sampling which focused on companies that were eligible for audit exemptions at the time of the survey.

Figure 2: CATI survey respondents, by employment size



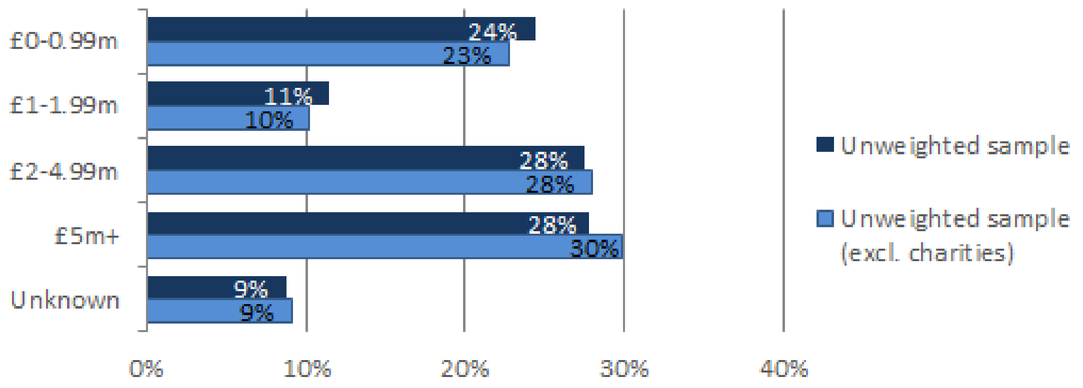
Source: BMG survey data (questions Q11 and Q12); unweighted base: All companies: 410 and companies excluding charities: 361

Note: Figures may not sum to 100 per cent due to rounding.

1.4.1.2 Turnover of companies surveyed

The interview sample also provided good coverage of companies with different levels of turnover, as shown in Figure 3. As with the number of employees, the slightly higher concentration of companies with turnover in excess of £5 million was due to the over-sampling of companies that were ineligible before 2012, which prioritised those closer to the turnover threshold of £6.5 million for the eligibility criteria at the time of the survey.

Figure 3: CATI survey respondents, by size of turnover

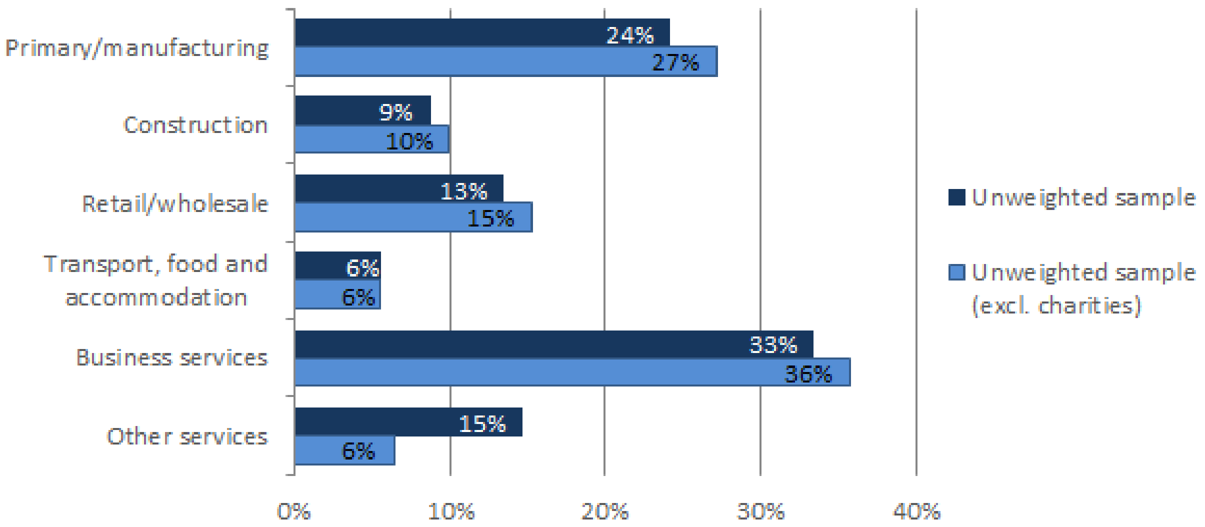


Source: BMG survey data (question Q10); unweighted base: All companies: 410 and companies excluding charities: 361

1.4.1.3 Sector of companies surveyed

The sample provided good coverage across the broad industry sectors, as shown in Figure 4. The concentration of companies in the business services sector is consistent with the wider population of small businesses[6]. Figure 4 also shows that the removal of charities had the greatest impact on the proportion of companies in the other services sector.

Figure 4: CATI survey respondents, by sector



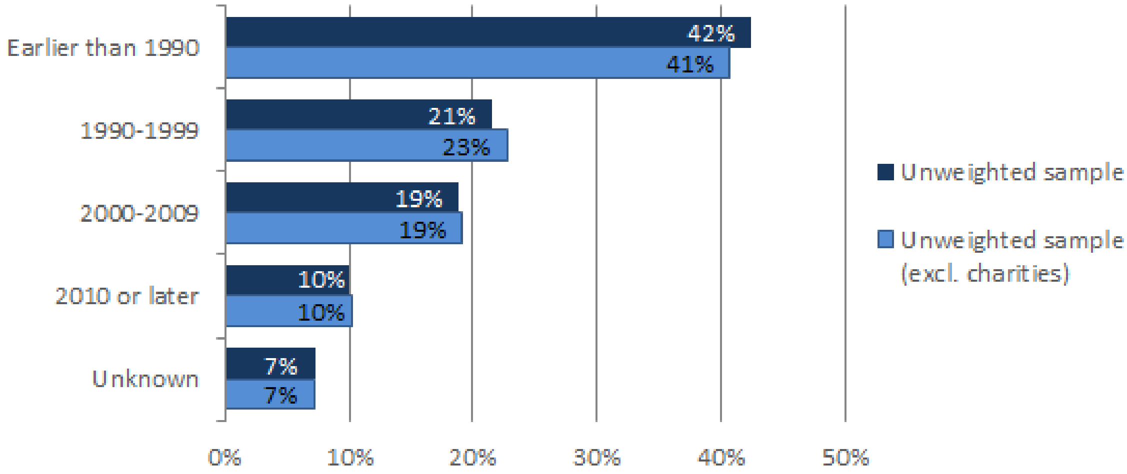
Source: BMG survey data (questions Q11 and Q12); unweighted base: All companies: 410 and companies excluding charities: 361

[6] ONS, 2015. 'UK Business: Activity, size and location: 2015'

Number of years of trading of companies surveyed

Figure 5 shows that the interview sample was split fairly evenly between those established before and after 1990. Only 10 per cent of the sample was established in 2010 or later, which is again due to over-sampling companies that were ineligible for audit exemptions before 2012.

Figure 5: CATI survey respondents, by age of company



Source: BMG survey data (question Q8); unweighted base: All companies: 410 and companies excluding charities: 361

Note: Figures may not sum to 100 per cent due to rounding.

1.4.2 Profile of companies interviewed

A total of 17 companies participated in the qualitative interviews including 9 that had taken up audit exemptions and 8 that had not. Overall, the qualitative sample included:

Six micro companies with fewer than five employees, three companies with five to nine employees and eight small companies with 10 to 49 employees. It included no companies with more than 50 employees.

A variety of industrial sectors. Four companies were in the primary and manufacturing sectors, two in the construction sector, one in the transport, food and accommodation sector, seven in the business services sector and three in the other services sector.

A range of ages including eight companies established more than 20 years ago, six companies established between 10 and 20 years ago, and two companies established within the last ten years. One respondent did not know when their company was established. The relatively small number of young companies is due in part to the sample focusing on those that were ineligible for audit exemptions prior to 2012.

1.5 Structure of this report

The remainder of this report is structured as follows:

- Section 2 sets out the context for the study by reviewing existing evidence on the rationale for, and impacts of, audit reform in the UK;
- Section 3 presents the key findings of the study, structured around the study objectives described above; and
- Section 4 presents the conclusions of the study.

There are also four annexes:

- Annex 1 describes the methodological approach to the study in greater detail;
- Annex 2 provides the questionnaire for the quantitative CATI survey;
- Annex 3 provides the topic guide for the qualitative semi-structured depth interviews; and
- Annex 4 describes the background and context for audit exemptions in the UK.

2 Study context

This section presents background and contextual information relating to audit exemptions in the UK. Further detail is provided in Annex 4.

2.1 Introduction

The UK Government's 'Better Regulation' agenda seeks to promote a business-friendly environment by finding more effective ways of designing and enforcing regulation, without placing unnecessary burdens on business[7]. A key objective is to streamline bureaucracy in order to provide a level-playing field for businesses to compete and, in so doing, support their productivity and growth.

In its 'Plan for Growth,' published in March 2011, the UK Coalition Government recognised that complying with regulation places a disproportionate burden on SMEs in terms of cost, time and resources. It also recognised that, "over time, both the volume of reporting requirements for UK business, and the associated costs, have increased," which led to general consensus on the need for UK audit requirements to be applied in "a more targeted and flexible manner to reduce compliance costs without significant impacts on disclosure […]"[8]. The Coalition Government therefore committed itself to reduce the number of UK SMEs required to undertake an audit. Specifically, proposals for regulatory reform in this area involved:

- amending UK legislation (by relaxing eligibility requirements) to enable a larger number of small companies to qualify for audit exemptions; and
- exempting qualifying subsidiaries from the requirement to prepare, audit and publish annual accounts where certain conditions are met[9].

2.2 Eligibility for audit exemptions

For company financial years ending on or before 30 September 2012, companies qualified for the small companies audit exemption if they had both:

- an annual turnover of no more than £6.5 million; and
- assets worth no more than £3.26 million.

The UK Coalition Government then amended national legislation to support greater take-up of audit exemptions. The eligibility criteria for the small companies audit exemption were changed such that, from 1 October 2012, companies qualified if they met at least two of the following three criteria:

- an annual turnover of no more than £6.5 million;

[7] www.gov.uk, 'Regulation Reform', https://www.gov.uk/government/topics/regulation-reform
[8] BIS, 2014. 'Impact assessment: audit exemptions'
[9] These conditions are set out in full in the impact assessment carried out by BIS (please see: BIS, 2014. 'Impact assessment: audit exemptions')

- assets worth no more than £3.26 million; and
- 50 or fewer employees on average.

The above thresholds for turnover and asset values have since been increased such that, for accounting years beginning on or after 1 January 2016, companies qualified for the small companies audit exemption if they met at least two of the following three criteria:

- an annual turnover of no more than £10.2 million;
- assets worth no more than £5.1 million; and
- 50 or fewer employees on average.

However, the fieldwork for this study was undertaken in 2015 and this research report therefore focuses on the thresholds that operated between 1 October 2012 and 31 December 2015.

There are also some exceptions to these eligibility criteria. For example, companies do not qualify as “small” if, at any time within the financial year to which their accounts relate, they were: (1) a public company or (2) a banking or insurance company. Also charities are subject to additional audit requirements in charity law with their own more limited audit exemptions, which means that for many, the audit exemptions in company law are not available.

The UK’s national legislation has also been amended to allow subsidiary companies to dispense with an audit, provided certain conditions are met – principally, parent undertakings are established under the law of a European Economic Area (EEA) state and declare that the parent company guarantees all outstanding liabilities to which subsidiary companies are subject at the end of the financial year to which the guarantee relates[10].

Dormant subsidiaries have also been exempted from undergoing audits. The rationale for relaxing financial reporting requirements for dormant subsidiary companies is that the preparation and filing of accounts for the public record provides little additional information given the lack of trading activity[11].

Exemptions are, however, conditional on receipt of a guarantee from parent companies that they are willing to guarantee all of their subsidiaries’ outstanding liabilities (until they are satisfied in full). Dormant subsidiaries with such a guarantee are additionally exempt from preparing and filing financial statements[12].

[10] For a more detailed list of conditions, see: BIS, 2014. ‘Impact assessment: audit exemptions’
[11] BIS, 2014. ‘Impact assessment: audit exemptions’
[12] Deloitte, 2013. ‘ICAEW publishes guidance on the audit exemption by parent guarantee’

2.3 Impact of the audit reforms

2.3.1 Take-up of audit exemptions

BIS' impact assessment of the 2012 audit exemption changes estimated that more than 100,000 additional 'active' companies (or an estimated 36,000 additional small companies and 83,000 UK subsidiaries) would qualify for audit exemptions and benefit through reduced accountancy and administrative costs as a result of the changes introduced in 2012[13]. A further 87,000 dormant UK subsidiaries were estimated to qualify for exemptions from the requirement to prepare and file accounts[14].

The increased take-up of audit exemptions is also likely to have implications for the firms undertaking audits. The Financial Reporting Council recently reported that the "number of firms registered to carry out statutory audit work continues to fall" in the UK[15]. The number of registered audit firms fell by nearly 11 per cent between 2008 and 2012 and by 2 per cent in 2012.

2.3.2 Potential benefits

BIS' impact assessment of the 2012 audit exemption changes also estimated that the audit reforms would generate significant cost savings for newly qualifying companies of between £168 million and £240 million for small companies and between £80 million and £299 million for qualifying subsidiaries in terms of unspent audit fees[16]. A possible reduction in the cost of capital for (small) companies who choose voluntarily to have an audit was also expected.

As regards newly qualifying dormant companies, savings of about £19 million were expected on an annual basis[17]. These savings were expected to mainly stem from a reduction in management time spent on the preparation and filing of accounts.

Many companies that are eligible for audit exemptions continue to undertake voluntary audits. Evidence from the literature suggests that there are various reasons explaining business decisions to undertake voluntary audits. Dedman et al. (2013) examined the determinants of voluntary audit in a sample of 6,274 companies that recently dispensed with audits[18]. Their results indicated that companies are more likely to purchase voluntary audits if: (1) they have greater agency costs[19]; (2) they are riskier (measured as those with poorer accounting performance and riskier types of balance sheet assets); (3) they wish to raise capital; and (4) they purchase non-audit services from their auditor. Overall, their results strongly support the idea that companies choose to be audited when it is in their interests to do so.

Similarly, research conducted by Collis (2010) indicated that a large proportion of audit-exempt entities still choose to have an audit – voluntary auditing was estimated to be undertaken by

[13] BIS, 2014. 'Impact assessment: audit exemptions'
[14] BIS, 2014. 'Impact assessment: audit exemptions'
[15] Financial Reporting Council, 2013. 'Key Facts and Trends in the Accountancy Profession'
[16] BIS, 2014. 'Impact assessment: audit exemptions'
[17] BIS, 2014. 'Impact assessment: audit exemptions'
[18] Dedman, E. et al., 2013. 'The Demand for Audit in Private Firms: Recent Large-Sample Evidence from the UK'
[19] Agency costs usually refer to the conflicts between shareholders and their company's managers. A shareholder, for instance, would want the manager to make decisions which will increase the share value. Managers, instead, would prefer to expand the business and increase their salaries, which may not necessarily increase share value (source: investinganswers.com).

about 40 per cent of audit-exempt entities in 2008[20]. The author found that some companies may voluntarily pursue audits “for the discipline it imposes, the continuity it provides […] and to keep everyone honest.”[21] The author also reported that about 50 per cent of the companies that have taken advantage of audit exemptions do not think there have been significant cost savings.

Additionally, under UK legislation, shareholders may still request that accounts be audited if they own at least 10 per cent of shares (by number or value)[22].

2.3.3 Potential costs

Companies taking up audit exemptions, following the changes to the eligibility criteria in 2012, were estimated to face transitional costs of between £60 million and £150 million in the first year[23]. These costs were expected to largely take the form of one-off legal costs, especially to those companies who choose to seek external advice about the operation of the parent company guarantee in the first year of operation. Ongoing costs (such as annual internal legal costs) at the group level were also expected for about 30,000 groups.

In addition to direct (business) costs, other evidence from the literature suggests that simplification measures, such as audit exemptions, could potentially lead to a loss of transparency in information-sharing[24]. A major concern raised is that reduced financial information could adversely impact on companies – it could become more difficult for exempt companies to obtain third-party finance if their financial accounts are not subjected to audit as they might be perceived as being less credible by providers of finance.

2.4 Updated estimates of the take-up of audit exemptions

BIS’ impact assessment of the 2012 audit exemption changes[25] stated that, according to data from Companies House, the number of non-audited companies was 1,398,400 in 2009/10. This represented 86 per cent of all non-dormant companies that had registered annual accounts at Companies House. This was significantly higher than the earlier Collis study from 2008, which had estimated take-up of the small companies audit exemption to be lower at around 60 per cent, although this was based on research with slightly larger small firms[26]. The impact assessment of the 2012 audit exemption changes therefore assumed a take-up range of between 60 and 85 per cent.

Companies House provides annual reports and data based on the Companies Register, the latest of which is the ‘Companies Register Activities: Statistical Release 2014/2015’. Replicating the analysis from the earlier impact assessment with the latest data from Companies House suggests that, in 2014/15, 1,814,900 companies in the UK did not have their individual (non-group) accounts audited[27]. These companies represented 90 per cent of

[20] Collis, J., 2010. ‘Directors’ views on accounting and auditing requirements for SMEs (small to medium-sized enterprises)’
[21] Collis (2014) cited in Bagshaw,K., 2014. ‘Checks and balances: audit exemptions for small business’
[22] Insight strategic associates, date unknown. ‘Audit exemptions’
[23] BIS, 2014. ‘Impact assessment: audit exemptions’
[24] BIS, 2013. ‘Simpler financial reporting for micro entities: The UK's proposal to implement the 'Micros Directive’
[25] BIS, 2014. ‘Impact assessment: audit exemptions’
[26] Collis, J (for BERR), 2008. ‘Directors’ Views on Accounting and Auditing Requirements for SMEs’
[27] Companies House, 2015. ‘Companies Register Activities 2014/15’ (Table F2: Annual Accounts Registered at Companies House by Accounts Type 2010-11 to 2014-15)

all non-dormant companies that had registered annual accounts at Companies House in 2014/15. This suggests an additional 416,500 companies have taken up an exemption from audit compared to 2009/10. This represents an increase of 30 per cent, which is greater than the 25 per cent growth in the overall number of non-dormant companies over the same period[28].

BEIS also provided an analysis of company data, using data from the FAME database, to inform this study. It estimated there to be 3,200,200 active / live companies in the UK in 2015, of which 1,997,900 were recorded as having unaudited accounts. This information suggests that 62 per cent of UK companies had not undergone an audit in 2015.

These findings suggest that the take-up of the small companies audit exemption was between 62 and 90 per cent of registered UK companies in 2015. This is broadly consistent with the range quoted in BIS' impact assessment of the 2012 audit exemption changes. It suggests that take-up may have increased slightly over time, which could be due to the changes to the eligibility criteria in 2012. This remains a fairly wide range, although the experience of this study suggests that the Companies House data is likely to provide a more accurate and robust estimate of take-up.

These figures relate to registered companies. Additionally, the above information does not describe:

- the number of companies eligible for the small companies audit exemption (based on turnover, asset values and number of employees);
- the characteristics of eligible companies taking up or not taking up an exemption; and
- the number and characteristics of companies that became eligible following the changes to the eligibility criteria in 2012 (having previously been ineligible).

Addressing these issues requires more comprehensive data than is currently available. However, to inform this study, BEIS also undertook analysis using a combination of FAME and IDBR data (matched using company numbers) to estimate the number of companies that became eligible for audit exemptions in 2012, having previously been ineligible under the previous criteria. This analysis used IDBR data for business turnover and employment to fill gaps in the FAME data and to provide historic data to assess eligibility before the changes to the eligibility criteria in 2012. This provided a more comprehensive dataset with which to assess eligibility and take-up both before and after the changes that were introduced in 2012.

The analysis estimated that there are around 44,700 companies in the UK that became eligible as a result of the 2012 changes to the eligibility criteria for audit exemptions, having previously been ineligible. This figure is larger than the 36,300 additional companies that were estimated in the impact assessment of the 2012 audit exemption changes. The data on take-up suggests that most (70 per cent) of the additional 44,700 companies had still undergone an audit despite becoming eligible for audit exemptions. The findings therefore suggest a relatively low take-up rate of 30 per cent amongst this population.

Table 2 summarises the above estimates of take-up. It shows the high and low estimates of overall take-up rates of 62 per cent (based on FAME data) and 90 per cent (based on

[28] Companies House, 2015. 'Companies Register Activities 2014/15' (Table F2: Annual Accounts Registered at Companies House by Accounts Type 2010-11 to 2014-15)

Companies House data). It also shows the results of BEIS' analysis of FAME and IDBR data and uses these to disaggregate the FAME estimate of overall take-up between those that were ineligible for audit exemptions until the eligibility criteria were changed in 2012 (30 per cent) and those that were eligible before and after 2012 (63 per cent).

Table 2: Summary of different estimates of take-up of audit exemptions

Source	Total number of companies taking up exemptions	Total number of companies in the population	Description of population	Take-up rate
Companies House	1,814,900	2,025,300	All 'live' (non-dormant) UK companies registering annual accounts at Companies House	90%
BEIS analysis of FAME data	1,999,700	3,200,200	All 'live' companies with a main address in the UK	62%
BEIS analysis of FAME & IDBR data	13,200	44,700	Companies ineligible for audit exemptions pre-2012 but eligible post-2012	30%
Analysis of FAME & IDBR data	-	-	Estimate of companies eligible for audit exemptions pre and post 2012	63%*

Sources: Companies House, 2015. 'Companies Register Activities 2014/15' (Table F2: Annual Accounts Registered at Companies House by Accounts Type 2010-11 to 2014-15); and BEIS analysis of FAME and IDBR data

Note: * The take-up rate for companies that were eligible for audit exemptions pre and post 2012 has been estimated from the FAME data in the above rows (as the difference between take-up rates for all registered companies and those that were previously ineligible for audit exemptions but became eligible in 2012).

3 Key findings

This section presents findings of the research into the small companies audit exemption. It is based on a quantitative telephone survey and qualitative interviews with companies that were eligible for audit exemptions at the time of interview. It explores the scale, characteristics and views of companies taking up and not taking up audit exemptions, it considers the reasons, motivations and impacts of their respective decisions and it discusses expectations of future take-up.

3.1 Scale of take-up of the small companies audit exemption

This section analyses the responses to the quantitative survey from the 361 companies that were eligible for audit exemptions at the time of interview (after excluding charities). . The survey findings are compared between the four groups defined in Table 3 below as well as between:

- those that took up audit exemptions (combining groups A and C) and those that did not (combining groups B and D); and
- those that were ineligible for audit exemptions before 2012 (combining groups A and B) and those that were eligible before and after the changes introduced in 2012 (combining groups C and D).

Table 3: Definition of sample sub-groups

	Group / Definition	Eligible pre 2012	Eligible post 2012	Took up exemption?	Sample size (weighted)
A	Companies ineligible pre-2012 and eligible post-2012 that took up audit exemptions	No	Yes	Yes	50
B	Companies ineligible pre-2012 and eligible post-2012 that did not take up audit exemptions	No	Yes	No	118
C	Companies eligible pre and post 2012 that took up audit exemptions	Yes	Yes	Yes	122
D	Companies eligible pre and post 2012 that did not take up audit exemptions	Yes	Yes	No	71

Overall, 41 per cent of the sample had taken up audit exemptions in the most recent year. This figure is lower than the estimates of take-up across the wider business population, described above in Section 2.4, because the survey aimed to collect views from a similar number of companies that had and had not taken up audit exemptions. This required companies that had not taken up audit exemptions to be over-sampled in the survey. However, the survey responses were weighted to be representative of the wider business population, using the take-up rates presented in Table 2 and profiles of the size and sector characteristics of the wider populations for each group, such that:

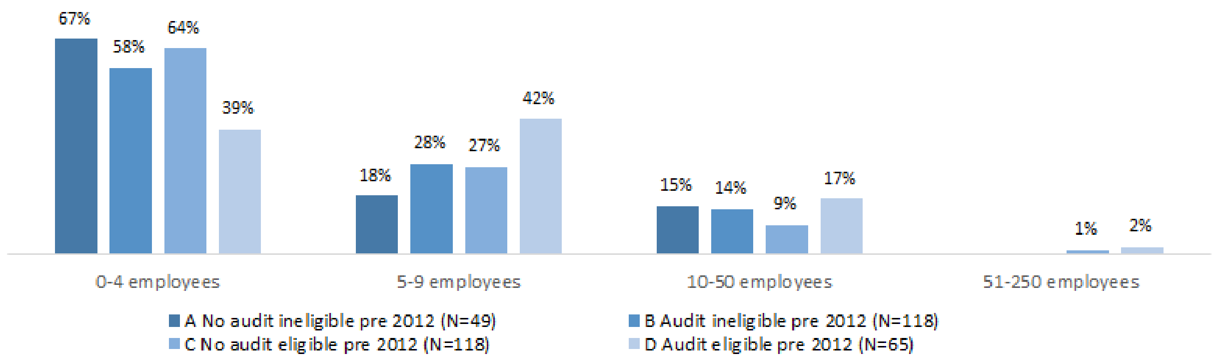
- 63 per cent of the companies that were eligible before and after 2012 had taken up audit exemptions; and
- 30 per cent of the companies that only became eligible for audit exemptions in 2012 had taken up an exemption. It is important to note, however, that this group represents a small proportion of the total number of eligible companies.

3.2 Take-up by business type and characteristics

This sub-section provides an analysis of the characteristics of companies in each group and the differences between those taking up audit exemptions and those continuing to undergo audits. Base sizes for each sub-group are presented in footnotes throughout this section and the findings should be treated with caution where they are based on responses from fewer than 50 companies.

The sample of companies was stratified by the following employment size bands: 0-4; 5-9; 10-50; and 51-250 employees. The sample companies with different numbers of employees is shown in Figure 6. The sample provided good coverage of micro (below 10 employees), small (10-50 employees) and medium companies (51-250 employees) but did not include large companies employing over 250 people. Figure 6 shows that more than half of the companies surveyed (57 per cent overall) have fewer than five employees. Group D has the largest proportion of companies employing five or more workers (61 per cent), of which 19 per cent employed ten or more and 2 per cent employed over 50. More broadly, the companies taking up audit exemptions (groups A and C) were more likely to have fewer employees than those undergoing audits (groups B and D). The average number of employees amongst those taking up audit exemptions was six, compared to eight for those that were eligible but still undergoing audits.

Figure 6: Survey respondents, by number of employees

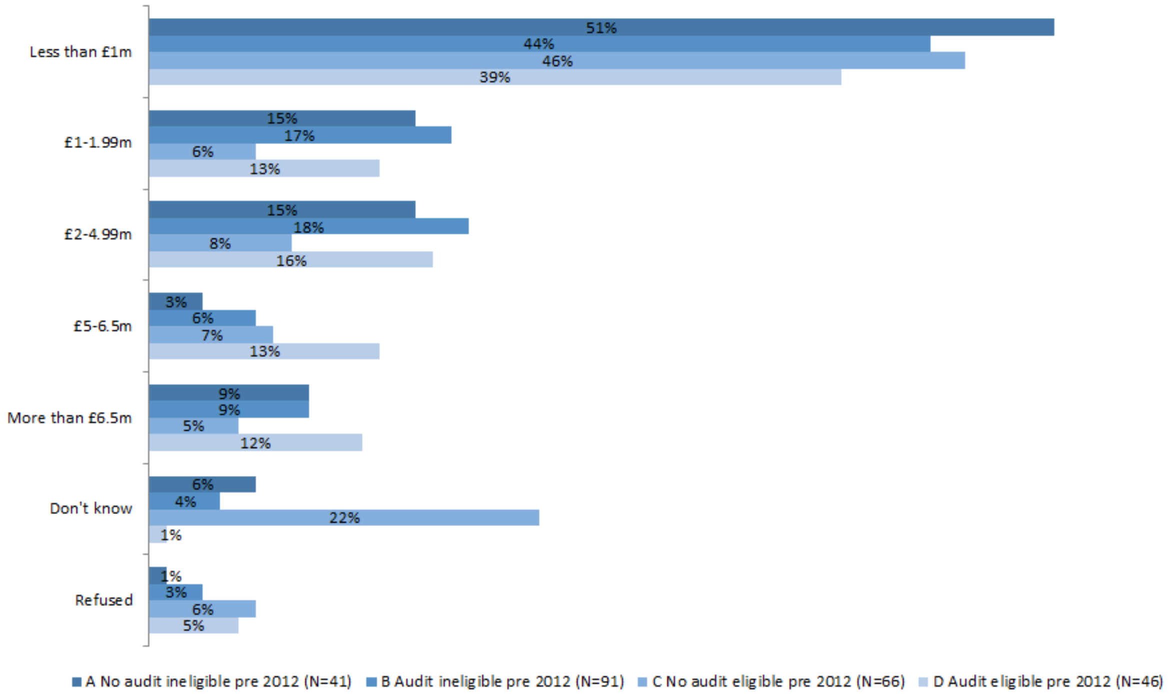


Source: BMG survey data (question Q9); unweighted base: All companies: 361 (comprising group A: 66, group B: 102, group C: 98 and group D: 95).

Note: Figures may not sum to 100 per cent due to rounding.

Figure 7 shows that the sample included companies with varied turnover. Overall, 46 per cent of the sample had an annual turnover of less than £1 million for the most recent year. Approximately 8 per cent of the sample had a turnover in excess of £6.5 million but still qualified for audit exemptions because they had no more than 50 employees and had assets of no more than £3.26 million in value. Similar to the findings relating to employee size, companies taking up audit exemptions (groups A and C) were more likely to have a smaller turnover than those undergoing audits (groups B and D). The average turnover amongst those taking up audit exemptions was £2.95 million, compared to £3.6 million for those that were eligible but still undergoing audits.

Figure 7: Survey respondents, by turnover

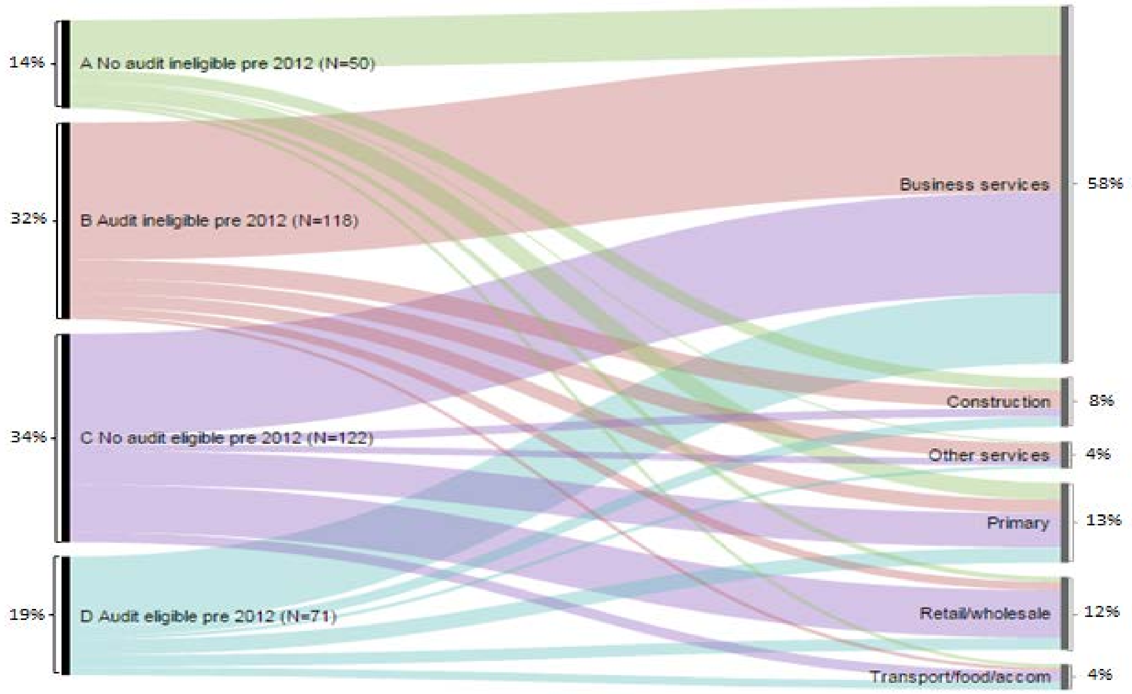


Source: BMG survey data (question Q10); unweighted base: All companies: 361 (comprising group A: 66, group B: 102, group C: 98 and group D: 95).

Note: Figures may not sum to 100 per cent due to rounding.

The sample provided varied coverage across the broad industry sectors, as shown in Figure 8. Business services was the most common sector, constituting more than half of survey sample (58 per cent), followed by primary/manufacturing (13 per cent) and retail wholesale trade (12 per cent) sectors. These trends were broadly consistent across the different sub-groups.

Figure 8: Survey respondents, by sector

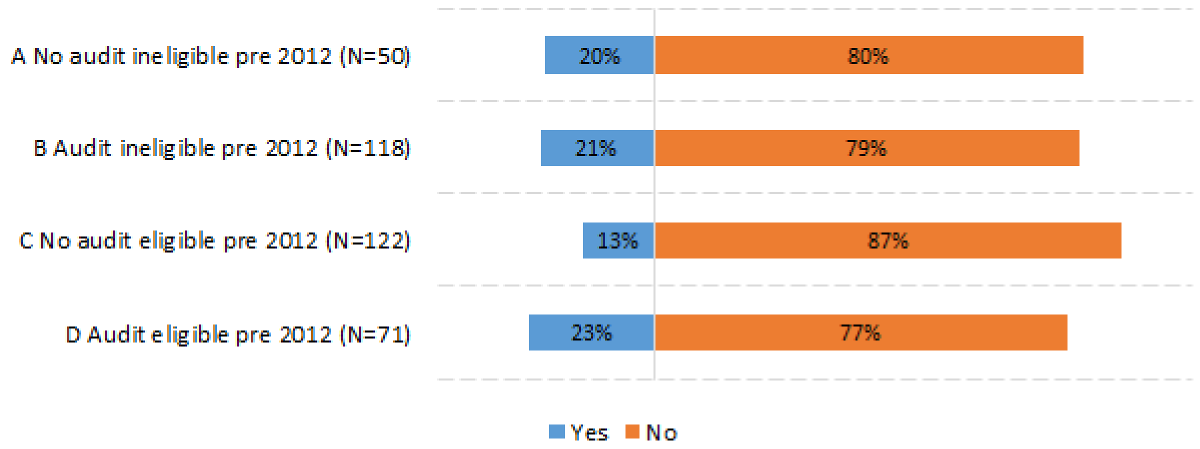


Source: BMG survey data (question Q11/Q12. Sector); unweighted base: All companies: 361 (comprising group A: 66, group B: 102, group C: 98 and group D: 95).

Note: Figures may not sum to 100 per cent due to rounding.

Figure 9 shows how many of the sample were part of a corporate group. In total, 19 per cent of the total survey sample indicated they were part of a corporate group. The trends across different sample groups were broadly similar, with the largest deviation from the mean being group C, with only 13 per cent of companies indicating they were part of a corporate group. Overall, 15 per cent of companies that took up audit exemptions (groups A and C) were part of a corporate group, compared to 22 per cent of companies still undergoing audits.

Figure 9: Survey respondents, by corporate group affiliation



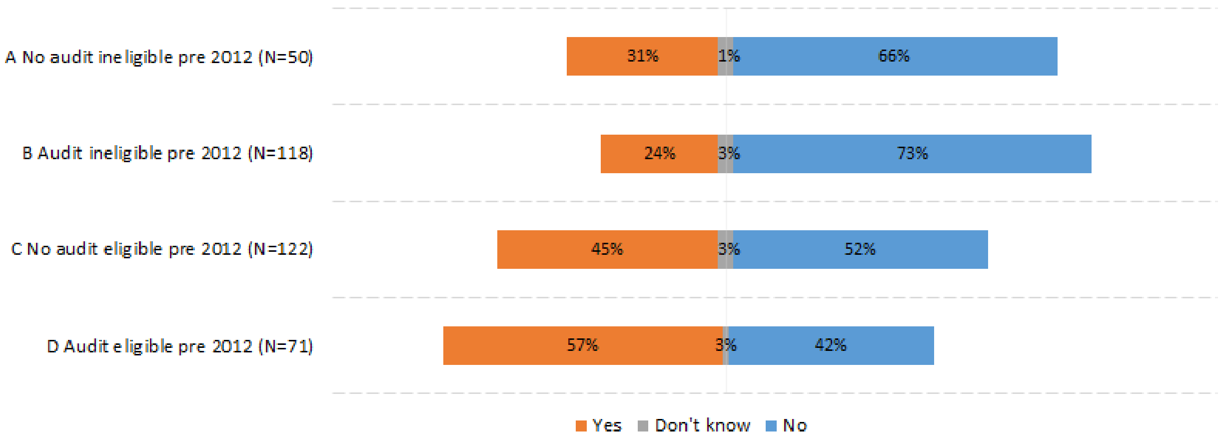
Source: BMG survey data (question Q6); unweighted base: All companies: 361 (comprising group A: 66, group B: 102, group C: 98 and group D: 95).

The survey sample also included broad coverage in terms of the age of companies with around half (54 per cent) of companies established since 1990. There was little variation in the average dates of establishment between groups although those companies taking up audit exemptions included a relatively large proportion of older companies (35 per cent were established pre-1980 compared to 16 per cent of those undergoing audits), but also a relatively large proportion of the youngest companies (34 per cent were established since 2000 compared to 25 per cent of those undergoing audits).

The survey also asked respondents whether their company holds membership of any trade bodies or industry associations (outlined in Figure 10). Overall, 38 per cent of companies in the sample held membership of a trade body, although there was considerable variation between groups. Only 24 per cent of respondent companies in group B were members of a trade body, compared to 57 per cent in group D. The differences between those that took up audit exemptions and those that did not were less marked: 41 per cent of those that took up audit exemptions were part of a trade body, which was slightly higher than the 36 per cent of companies that did not take up audit exemptions.

The sample held membership of a broad range of trade bodies and industry associations but there were no clear links between these associations and the take-up of audit exemptions.

Figure 10: Survey respondents, by trade body

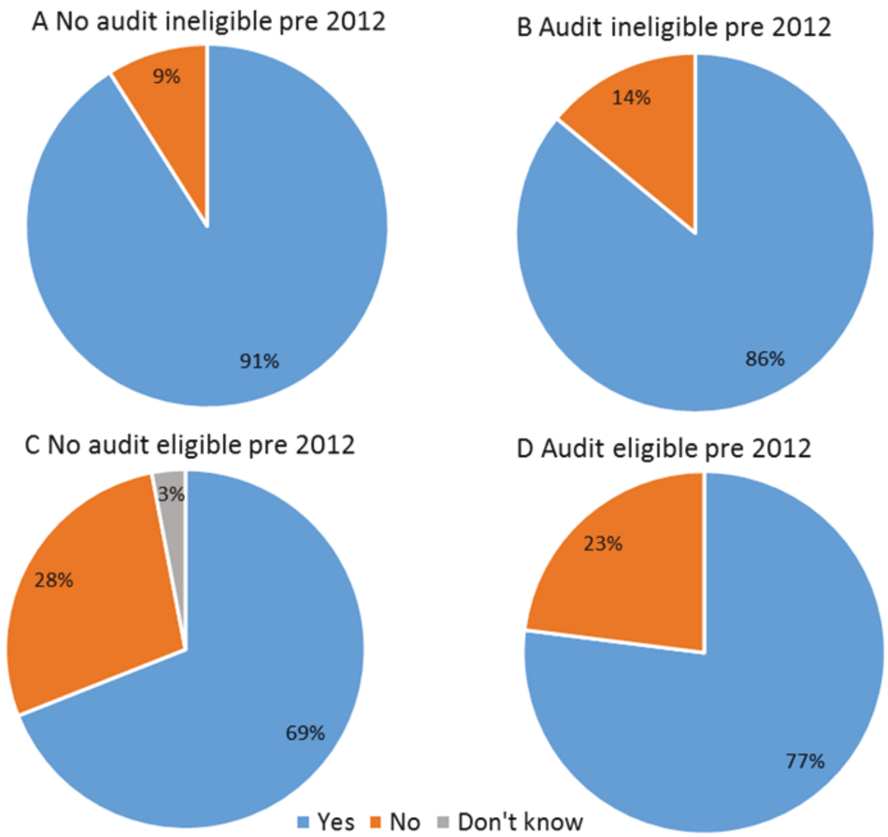


Source: BMG survey data (question Q13); unweighted base: All companies: 361 (comprising group A: 66, group B: 102, group C: 98 and group D: 95).

Note: Figures may not sum to 100 per cent due to rounding.

The quantitative survey also asked companies whether they had shareholder, lenders and other external investors to explore whether this could influence decisions regarding take-up of audit exemptions. The survey found that 79 per cent of companies in the sample had shareholders. Figure 11 shows that groups A and B had the largest proportion of companies with shareholders, with a respective 91 and 86 per cent, suggesting that shareholders were more likely amongst the companies that were ineligible for audit exemptions before 2012. Overall, those taking up audit exemptions were less likely to have shareholders (75 per cent), compared to those not taking up an exemption (81 per cent).

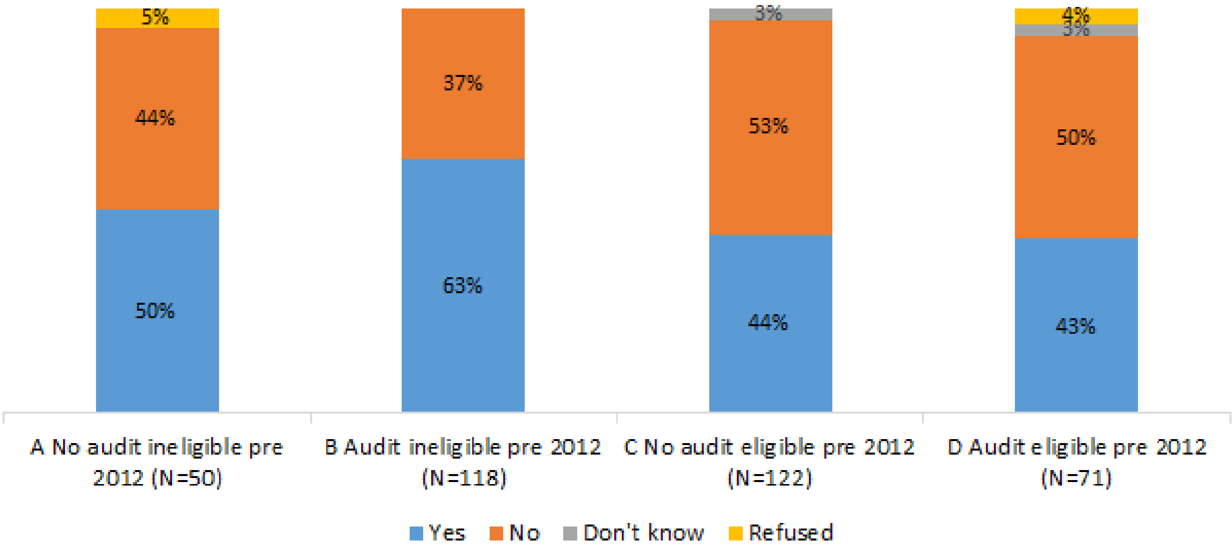
Figure 11: Survey respondents, by presence of shareholders



Source: BMG survey data (question Q15); unweighted base: All companies: 361 (comprising group A: 66, group B: 102, group C: 98 and group D: 95).

Figure 12 shows that around half (51 per cent) of the companies in the survey sample had raised funds using loans from banks or other creditors. The use of lenders was most prevalent among group B companies, with almost two thirds (63 per cent) reporting having lenders. In contrast, those that were eligible for audit exemptions before and after 2012 were the least likely to have lenders (groups C and D), as only around 44 per cent reported having lenders. Overall, the presence of lenders was slightly higher amongst those that did not take up audit exemptions (56 per cent reported having lenders) compared to those that did take up an exemption (46 per cent reported having lenders).

Figure 12: Survey respondents, by presence of lenders

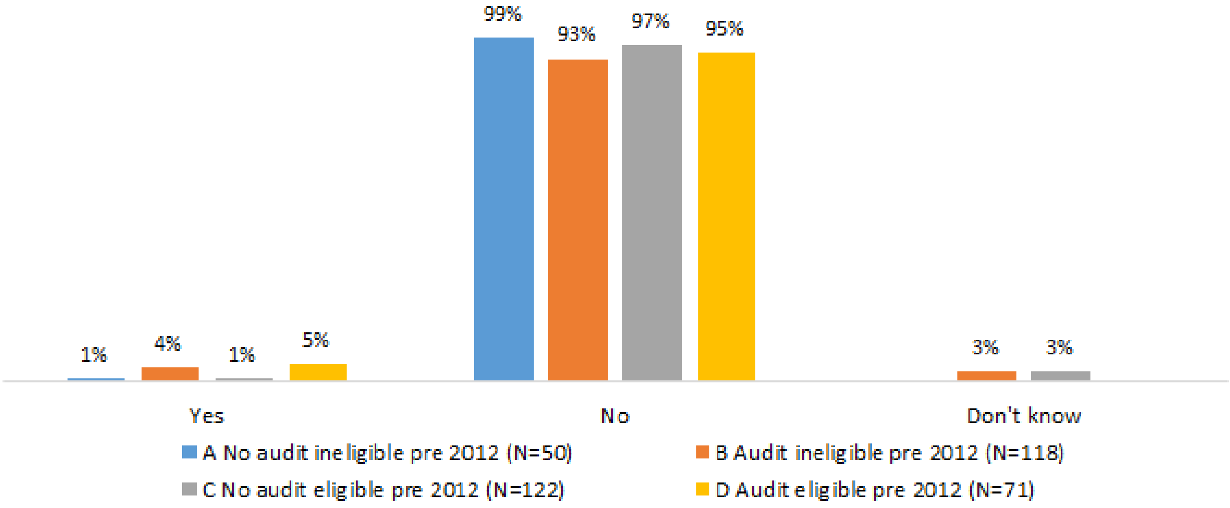


Source: BMG survey data (question Q16); unweighted base: All companies: 361 (comprising group A: 66, group B: 102, group C: 98 and group D: 95).

Note: Figures may not sum to 100 per cent due to rounding.

Figure 13 shows the majority of companies (96 per cent overall) reported not having external investors of capital who are not shareholders in the company or lenders via banking services. However, the presence of other external investors was also slightly higher amongst those that did not take up audit exemptions (4 per cent) compared to those that did take up an exemption (1 per cent). These findings therefore suggest that the take-up of audit exemptions is generally lower for companies that reported having shareholders, lenders and/or external investors.

Figure 13: Survey respondents, by presence of external investors



Source: BMG survey data (question Q17); unweighted base: All companies: 361 (comprising group A: 66, group B: 102, group C: 98 and group D: 95).

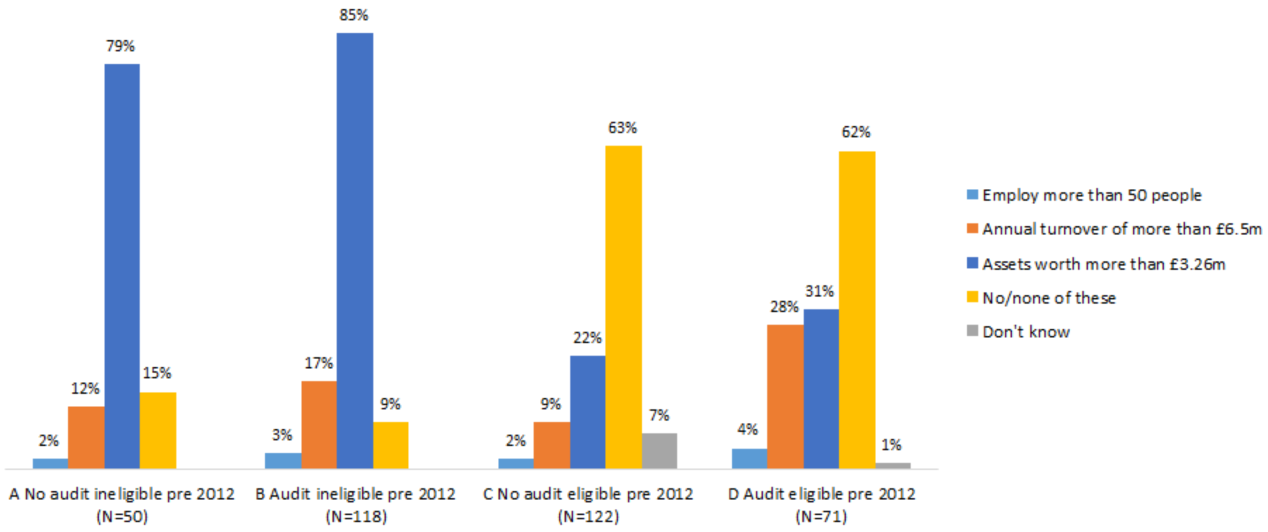
Note: Figures may not sum to 100 per cent due to rounding.

The quantitative survey also asked companies about their expectations for future growth, to test whether this was a reason for not taking up audit exemptions (for example, a company might decide not to take up audit exemptions if they expect to grow rapidly and become ineligible for audit exemptions in the near future).

Figure 14 illustrates the expectations of companies over the next three years. The findings suggest some significant differences between companies that were eligible and ineligible for audit exemptions before 2012. Almost two thirds of respondents in groups C and D (63 and 62 per cent respectively) reported not expecting to exceed any of the three thresholds for the eligibility criteria relating to employment, turnover and assets values in the next three years. In contrast, only 15 and 9 per cent respectively of the companies in groups A and B (that were ineligible before the eligibility criteria changed in 2012) reported no expectations of exceeding the eligibility criteria. The survey found that these companies were instead relatively likely to expect that they would exceed the criteria for asset values within the next three years (reported by 83 per cent of companies in groups A and B). However, since the large majority of respondents expect to stay within the turnover and employment thresholds, it is unlikely that many of these companies would become ineligible for audit exemptions based on their expectations at the time of interview (only 15 per cent and 2 per cent of companies in groups A and B expected to exceed the criteria for turnover and employees in the next three years).

The weighted averages across those taking up audit exemptions (groups A and C) and those not taking up an exemption (groups B and D) suggested that those that had taken up audit exemptions were less likely to expect to exceed any thresholds (47 per cent) compared to those that had not taken up an exemption (24 per cent).

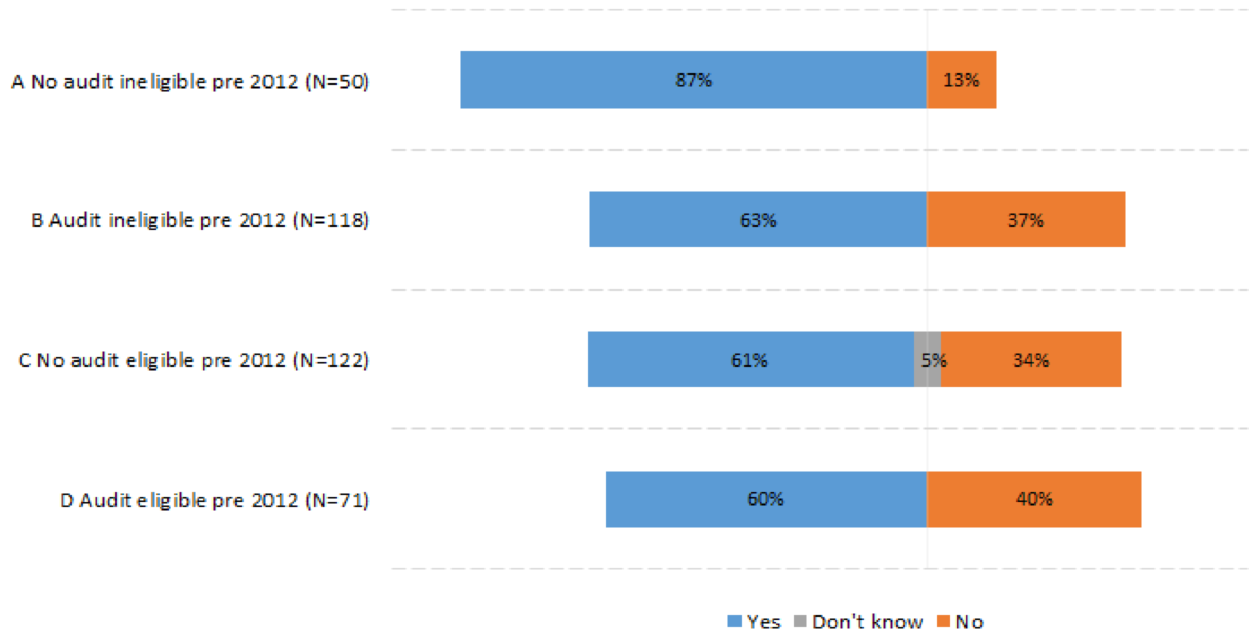
Figure 14: Survey respondents, expectations of exceeding audit exemption thresholds within the next three years



Source: BMG survey data (question Q18); unweighted base: All companies: 361 (comprising group A: 66, group B: 102, group C: 98 and group D: 95).

The quantitative survey also asked about awareness of the changes to the eligibility criteria that were introduced in 2012 in case this was a reason for not taking up audit exemptions, particularly amongst those that were ineligible prior to those changes. The findings, presented in Figure 15, suggest that awareness of the changes introduced in 2012 was relatively high amongst those that were previously ineligible (on average, 70 per cent of those that were previously ineligible were aware of the changes compared to 61 per cent of those that were already eligible before 2012), although this might be expected since these were the companies affected by the changes. Interestingly, amongst those that were previously ineligible, awareness of the changes was particularly high amongst those that then took up audit exemptions (87 per cent) compared to those that did not (63 per cent). This suggests that a lack of awareness of the changes in 2012 could mean that some of these companies had not taken up audit exemptions because they were not aware that they had become eligible as a result of the changes introduced in 2012. This issue is explored in more detail below.

Figure 15: Survey respondents' awareness of the changes introduced in 2012 to the eligibility criteria for audit exemptions



Source: BMG survey data (question Q19); unweighted base: All companies: 361 (comprising group A: 66, group B: 102, group C: 98 and group D: 95).

Overall, two-thirds of the sample (67 per cent) believed they were eligible for an audit exemption. A further 19 per cent did not know whether they were eligible, while the remaining 14 per cent reported that they were not eligible for audit exemptions. When asked why they felt that their company was ineligible for an audit exemption, the 48 (unweighted) respondents reporting that they were ineligible gave a wide range of answers including:

- because the company is a listed entity or public company;
- because the company is a financial services provider;
- because the group of which the company is a part is large or medium sized; and
- because of the requirements of lenders, shareholders, investors or regulators.

However, the most common reason was because respondents had mistakenly thought their turnover, assets and employees exceeded the eligibility criteria. This is an important finding and suggests that a lack of awareness of eligibility criteria for audit exemptions is likely to be a reason for some companies not taking up audit exemptions.

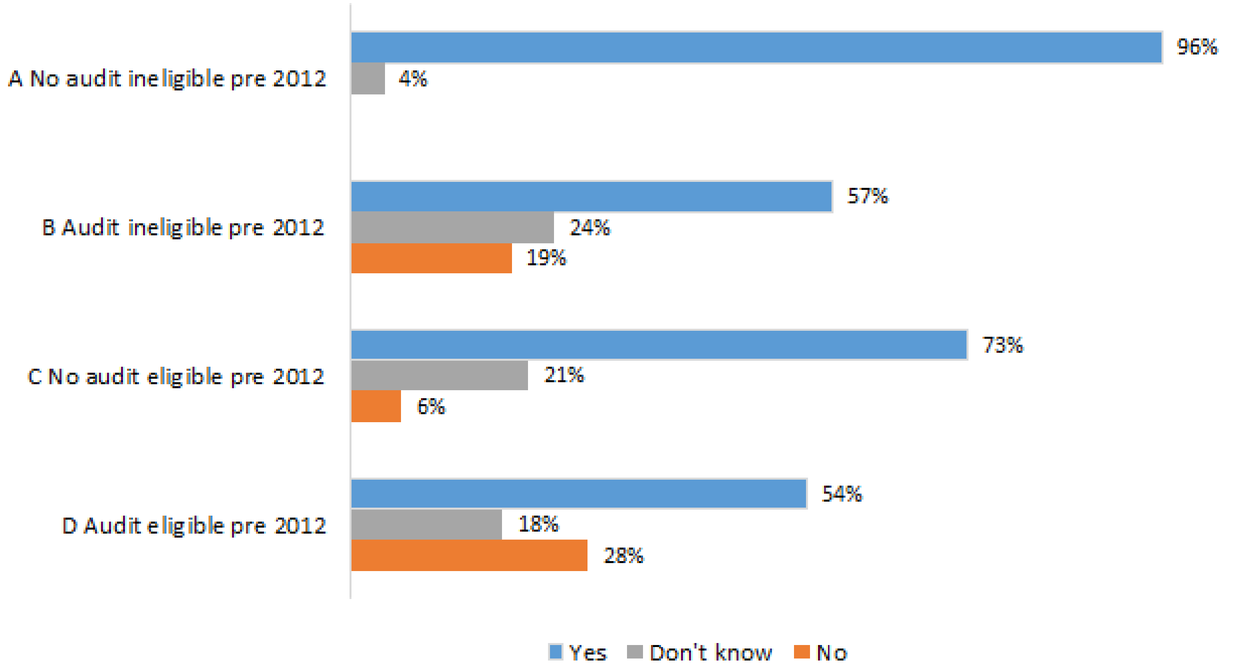
Figure 16 shows the proportion of respondents in each group that believe their company is eligible for exemption from undergoing audits. As might be expected, those that took up audit exemptions (groups A and C) were more likely, on average, to think that they were eligible for audit exemptions compared to those that did not take up an exemption (groups B and D). For example:

80 per cent of those taking up an audit exemption (groups A and C) felt they were eligible compared to only 56 per cent of those that had not taken it up (groups B and D);

16 per cent of those taking up an audit exemption (groups A and C) were not sure whether they were eligible compared to 22 per cent of those that had not taken it up (groups B and D); and

4 per cent of those taking up an audit exemption (groups A and C) reported thinking they were ineligible compared to 22 per cent of those that had not taken it up (groups B and D).

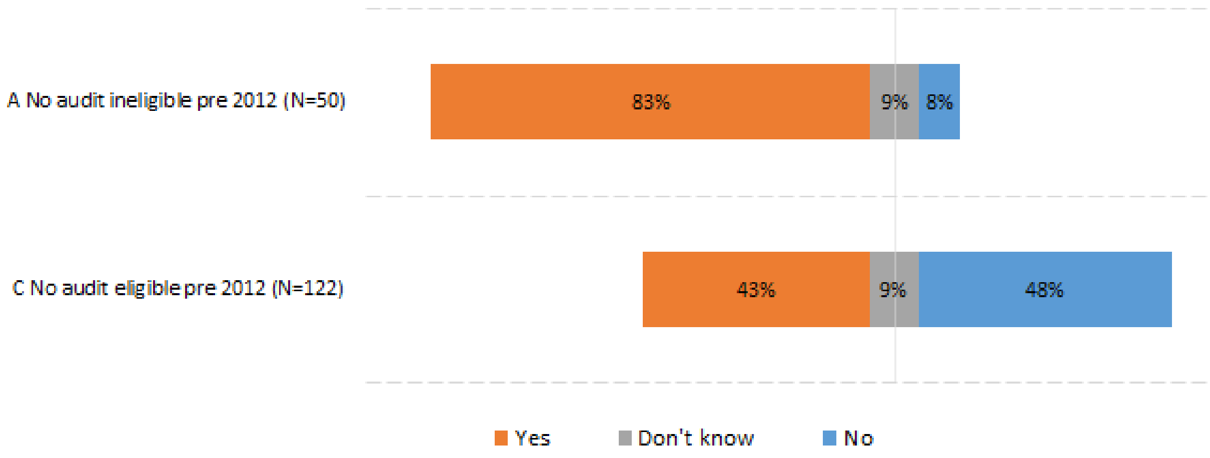
Figure 16: Survey respondents, by perceptions of eligibility for audit exemptions at the time of interview



Source: BMG survey data (question Q20); unweighted base: All companies: 361 (comprising group A: 66, group B: 102, group C: 98 and group D: 95).

The quantitative survey also asked companies that had taken up audit exemptions whether they had ever undergone an audit. As Figure 17 illustrates just over half (55 per cent) of these respondents (in groups A and C) had previously been through an audit and 36 per cent had not. However, there was significant variation between the two groups, with only 43 per cent of companies in group C having undergone an audit, compared to 83 per cent in group A. This is perhaps unsurprising as it suggests that those that were ineligible for audit exemptions before 2012 are significantly more likely to have previously undergone an audit.

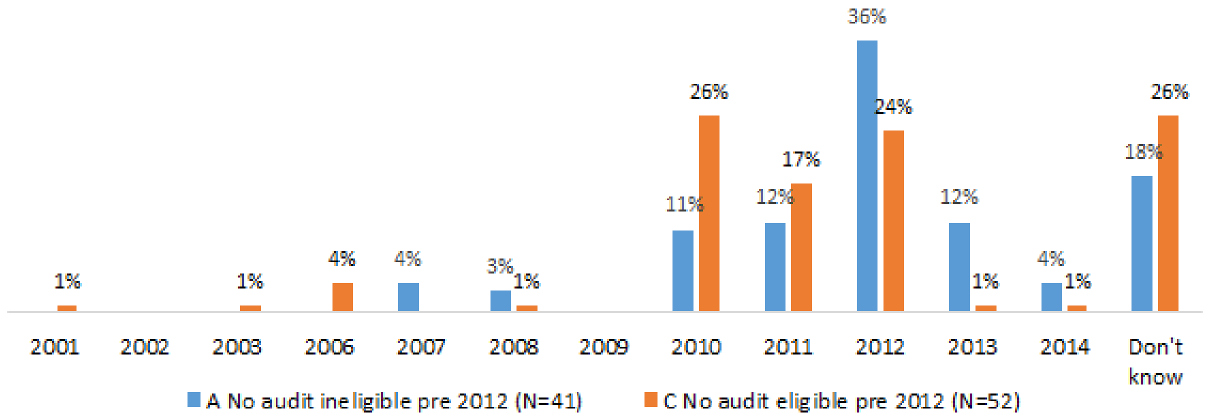
Figure 17: Survey respondents that have previously undergone an audit



Source: BMG survey data (question Q23); unweighted base: All companies that had taken up audit exemptions: 164 (comprising group A: 66, and group C: 98).

The 55 per cent of companies that had previously been through an audit were also asked when they had undergone their last audit. Figure 18 shows that for most of these companies (61 per cent), their last audit was undertaken between 2010 and 2012. A relatively small proportion (8 per cent) of these companies had undertaken audits since the eligibility criteria had changed in 2012, although this was significantly higher amongst group A than group C (i.e. 16 per cent of those that had previously undergone an audit had done so since 2012 for group A compared to 2 per cent for group C).

Figure 18: Survey respondents, by year of company's last audit



Source: BMG survey data (question Q24); unweighted base: All companies that were taking up audit exemptions at the time of interview but had previously undergone an audit: 98 (comprising group A: 55, and group C: 43).

Note: Figures may not sum to 100 per cent due to rounding.

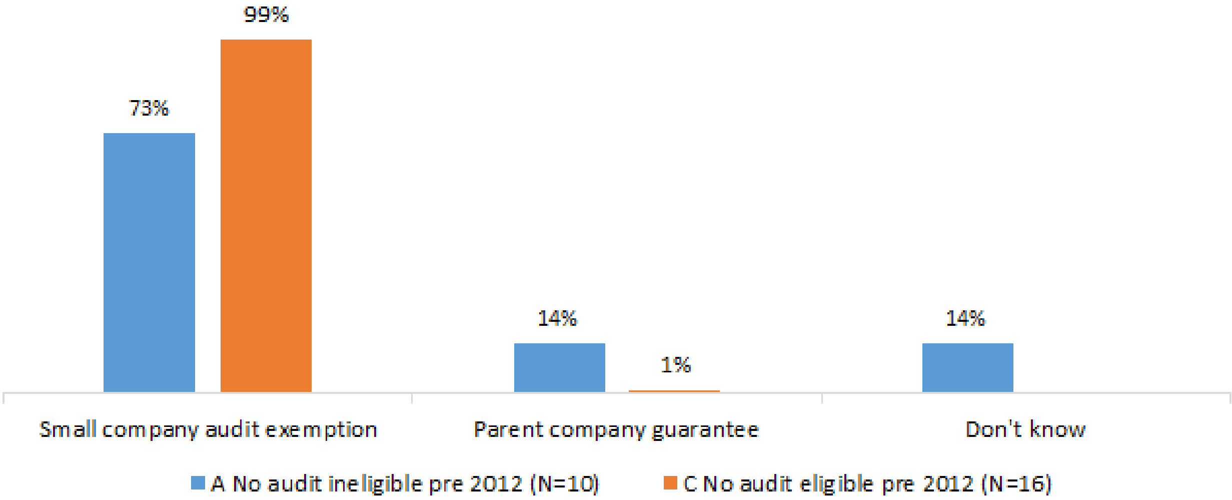
3.3 Reasons and motivations for taking up the small companies audit exemption

This sub-section explores the reasons and motivations for taking up audit exemptions. Conversely, the reasons and motivations for not taking up audit exemptions are explored below in Section 3.5.

Companies that were part of a corporate group and took up audit exemptions were asked whether they had done so because of the small companies audit exemption, a parent company guarantee or any other reason. The large majority (89 per cent) had taken up the small companies audit exemption, followed by those with a parent company guarantee (6 per cent). There were no other reasons reported by respondents.

Figure 19 shows that group A had the largest proportion of parent company guarantees, representing 14 per cent of companies that were part of a group, compared to just 1 per cent in group C. This suggests that parent company guarantees were more common amongst companies that were previously ineligible for audit exemptions (prior to the changes introduced in 2012). This group was also less likely to know the means through which they were taking up audit exemptions (14 per cent said they did not know). However, it should be noted that these results are based on a relatively small number of responses from 27 companies that were part of a group and had taken up audit exemptions.

Figure 19: Take-up of audit exemptions, by type of exemption



Source: BMG survey data (question Q26); unweighted base: All companies that were part of a corporate group and had taken up audit exemptions: 27 (comprising group A: 15, and group C: 12).

Note: Figures may not sum to 100 per cent due to rounding.

Extending the analysis across all respondents from groups A and C suggests that 98 per cent of all companies taking up audit exemptions had taken up the small companies audit exemption, 1 per cent had a parent company guarantee and 1 per cent did not know which type of audit exemption they had taken up.

The survey asked respondents why their company had decided to take up audit exemptions. The most common reason was to save money spent on auditors, which was cited by around half (51 per cent) of all respondents in groups A and C. This was followed by saving time spent interacting with auditors and not seeing the value in undergoing an audit, which were reported by approximately one-in-three respondents (32 per cent) in groups A and C. Other common reasons for taking up audit exemptions included: being advised by their accountant (reported by 20 per cent); finding the audit process too complicated (16 per cent); and simply because they were eligible to do so (3 per cent).

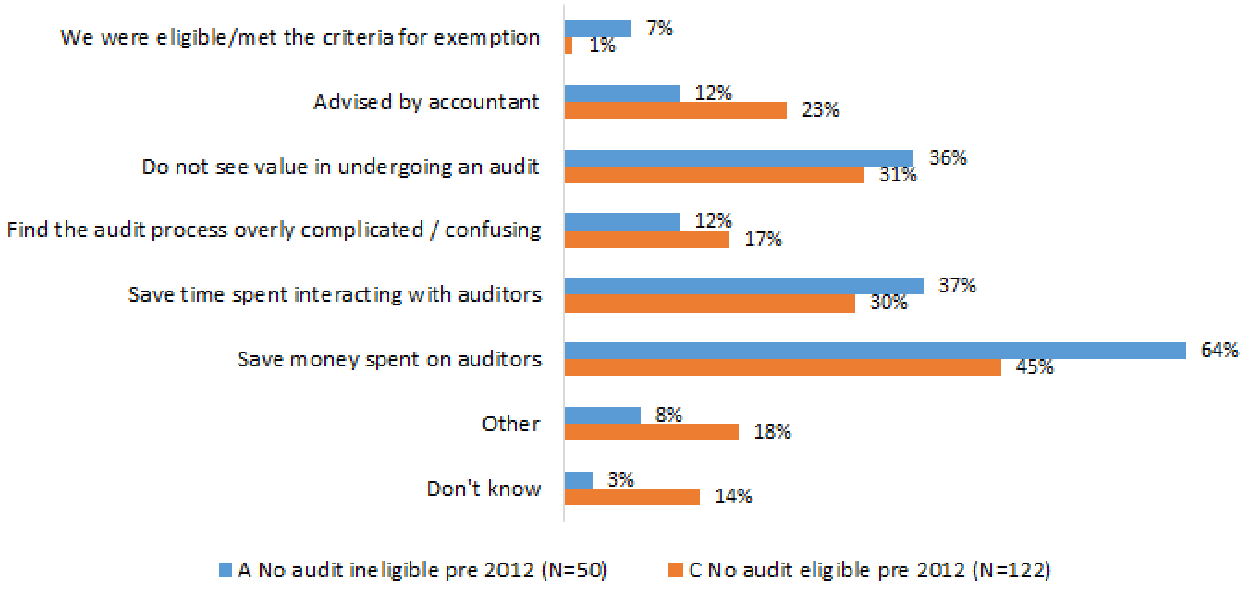
The qualitative interviews corroborated the survey findings as most of the interviewed companies felt that audits are too “resource-intensive”, especially in terms of time and money. In addition, for some, the pressure on internal resources has been further amplified when “less experienced” auditors are assigned to perform routine audit checks.

"The main negative impact is on time. Usually it amplifies with having less experienced auditors around - you've got to brief them, provide them with a lot of background information to get them up to speed about your business, explain to them what the business does and so on […].”

[Micro company, primary/manufacturing]

Figure 20 shows that those that were ineligible for audit exemptions before 2012 (group A) were more likely to report saving money and time from not dealing with auditors and not seeing the value in audits. In contrast, those in group C were relatively more likely to cite being advised by their accountant or finding the audit process too confusing.

Figure 20: Reasons for taking up audit exemptions



Source: BMG survey data (question Q27); unweighted base: All companies that had taken up audit exemptions: 164 (comprising group A: 66, and group C: 98).

The survey respondents who provided multiple reasons for their company using an audit exemption were also asked to specify their principal reason for doing so. The majority of respondents providing multiple reasons (67 per cent) stated that saving money was their main reason. This was followed by 'seeing no value in the audit process' (19 per cent), and being advised by their accountant (6 per cent).

The qualitative interviews explored reasons for taking up audit exemptions in greater depth and found that most interviewees felt that audits offer greater benefits to larger firms.

"You need to know that, for a small business like me, there are no benefits of having an audit. So when audit exemptions took effect, there was great motivation to stop doing it. […]. In big companies, it is more difficult to know if someone is issuing dodgy invoices or if some people are not […] doing their job properly. You may only know through an audit, so I guess an audit does add value. However, in my business, I know what is going on; […] if something's been missed, I can discuss it with my accountant and work out the implications. So for me, an audit adds no value - it's just a waste of time as we are basically replicating the work of our accountant."

[Micro company, business services / management of real estate]

3.4 Impacts for companies taking up audit exemptions

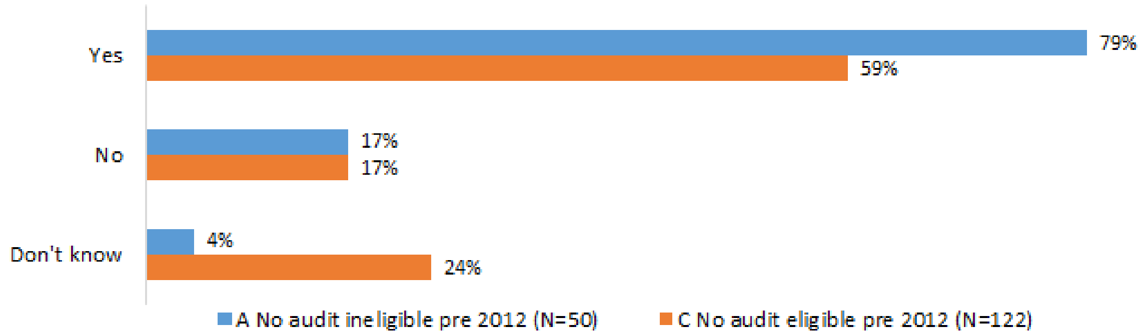
This sub-section discusses the impacts experienced by companies taking up audit exemptions. The impacts experienced by companies not taking up audit exemptions are covered in Section 3.6.

The section starts by exploring the identified benefits of audit exemptions before considering potential negative consequences and the overall net impacts of taking up audit exemptions.

3.4.1 Benefits of exemption

In total, around two-thirds (65 per cent) of respondents taking up audit exemptions felt that their company had benefited positively from doing so. However, 17 per cent reported feeling no benefits and a further 18 per cent were unsure. Figure 21 shows that companies in group A were most likely to feel a positive effect (with 79 per cent of companies perceiving a positive effect) in comparison to group C (59 per cent). Group C also had the largest proportion (24 per cent) of companies that were unsure whether any benefits were gleaned by their exclusion from the audit process. This suggests that positive benefits were reported by a larger proportion of those that had recently become eligible for audit exemptions (group A), compared to those that were eligible before 2012 (group C).

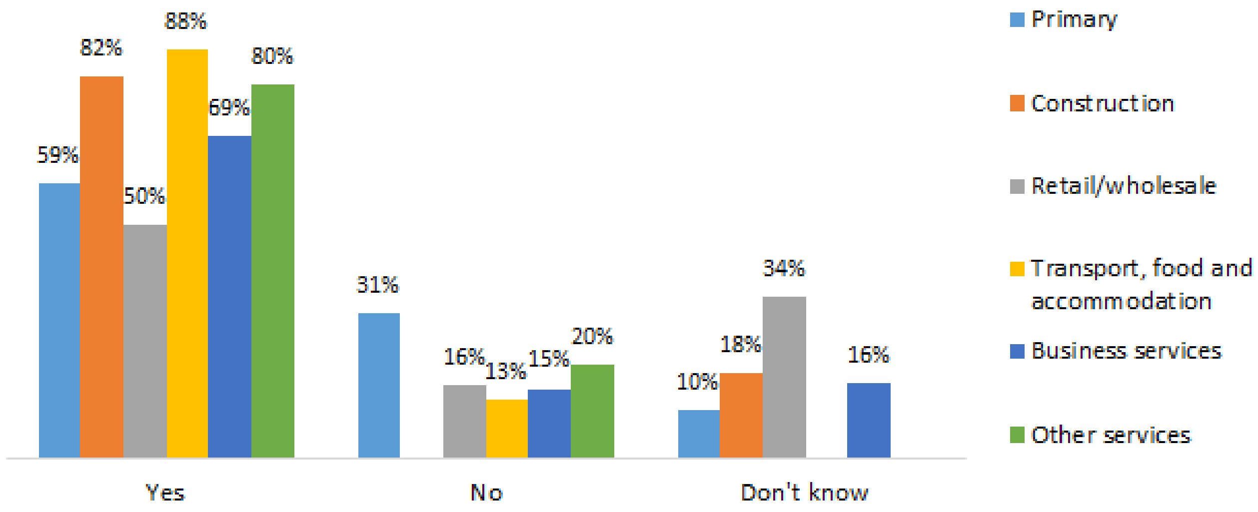
Figure 21: Incidence of benefits from taking up audit exemptions



Source: BMG survey data (question Q29); unweighted base: All companies that had taken up audit exemptions: 164 (comprising group A: 66, and group C: 98).

There were also some differences in views across different business sizes and sectors (as illustrated by Figure 22). For example, micro companies employing fewer than five people were least likely to view missing an audit as beneficial. In all, only 59 per cent of the 110 micro companies in groups A and C attested a positive effect of audit exemptions and 19 per cent felt there was no impact at all. However, these differences were not significant at the 95 per cent confidence level when compared to the 65 per cent reporting benefits and 17 per cent reporting no benefits across all companies taking up audit exemptions. Further, companies in the primary/manufacturing sector were significantly more likely to report having experienced no benefits (31 per cent) compared to the other sectors (16 per cent on average).

Figure 22: Incidence of benefits from taking up audit exemptions, by sector

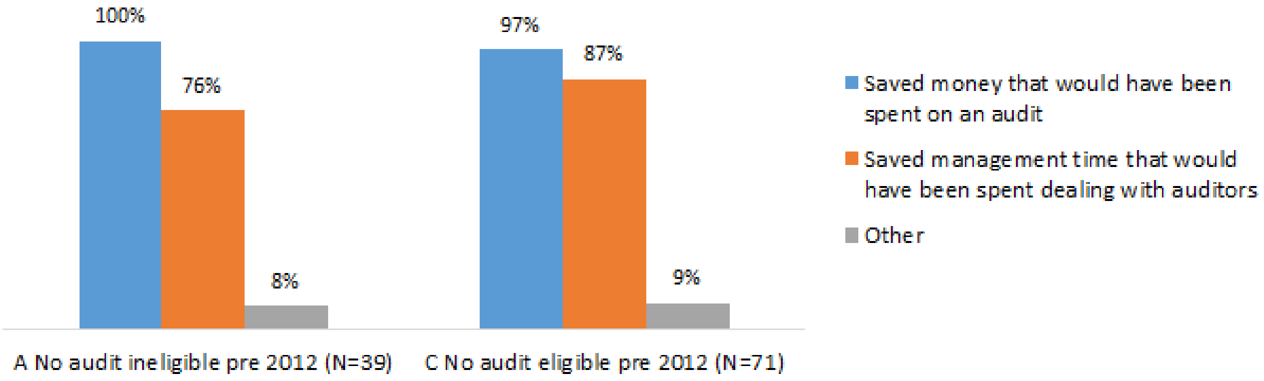


Source: BMG survey data (question Q11, Q12 and Q29); unweighted base: All companies that had taken up audit exemptions: 164 (comprising companies in primary sectors: 50, construction sectors: 18, retail/wholesale sectors: 27, transport, food and accommodation sectors: 8, business services sectors: 56, and other services sectors: 98).

Note: Figures may not sum to 100 per cent due to rounding.

The survey also asked respondents who perceived a positive impact from the take-up of audit exemptions (shown in Figure 23), how it had benefited their company. Figure 23 demonstrates that almost all respondents in both groups A (100 per cent) and C (97 per cent) said that they saved money that they would otherwise have spent on an audit. A large proportion of respondents (76 and 87 per cent in groups A and C respectively) also said they had saved management time they would otherwise have spent dealing with auditors. The findings suggest little difference by business size except amongst the largest 36 companies in the sample (with turnover of more than £5 million), which were slightly less likely to report time and cost savings from not undergoing audits (i.e. 88 per cent and 81 per cent respectively reported time and cost savings compared to 98 per cent and 83 per cent for all companies reporting positive impacts).

Figure 23: Type of benefits experienced as a result of taking up audit exemptions



Source: BMG survey data (question Q30); unweighted base: All companies that had reported a positive impact from taking up audit exemptions: 119 (comprising group A: 53, and group C: 66).

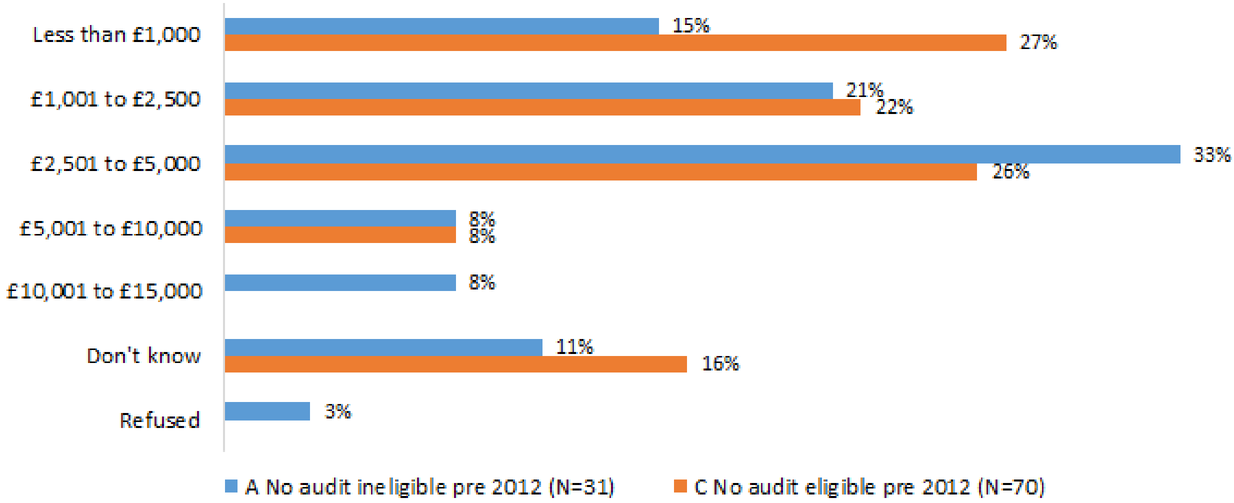
The quantitative survey also asked respondents who reported savings to estimate the scale of those savings. Responses ranged from £500 to £20,000 per annum. This broad range is likely to reflect large differences in audit fees and the complexity of audit, in terms of time requirements, which are likely to vary according to the size and sector of the company.

The average saving was reported to be £3,960 per annum based on 73 responses. The average savings were slightly higher amongst group A (companies that were ineligible before 2012) at £4,500 per annum (based on 29 responses) compared to group C (those that were eligible before and after 2012) at £3,600 per annum (based on 44 responses).

However, the reported savings are significantly lower than the average audit fees described by groups B and D in Section 3.1 of £7,470 on average (based on 147 responses) including £8,000 for those who became eligible in 2012 (group B) and £6,590 for those who were eligible before and after 2012 (group D), based on 92 and 55 responses respectively. This suggests that the perceived benefits of not paying for an audit (among those taking up audit exemptions) are lower than the perceived costs of the latest audit (among those continuing to undergo audits).

Figure 24 presents respondents' views on the scale of financial savings per annum from not undergoing audits and makes comparisons between groups A and C. Three-quarters (75 per cent) of respondents believed that their company would save less than £5,000 per annum. Only 11 per cent of respondents believed audit exemptions had enabled them to save upwards of £5,000, the majority of which were larger companies (both in terms of number of employees and turnover). However, in contrast to this trend, the 8 per cent of companies in the highest savings bracket (£10,001-£15,000) are made up exclusively of companies employing fewer than five people and in the two lowest turnover bands (i.e. less than £2 million of turnover). However, the base of respondents was too small to make any comparisons by business size or sector.

Figure 24: Scale of financial savings from taking up audit exemptions



Source: BMG survey data (question Q31); unweighted base: All companies reporting savings from taking up audit exemptions: 118 (comprising group A: 53, and group C: 65).

Note: Figures may not sum to 100 per cent due to rounding.

The quantitative survey also probed further, asking the 118 companies that reported savings what they had done with the savings made as a result of taking up audit exemptions. The most common responses were:

- reinvesting in the business (22 per cent of those making savings from taking up audit exemptions);
- using the savings for cash flow or working capital (11 per cent); and
- improving the profitability of the company (2 per cent).

Respondents also provided a range of other responses, which included paying off creditors and other investments such as property development and paying the savings into a bank account. The repayment of debts was also cited during the qualitative interviews with companies, while examples of reinvesting in the business included investments in staff training and development.

“I was able to enrol for courses in manual and computerised accounting at our local college.”

[Small company, primary / manufacturing]

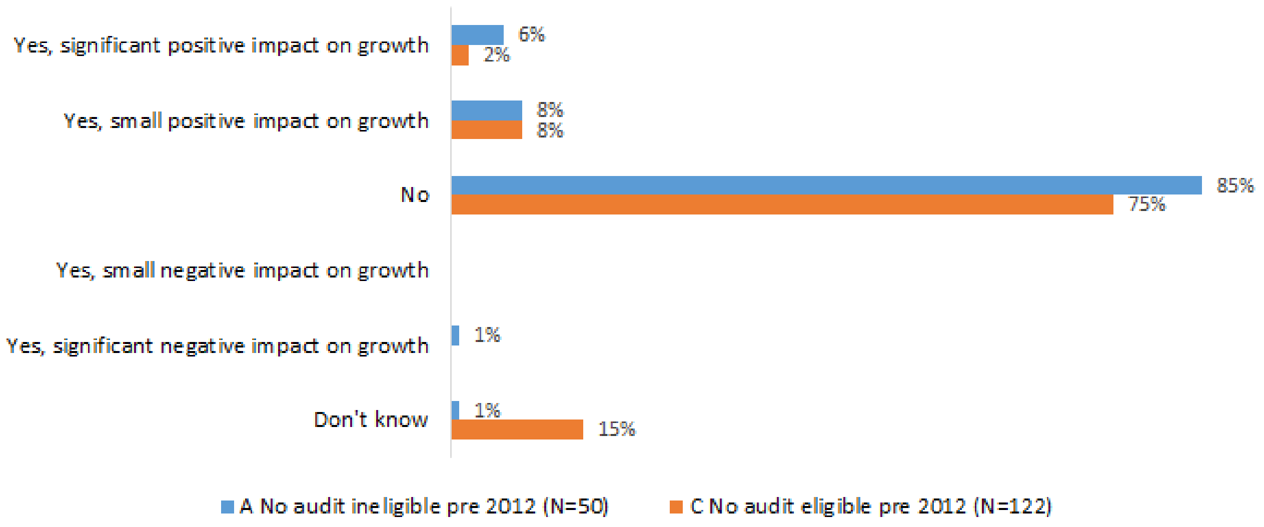
However, some of the 118 survey respondents that reported savings had either done nothing with the savings (10 per cent), or did not know what they had done with the savings (24 per cent), which suggests that the savings were sometimes not considered to be of a significant scale.

The survey responses also suggested that companies with shareholders are much less likely to reinvest savings compared to those without (14 per cent of the 102 companies with shareholders that reported savings compared to 41 per cent of the 16 companies without shareholders). In contrast, companies with lenders were more likely to reinvest savings (34 per cent of the 55 companies with lenders that reported savings compared to 8 per cent of the 61 companies without lenders) but less likely to use the savings to improve their cash flow or working capital (6 per cent compared to 19 per cent respectively).

The survey also asked respondents that had taken up audit exemptions whether they felt their decision had any positive or negative impacts on the growth of their business. In total, 78 per cent of these respondents said that their company's growth had not been affected (either positively or negatively) by taking up audit exemptions. This suggests that, in many cases, the impacts of audit exemptions are not considered significant. However, the respondents that reported an impact on growth were significantly more likely to report a positive impact (11 per cent) than a negative impact (less than 1 per cent).

Figure 25 shows that there were no significant differences between groups A and C, although respondents in group A were slightly more likely to report a significant positive impact on their growth (6 per cent compared to 2 per cent for group C).

Figure 25: Incidence of positive and negative impacts on companies' growth



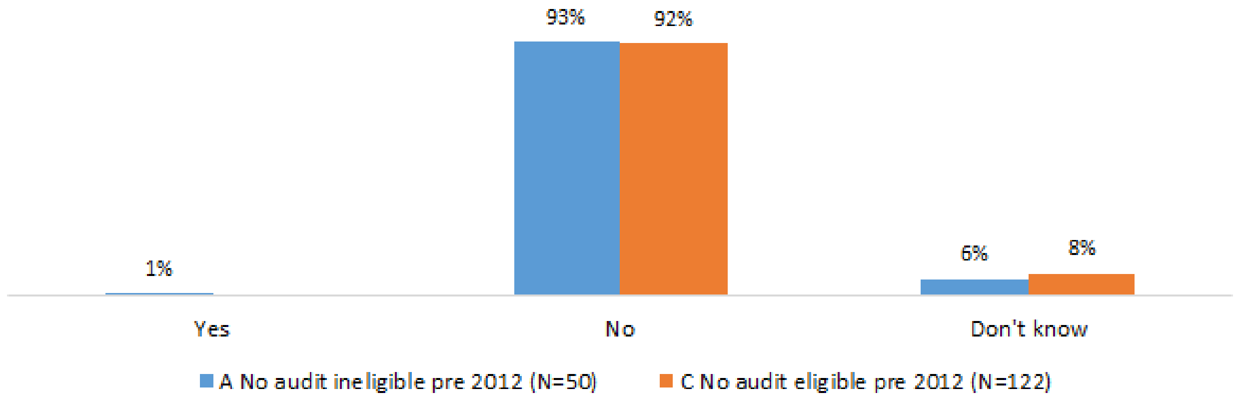
Source: BMG survey data (question Q33); unweighted base: All companies that had taken up audit exemptions: 164 (comprising group A: 66, and group C: 98).

Note: Figures may not sum to 100 per cent due to rounding.

3.4.2 Negative or unintended consequences

The survey also explored the potential for negative consequences resulting from taking up audit exemptions. However, Figure 26 shows that almost all survey respondents that had taken up audit exemptions (92 per cent) stated that their companies had suffered no negative consequences and only two respondents reported any negative or unintended consequences from taking up audit exemptions. One suggested it had negatively impacted on their credit scores, while another suggested that lenders had required audits to meet their lending criteria.

Figure 26: Incidence of perceived negative consequences of taking up audit exemptions



Source: BMG survey data (question Q34); unweighted base: All companies that had taken up audit exemptions: 164 (comprising group A: 66, and group C: 98).

Akin to the survey, the qualitative interviews also produced very little evidence of any negative consequences associated with taking up audit exemptions. However, a few companies felt that audit exemptions could create uncertainty among certain groups, most notably shareholders, investors, lenders, suppliers and consumers. As such, a perceived lack of oversight could potentially undermine the credibility of companies.

“Lenders require adequate transparency and visibility – having your accounts audited can provide a great sense of security”

[Small company, business services]

“I can see that suppliers would value an audit, particularly if there is a situation where a business is using them for the first time.

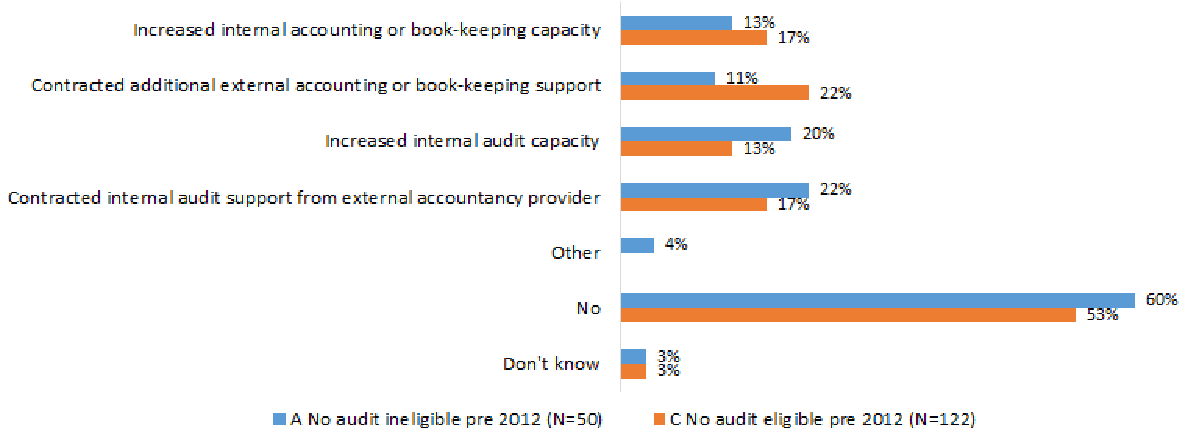
[Micro company, construction]

The quantitative survey also asked respondents whether they had taken on any alternative forms of assurance or scrutiny for their accounting processes following take-up of audit exemptions. The survey found that the majority of these respondents (55 per cent) reported that their company had not enforced any alternative forms of scrutiny in the absence of an audit. However, those that had introduced alternative forms of scrutiny were split relatively evenly between those that had:

- increased internal accounting or book-keeping capacity (16 per cent of those that had taken up audit exemptions);
- contracted additional external accounting or book-keeping support (19 per cent);
- increased internal audit capacity (15 per cent); and
- contracted internal audit support from external accountancy provider (18 per cent).

Figure 27 presents the differences between groups A and C. It shows that group C companies, that were eligible before and after the changes in 2012, were relatively more likely to contract additional accounting or book-keeping support (both internal and external support) in comparison to those in group A. In contrast, the companies in group A that were ineligible for audit exemptions prior to 2012 were found to be more likely, on average, to have increased auditing capacity (both internal and from external providers).

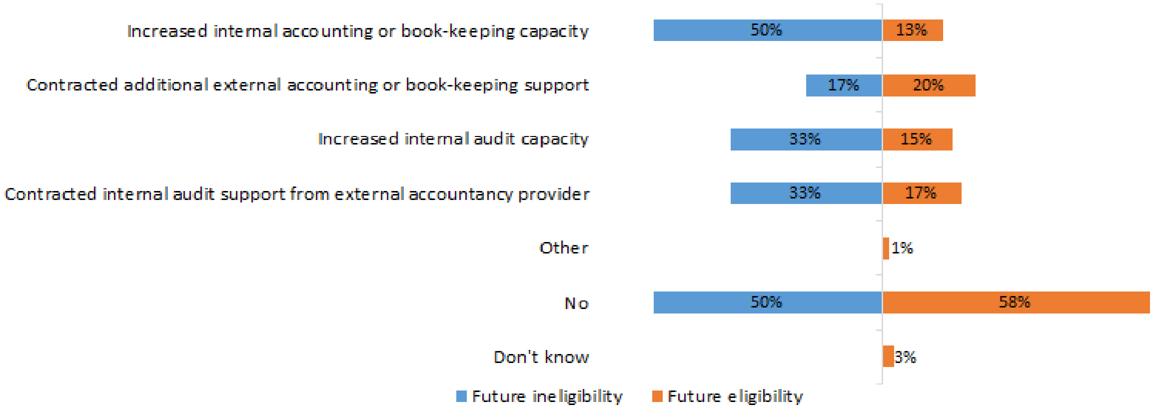
Figure 27: Alternative forms of assurance or scrutiny of accounting processes in the absence of audits



Source: BMG survey data (question Q37); unweighted base: All companies that had taken up audit exemptions: 164 (comprising group A: 66, and group C: 98).

The survey responses also suggested that companies expecting to grow to such an extent that they become ineligible for an exemption in the future (based on the 2015 criteria), were more likely to have introduced alternative means of scrutiny (alternative forms of scrutiny had been introduced by 58 per cent of companies that expect to be ineligible in the future compared to 39 per cent of those that expect to remain eligible for audit exemptions). Figure 28 shows that the companies that expected to be ineligible in the future were significantly more likely to have increased their own internal accounting and book-keeping capacity and were also slightly more likely to have increased their internal and external auditing capacity.

Figure 28: Alternative forms of assurance or scrutiny introduced, by expectations of future eligibility for audit exemptions



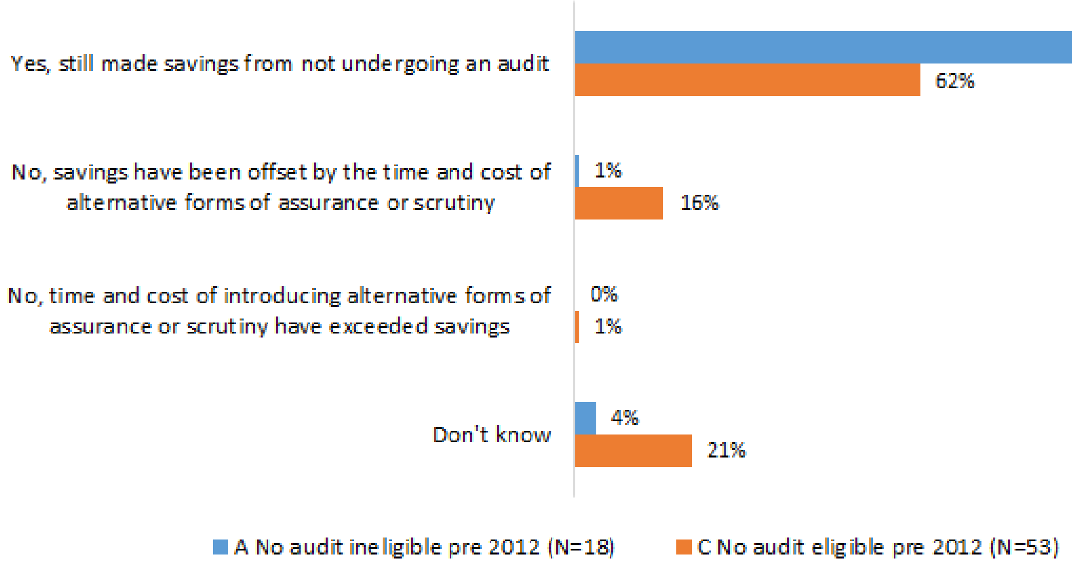
Source: BMG survey data (question Q18 and Q37); unweighted base: All companies that had taken up audit exemptions: 164 (including companies expecting to be eligible in the future: 130, and ineligible in the future: 31).

3.4.3 Overall impact

Companies that introduced alternative forms of scrutiny were asked whether they felt they had still made overall time and cost savings from not undergoing audits or whether the savings had been offset by the introduction of these alternative forms of assurance or scrutiny. The responses to the survey suggested that most of these companies (70 per cent) reported still making savings from not undergoing an audit. Only 1 per cent of companies using additional forms of scrutiny felt that the time and costs of doing so had exceeded the savings from not undergoing an audit.

Figure 29 shows differences between those that were eligible before and after 2012 (group C) and those that were ineligible before the changes were introduced in 2012 (group A). The survey responses suggest that group A companies are more likely to report savings (96 per cent) compared to group C (62 per cent). This suggests that companies that had taken up audit exemptions since becoming eligible to do so in 2012 were again more likely to have made savings compared to those that were eligible for audit exemptions before 2012.

Figure 29: Incidence of cost savings for those using alternative forms of scrutiny



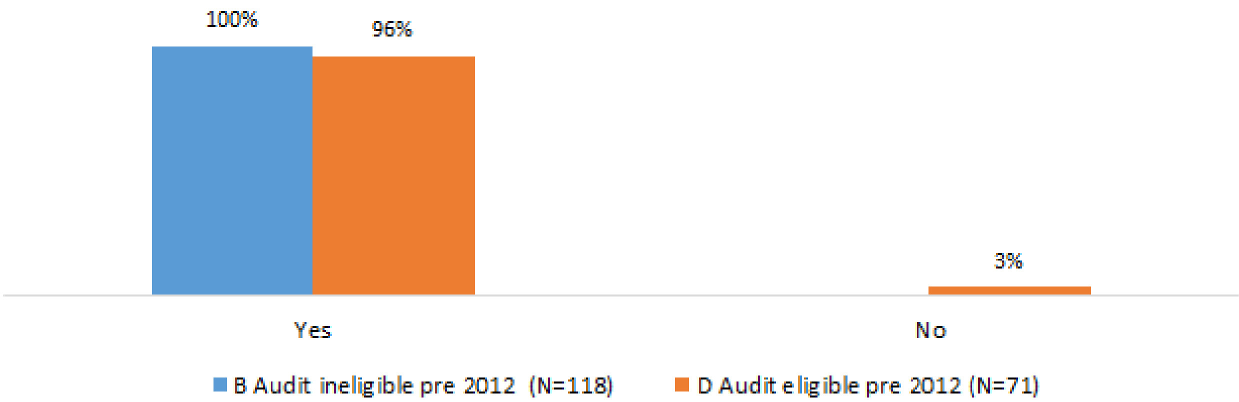
Source: BMG survey data (question Q38); unweighted base: All companies that had taken up audit exemptions and introduced alternative forms of scrutiny: 68 (comprising group A: 28, and group C: 40).

Note: Figures may not sum to 100 per cent due to rounding.

3.5 Reasons and motivations for not taking up audit exemptions

This sub-section explores the reasons and motivations for not taking up audit exemptions and focuses exclusively on companies that did not take up an exemption (i.e. companies in groups B and D). As can be seen from Figure 30, almost all respondents who had not taken up audit exemptions (98 per cent) reported always undergoing an annual audit (or for at least the last three to five annual accounts the company has filed).

Figure 30: Companies always undergoing an annual audit (for respondents not taking up audit exemptions at the time of interview)



Source: BMG survey data (question Q41); unweighted base: All companies that had not taken up audit exemptions: 197 (comprising group B: 102, and group D: 95).

Note: Figures may not sum to 100 per cent due to rounding.

The survey findings therefore suggest that companies are unlikely to switch between undergoing audits and taking up audit exemptions from year to year. Further, once companies have decided to take up audit exemptions, this evidence suggests that they are unlikely to switch back to undergoing audits unless they grow and are no longer eligible for audit exemptions.

The respondents were also asked why they had decided not to take up an exemption from undergoing an audit. This was asked as an open question in the survey and the responses are summarised below in Figure 31. The two most common reasons for continuing to undergo audits were due to:

- requirements imposed by lenders (17 per cent of those not taking up audit exemptions); and
- companies being unaware that they were eligible for audit exemptions (16 per cent).

Similar findings were gathered from the qualitative interviews and the obligation to fulfil third-party compliance requirements was a commonly-cited reason for not taking up audit exemptions.

“The bank requires us to be audited - they need audited accounts before they give us the money. It's a covenant”

[Small company, accommodation]

“The fact that your business has been properly audited […] gives suppliers some confidence - it's a seal of approval on your accounts if you have a clean audit report.”

[Micro company, construction]

Additionally, some companies reported that stringent internal procedures are in place that require audits to be carried out on a regular basis, owing to the “comfort” they provide to management.

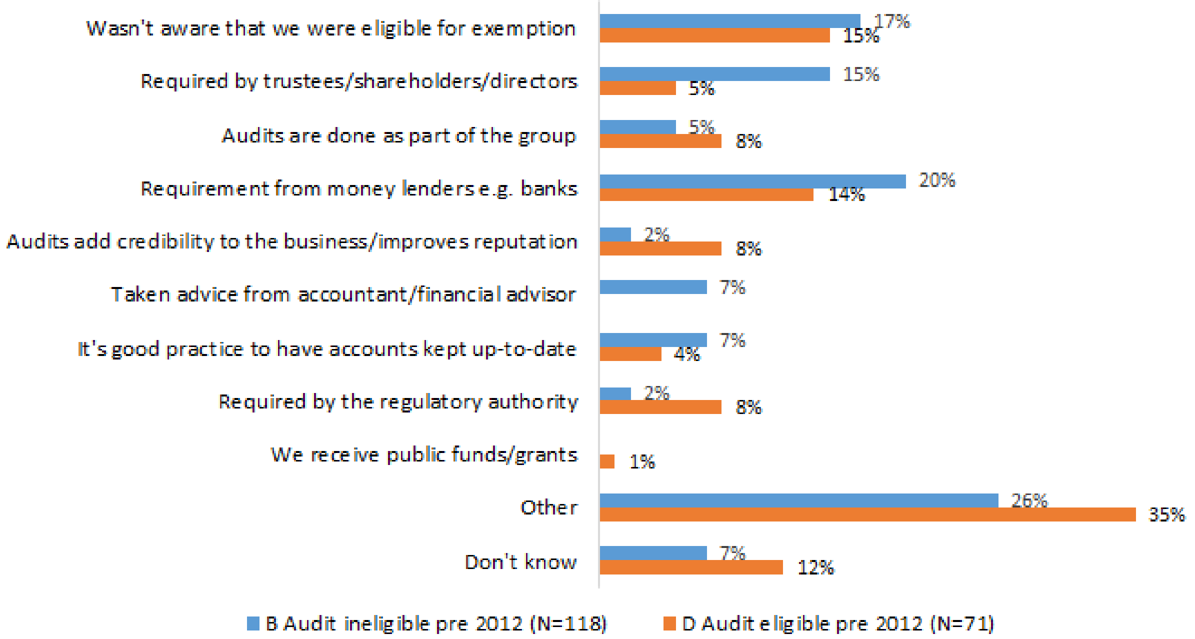
"Auditors can pick on things we might have overlooked. They are here to scrutinise our work and provide a fresh perspective on how we are running the company. They can easily spot mistakes - we are fortunate we do not make many but we are human after all. Directors feel more comfortable having auditors around - just checking that we've got everything spot-on.”

[Micro company, primary / manufacturing]

However, a wide range of reasons were provided by the sample for continuing to undergo audits including: meeting the requirements of trustees/shareholders/directors, funders or regulators; audits being undertaken by all companies in a group; perceptions that audits add credibility to a company and improve its reputation; following the advice of accountants; and perceptions that audits represent good financial practice.

Figure 31 suggests some significant differences between companies that were eligible for audit exemptions before and after 2012 and those that were ineligible until the changes in 2012. The responses suggest that the companies in group B that became eligible for audit exemptions in 2012 were more likely, on average, to undergo audits to meet the requirements of shareholders and lenders and follow the advice of their accountants. However, they were only slightly more likely to be unaware that they were eligible for audit exemptions, suggesting that those who became eligible in 2012 are almost as likely to be aware that they are eligible as those companies that were eligible before 2012.

Figure 31: Reasons for not taking up audit exemptions



Source: BMG survey data (question Q42); unweighted base: All companies that had not taken up audit exemptions: 197 (comprising group B: 102, and group D: 95).

3.6 Impacts for companies not taking up audit exemptions

This sub-section discusses the impacts experienced by companies not taking up audit exemptions and continuing to undergo audits. As in the previous section, it focuses exclusively on companies that did not take up audit exemptions (i.e. groups B and D). The section explores whether these companies think they could benefit from taking up audit exemptions and the potential benefits of doing so.

The survey found that 27 per cent of these companies felt that they would not benefit from taking up audit exemptions. However, this was significantly lower than the 50 per cent that thought they would benefit from saving the time spent dealing with auditors and the 67 per cent that thought they would benefit from saving the cost of undergoing an audit.

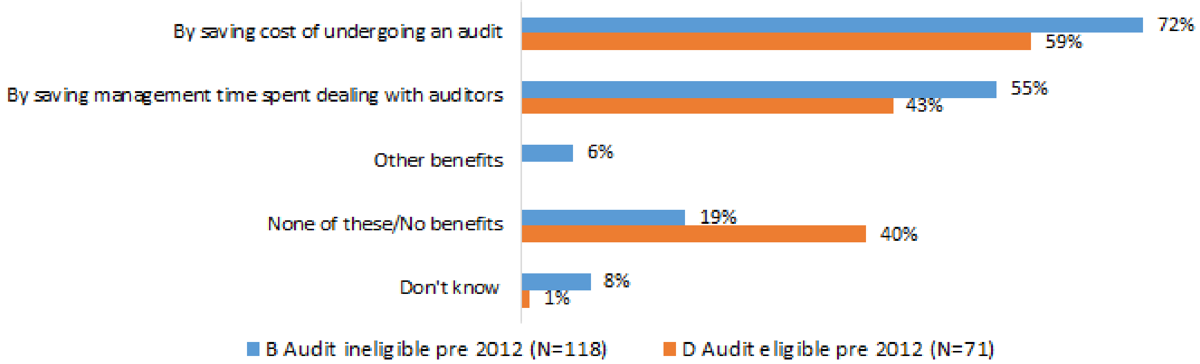
Similar to the survey, the qualitative interviewees that had not taken up audit exemptions expressed mixed views with regards to taking up audit exemptions in the future. On the one hand, companies recognised that they would no longer incur audit fees if they were to take up audit exemptions, and would also save time from not undergoing audits (although a few interviewees explained that time savings were likely to be negligible for their companies, given that "the preparation of annual audited documents" is outsourced to external accountants). On the other hand, a few of the interviewees warned that the lack of disclosure, resulting from taking up audit exemptions, could create uncertainties around their business operations and strategy.

"The business would have to forego important intangible benefits, notably an external and independent […] assessment of its internal balances and financial status, which would otherwise provide a certain level of reassurance to our shareholders and lenders"

[Small company, transport, food and accommodation sector]

Figure 32 shows that a higher proportion of surveyed companies in group B felt they would benefit from cost and time savings (72 per cent and 55 per cent respectively) compared to group D (59 per cent and 43 per cent respectively). This mirrors the above findings from respondents already taking up audit exemptions – companies that became eligible for audit exemptions in 2012 are more likely to perceive benefits from taking up audit exemptions compared to those that were already eligible before 2012.

Figure 32: Potential benefits of taking up audit exemptions, for eligible companies that were undergoing audits at the time of interview



Source: BMG survey data (question Q44); unweighted base: All companies that had not taken up audit exemptions: 197 (comprising group B: 102, and group D: 95).

Those who reported expecting benefits from taking up audit exemptions were then asked for their perceptions of the overall time and cost savings that they would expect if they had they not undergone an audit. The average expected saving, for those undergoing audits at the time of interview, was £8,680 per annum (based on 113 responses). There was a small variation only between the average estimates for groups B (£8,980 per annum based on 76 responses) and D (£8,060 per annum based on 37 responses).

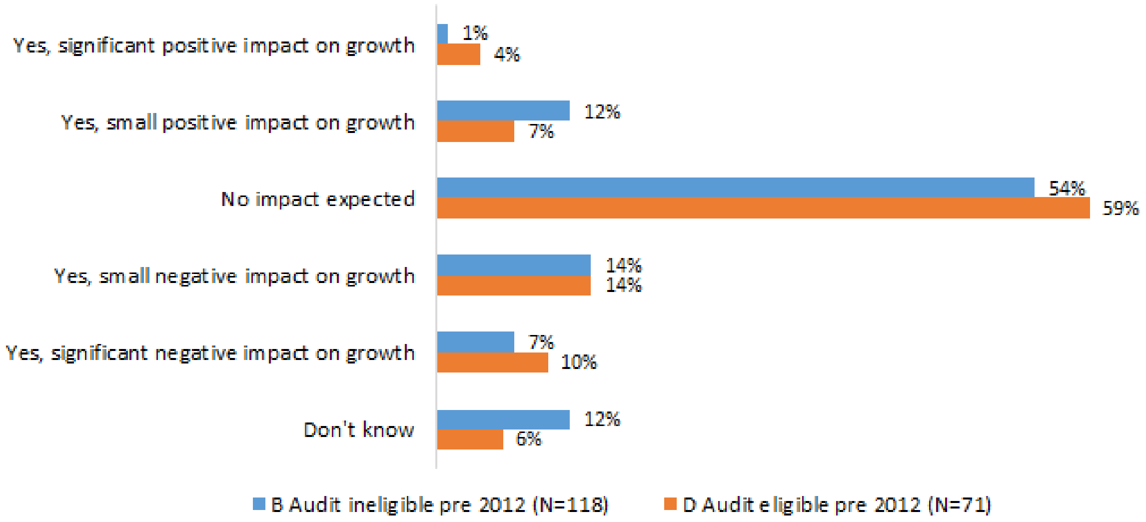
These anticipated cost savings are slightly higher than the average audit fee reported amongst those companies undergoing audits of £7,470 for their most recent audit based on 147 responses (comprising averages of £8,000 for companies in group B – based on 92 responses – and £6,590 for those in group D – based on 55 responses). These anticipated cost savings are also significantly higher than the average savings reported by those who had already taken up audit exemptions (of approximately £3,960 per annum).

An analysis of differences by business size suggests that companies with five or more employees are likely to anticipate more significant savings (averaging £9,810 per annum based on 53 responses) compared to micro companies with fewer than five employees (averaging £7,640 per annum based on 60 responses). There were also differences by sector, as anticipated savings from audit exemptions were highest in primary/manufacturing and business services sectors (averaging £9,460 per annum based on 89 responses) compared to all other sectors (averaging £5,820 per annum based on 24 responses).

Companies that were continuing to undergo audits were also asked whether they expected that taking up audit exemptions would impact, positively or negatively, on the growth of their business (as shown by Figure 33). The responses suggested that these companies were less likely to expect positive impacts, and were more likely to expect negative impacts, compared to the actual impacts reported by those that had already taken up audit exemptions. More than half of respondents (56 per cent) said that an audit exemption would have no bearing on the company's growth. However, 22 per cent of respondents anticipated that taking up audit exemptions would have a negative impact on growth (including 8 per cent who expected a significant negative impact), compared to 12 per cent who expected take-up to have a positive impact on the growth of their business (including only 2 per cent who expected a significant positive impact). These findings were broadly consistent across groups B and D.

An analysis by business size suggested that micro companies with fewer than five employees were relatively likely to expect positive impacts on their company from taking up audit exemptions (16 per cent of the 100 companies with fewer than five employees) compared to companies with five or more employees (9 per cent of the 93 companies with five or more employees). Similarly, those companies with five or more employees were more likely to expect negative impacts from taking up audit exemptions (28 per cent) compared to micro companies with fewer than five employees (18 per cent).

Figure 33: Survey respondents, by impact on companies' growth



Source: BMG survey data (question Q46); unweighted base: All companies that had not taken up audit exemptions: 197 (comprising group B: 102, and group D: 95).

Similar responses were provided via the qualitative interviews, as interviewees generally expected minimal impacts on their business growth from taking up audit exemptions. However, a few interviewees raised concerns about audit exemptions potentially impacting adversely on "external perceptions of their business" due to a lack of transparency and scrutiny around internal operations and finances. One interviewee further explained that this perceived lack of accountability could result in prospective investors becoming disengaged.

"Funders provide the necessary financing for expansion work and generally require a set of audited accounts. If audit exemptions were taken up, this could result in little funding available to grow the business further."

[Small company, other services]

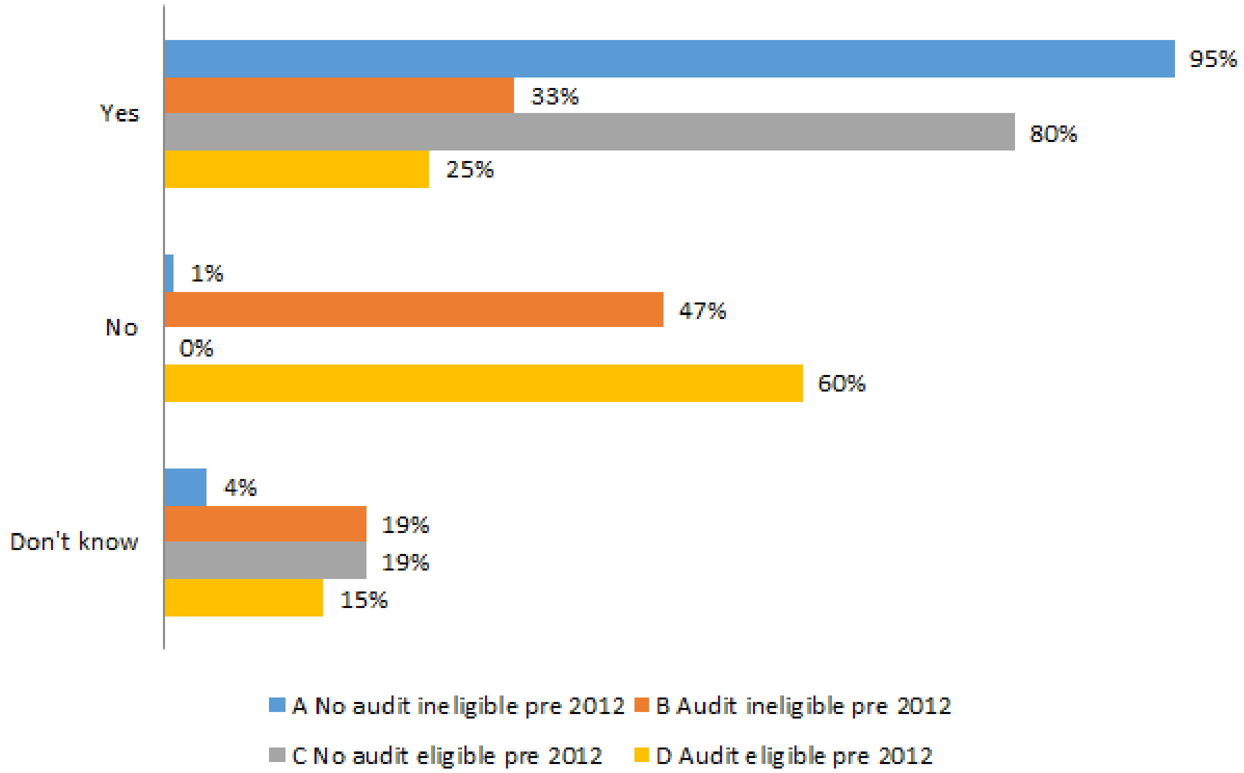
3.7 Expectations of take-up in the future

This sub-section explores expectations of future take-up and makes comparisons between those that have already taken up audit exemptions and those that were continuing to undergo audits at the time of interview. The survey found that, on average:

- the large majority (84 per cent) of companies that had already taken up audit exemptions expected to continue to do so (assuming they remained eligible to do so), while less than 1 per cent reported that they were unlikely to continue to take up audit exemptions; and
- 30 per cent of companies that were undergoing audits at the time of interview expected to take up audit exemptions in the future, while 52 per cent expected to continue to undergo audits.

As can be seen from Figure 34, there was some variation between groups with those who became eligible for audit exemptions in 2012 (having previously been ineligible) more likely to take up and continue to take up audit exemptions in the future compared to those that were eligible before and after 2012. Figure 34 also shows that there is uncertainty about future levels of take-up for around 16 per cent of the survey sample.

Figure 34: Future expectation of take-up of audit exemptions



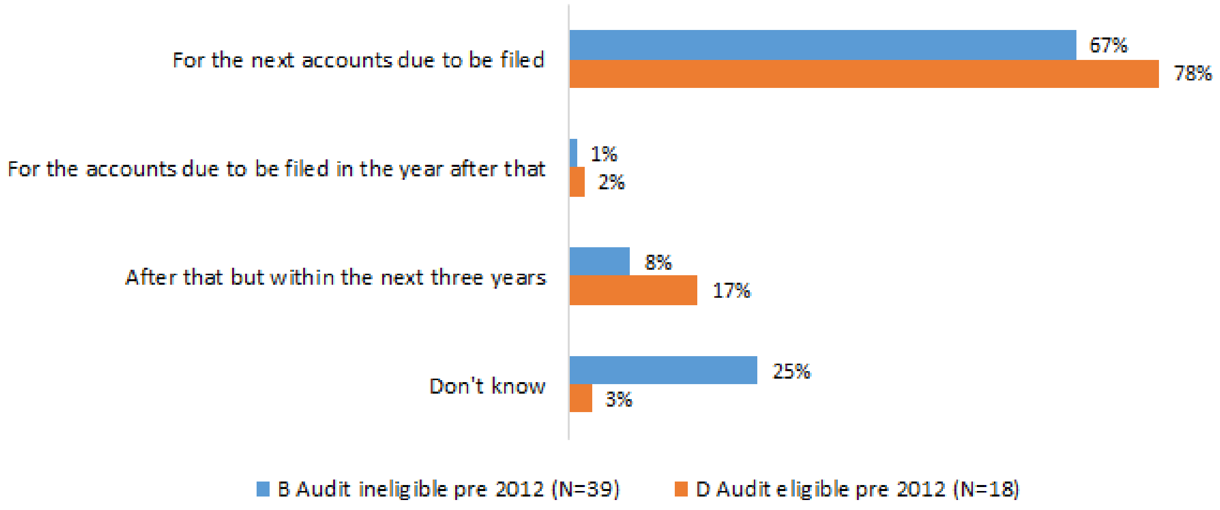
Source: BMG survey data (questions Q39 and Q47); unweighted base: All companies: 361 (comprising group A: 66, group B: 102, group C: 98 and group D: 95).

Note: Figures may not sum to 100 per cent due to rounding.

The respondents that had not taken up audit exemptions but expected to do so in the future were also asked when they expected to take up audit exemptions. Figure 35 shows that 70 per cent of these respondents expected to take up audit exemptions for the next set of accounts due to be filed, with a further 12 per cent indicating they expected to take up audit exemptions within (at least) the next three years. However, a quarter (25 per cent) of respondents in group

B were unsure when they would take up the small companies audit exemption, suggesting higher levels of uncertainty amongst those that became eligible for audit exemptions as a result of the changes introduced in 2012.

Figure 35: Expectations of when companies are likely to start taking up audit exemptions, for those undergoing audits at the time of interview



Source: BMG survey data (question Q48); unweighted base: All companies that had not taken up audit exemptions at the time of interview but expected to do so in the future: 45 (comprising group B: 26 and group D: 19).

Note: Figures may not sum to 100 per cent due to rounding.

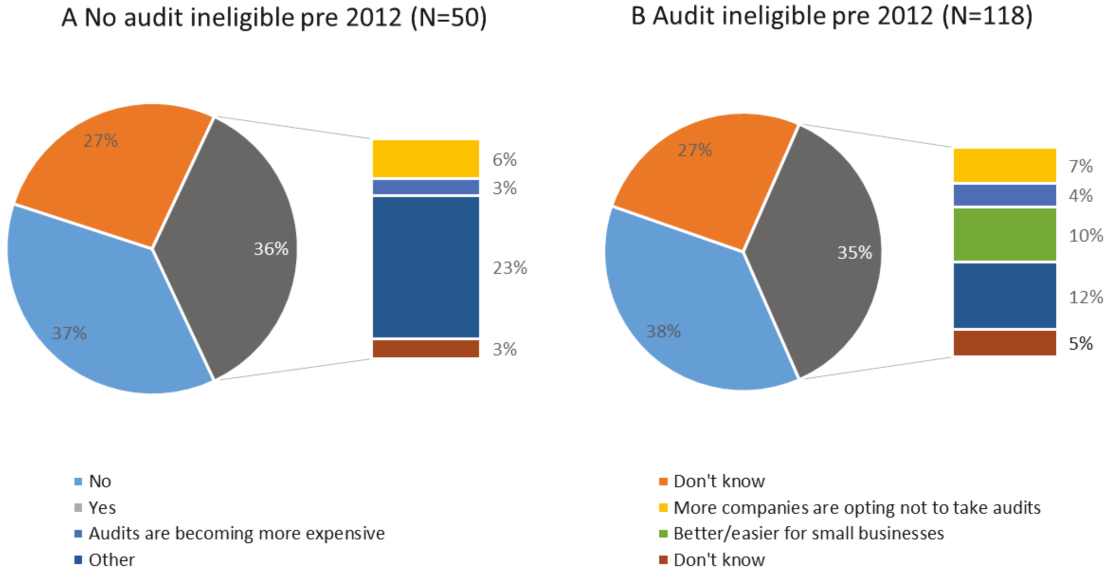
3.8 Business views on the small companies audit exemption

This final sub-section explores general business views on the small companies audit exemption and makes comparisons between the four sub-groups. Figures 36 and 37 (below) show the percentage of respondents in groups A, B, C and D who reported that the market for audits has changed since 2012 and summarise the perceived changes.

The responses suggest that a significantly larger proportion of companies in groups A and B (who became eligible because of the new criteria introduced in 2012) reported that the market had changed since 2012 compared to groups C and D (who were already eligible for audit exemptions in 2012). The responses show that 36 per cent of group A and 35 per cent of group B reported changes in the markets for audits compared to just 6 per cent of group C and 5 per cent of group D.

There were also significant differences in the perceived changes in the audits marketplace. For groups C and D, the key change was simply that more companies were choosing not to undergo audits. However, companies in groups A and B provided a longer list of changes, which also included suggestions that audits are becoming more expensive but that the process is becoming better and easier for small companies. Other reasons included the market becoming more competitive and audits becoming cheaper and ‘more cost effective’, more onerous auditing procedures and processes, credit ratings not being so dependent on audits, reduced requirements for companies to undergo audits, and reduced workloads for accountants and auditors from decreasing levels of demand.

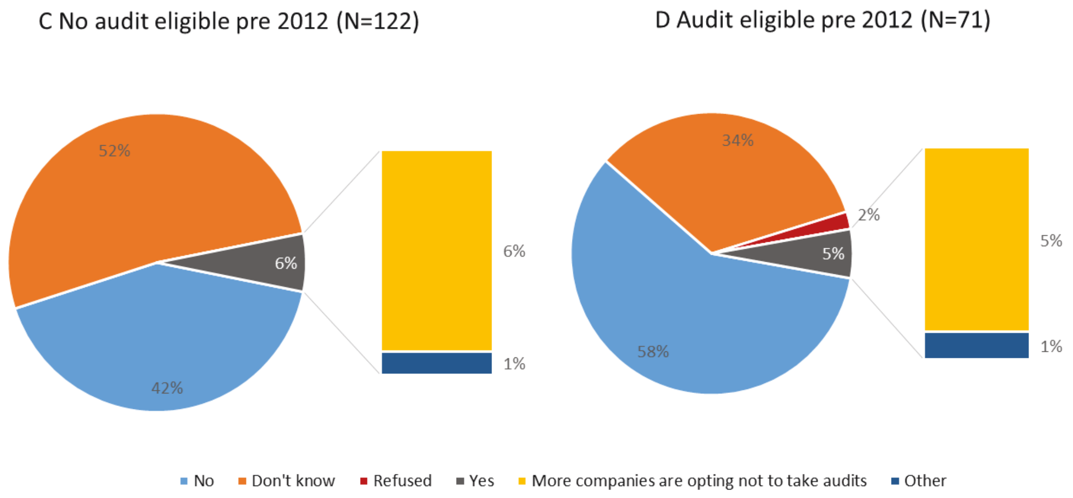
Figure 36: Respondents' views of recent changes in the market for audits since 2012 (groups A and B)



Source: BMG survey data (question Q49 and Q50); unweighted base: All companies that became eligible for audit exemptions as a result of the changes introduced in 2012: 168 (comprising group A: 66 and group B: 102)

Note: Figures may not sum to 100 per cent due to rounding.

Figure 37: Respondents' views of recent changes in the market for audits since 2012 (groups C and D)



Source: BMG survey data (question Q49 and Q50); unweighted base: All companies that were eligible for audit exemptions before 2012: 193 (comprising group C: 98 and group D: 95)

Note: Figures may not sum to 100 per cent due to rounding.

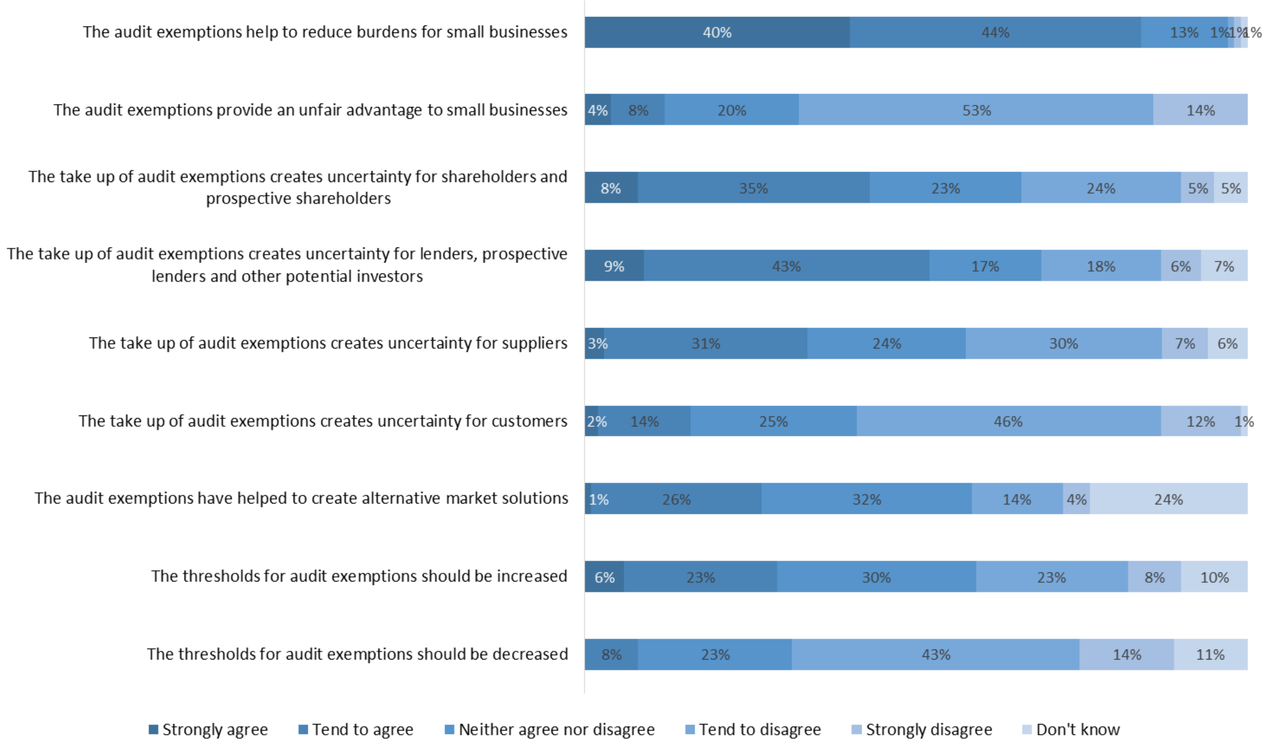
The qualitative interviews were able to explore these perceived changes in greater depth. One interviewee explained that audit exemptions have changed business perceptions in terms of the need for 'full audits' and have encouraged growth of risk-based auditing practices. These are effectively 'streamlined' audits, whereby auditable activities are prioritised on the basis of the risk they pose to the business – i.e. only the higher risk areas are subject to an audit.

"Audit exemptions encourage partial audits which are more targeted and therefore less onerous, although they would still provide us with the assurance that the business is operating properly."

[Micro company, primary/manufacturing sector]

The survey also explored respondents' views with regard to the small companies audit exemption and its impacts. Figure 38 presents the combined views of groups A and B, with statements ranked in terms of their perceived importance (on a scale including strongly disagree, disagree, neither agree nor disagree, agree and strongly agree), while Figure 39 presents the combined views for groups C and D.

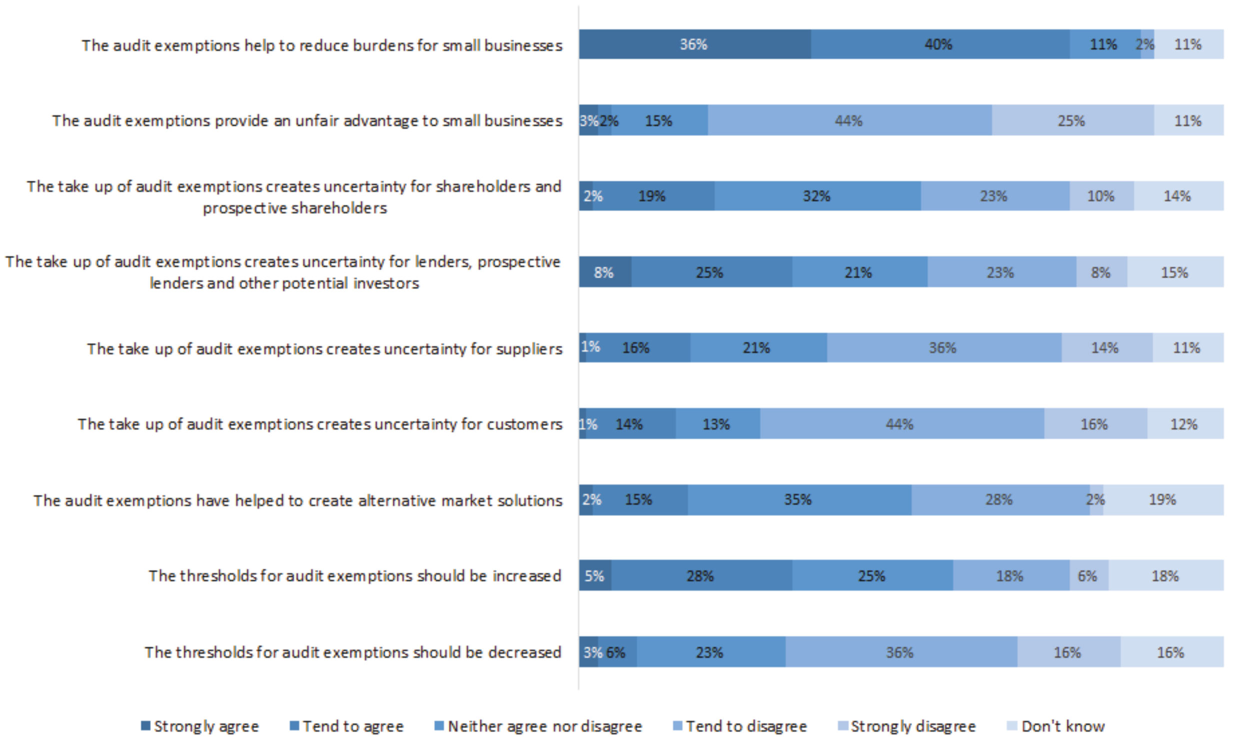
Figure 38: Levels of agreement with statements on audit exemptions and their impacts (groups A and B)



Source: BMG survey data (question Q51); unweighted base: All companies: 168

Note: Figures may not sum to 100 per cent due to rounding.

Figure 39: Levels of agreement with statements on audit exemptions and their impacts (groups C and D)



Source: BMG survey data (question Q51); unweighted base: All companies (groups C and D): 193

Note: Figures may not sum to 100 per cent due to rounding.

The findings suggest very strong levels of agreement that audit exemptions do help to reduce burdens for small businesses. In total, 84 per cent of companies in groups A and B and 76 per cent of companies in groups C and D agreed (or strongly agreed) that audit exemptions help to reduce burdens for small businesses.

Most respondents also disagreed that the audit exemptions provide an unfair advantage to small businesses. Approximately two-thirds of companies in groups A and B (67 per cent) and groups C and D (69 per cent) disagreed with the assertion that exemptions provide an unfair advantage to small businesses. Companies in the construction and the retail/wholesale sectors were the most likely to feel that exemptions gave an unfair advantage, according to a respective 25 and 22 per cent of respondents across groups A and B.

Participants in the qualitative interviews were unanimous in their disagreement that audit exemptions provide an unfair advantage to small businesses. It was generally felt that small businesses meet tougher day-to-day challenges and ought to be provided "some support or […] concession."

"Small businesses tend to have less turnover when compared to larger companies. An audit therefore represents an unnecessary expense […]."

[Micro company, business services]

"Smaller businesses do not have the same amount of disposable income as larger businesses. Also, small businesses are usually simpler, in terms of the level of financial reporting required, so they should not have the same audit scope as the larger businesses."

[Micro company, business services]

The views of survey respondents were more mixed in terms of the potential impacts of audit exemptions on the perceived risk for investors. Relatively large proportions of respondents from groups A and B reported that exemptions create uncertainty for shareholders (42 per cent) and lenders (52 per cent). In contrast, respondents from groups C and D felt these issues were less significant with only 21 per cent agreeing that audit exemptions create uncertainty for stakeholder and 33 per cent agreeing that they create uncertainty for lenders. Differing views were also reported through the qualitative interviews, although most agreed that audits do not necessarily influence third parties' investment and / or financing decisions.

"Our shareholders are the executives of this company so there's no real issue of them being in the dark."

[Micro company, primary / manufacturing]

"My business deals with property. Most of the banks have collateral and security on the property we own - so they have financial security. Audited accounts are no longer as meaningful to them."

[Micro company, business services]

"Shareholders should understand the position of the business anyway, so I don't think that having an audit would make any significant difference to their understanding of the business."

[Small company, business services]

The survey respondents were generally less concerned about the potential impacts on the uncertainty of suppliers and customers that might result from taking up audit exemptions. Around one-in-three respondents (34 per cent) from groups A and B agreed that audit exemptions create uncertainty for suppliers, while only 16 per cent agreed that they create uncertainty for customers. As above, groups C and D were typically less concerned with only 17 per cent and 15 per cent agreeing that audit exemptions created uncertainty for suppliers and customers respectively.

There were also relatively low levels of agreement that audit exemptions had helped the creation of alternative market solutions. Around a quarter (27 per cent) of respondents from groups A and B agreed with this statement compared to 17 per cent of respondents from groups C and D. The qualitative interviews also identified mixed views as regards the likelihood of audit exemptions encouraging the creation of alternative market solutions. For instance, one company felt that audit exemptions would not have any significant impact as "most auditing firms already provide a breadth of accounting services." Conversely, another interviewee believed that audit exemptions could induce greater innovation among accounting firms which may expand and offer new types of services, such as tailored business advice and other bespoke services to small businesses.

Finally, there were mixed views regarding whether the thresholds for audit exemptions should be increased or decreased. Over half of companies in groups A and B (57 per cent) and groups C and D (52 per cent) agreed that the 2015 thresholds should not be decreased. There were also similar proportions of companies that agreed that 2015 thresholds should increase and those who agreed that thresholds should not increase. In conclusion, the results appear to suggest that the eligibility thresholds in 2015 were acceptable to most of the survey sample. The qualitative interviews found that most companies felt that these thresholds were about right, although some companies advised that the thresholds should be monitored and reviewed on a regular basis to ensure they are still "relevant".

"I think the thresholds are about right for the moment. I think they should just be monitored in line with inflation."

[Micro company, business services]

"I think wherever you have a cut-off, it can be fairly arbitrary. I think what's important is that they are reviewed on a fairly regular basis. Inevitably, over time, they would probably need to be increased or decreased. What the government should aim at is to ensure the thresholds are still relevant and the exemptions serve their purpose."

[Micro company, other services / cultural education]

A small number of participants in the qualitative interviewees favoured an increase in the eligibility thresholds, the rationale being that a much higher proportion of small companies would be eligible for audit exemptions, allowing them to opt out of the compulsory audit and potentially "save some money".

4 Conclusions

This section draws conclusions in relation to the original research questions and study objectives.

4.1 Concluding remarks

4.1.1 Take-up of audit exemptions

Up to 90 per cent of all UK registered companies – especially smaller companies without shareholders – were likely to have benefited from the Coalition Government's audit exemptions in 2015, and this figure is expected to grow in the future.

The study estimated that between 62 and 90 per cent of all UK registered companies were likely to have taken up audit exemptions in 2015. This is a wide range, although the study findings suggest that the higher estimate, based on Companies House data, is likely to be the most robust.

Take-up of audit exemptions is likely to continue to increase over time as the large majority of those that already take up audit exemptions (84 per cent) expect to continue to do so while 30 per cent of those undergoing audits in 2015 expected to take up audit exemptions in the future. Further, take-up is also expected to increase as a result of the increased eligibility thresholds that have since been introduced for accounting years beginning on or after 1 January 2016.

The above estimates of take-up are broadly consistent with those provided in BIS' impact assessment of the 2012 audit exemption changes, which estimated take-up of between 60 and 85 per cent[29]. The slight increase in the estimates produced for this study seems sensible given the changes in the eligibility criteria in 2012, which have increased the number and proportion of companies that are now eligible for audit exemptions. However, as part of this study BEIS has used IDBR and FAME data to estimate a relatively low take-up rate of 30 per cent amongst the 44,700 UK companies that became eligible for audit exemptions in 2012, having previously been ineligible under the previous criteria.

The survey findings also suggest that:

- those taking up audit exemptions were typically smaller, with fewer employees and a smaller turnover and were less likely to expect that they might exceed the 2015 eligibility thresholds within the next three years.
- the take-up of audit exemptions is generally lower for companies that reported having shareholders, lenders and/or external investors, suggesting that these companies may be more likely to undergo audits to satisfy and provide confidence to these external parties.

4.1.2 General views on audit exemptions

[29] BIS, 2014. 'Impact assessment: audit exemptions'

Audit exemptions are a valuable resource in helping to reduce burdens for small businesses but some companies are concerned about the risk of negative impacts for the confidence of lenders and stakeholders.

The survey found high levels of support for audit exemptions amongst eligible companies, including those that were undergoing audits and those that had taken up audit exemptions. Respondents generally felt that audit exemptions help to reduce burdens for small businesses but are also fair and do not offer an unfair advantage to small businesses. The qualitative research findings suggested that companies were more likely to feel that it is unfair for small businesses to undergo audits as the costs are disproportionately large for small business and the potential benefits are relatively low.

The main risks of taking up audit exemptions and not having audited accounts were found to be the associated impacts on confidence and uncertainty for shareholders and lenders. However, these issues were mentioned by a minority of companies, while some suggested that the perceived importance of having audited accounts was diminishing over time for these external parties.

The survey respondents and interviewees generally felt that audit exemptions had only led to minimal changes in the market for audits, which already provides a broad range of products and services. However, the research identified some suggestions that the market was becoming:

- more competitive, resulting in cheaper and more cost-effective audits; and
- more innovative, with the introduction of new products such as streamlined or partial audits where companies can prioritise the audit of particular activities.

4.1.3 Reasons and motivations for decisions relating to audit exemptions

The key motivation for taking up audit exemptions is to save money and time – but, for some, these savings are insufficient to offset potential negative consequences – while inertia and a lack of awareness can also be barriers to take-up.

The principal reason for taking up audit exemptions was to save the money spent on auditors. Other reasons included the time saved from not having to interact with auditors, simply not seeing any value in going through the audit process, which was particularly common amongst micro companies, finding the audit process overly complicated and confusing, and following the advice of accountants.

The research also identified reasons for not taking up audit exemptions including:

- inertia and the fact that some companies have always undergone audits. Similarly, those taking up audit exemptions are unlikely to switch back to audits unless they grow and are no longer eligible;
- a lack of awareness of eligibility for audit exemptions. Awareness of eligibility criteria is significantly lower amongst those undergoing audits and many survey respondents either thought they were ineligible or did not know if they were eligible, most of whom had wrongly assumed they exceeded the eligibility thresholds; and

- deciding that the potential savings from not having audits are insufficient to offset potential negative consequences, such as the impacts on lenders. The research identified examples of audits being required as preconditions for loans, but also examples of companies choosing to undergo audits because they perceived this to improve their reputation and provide comfort and confidence to others.

4.1.4 Impacts of decisions to take up and not take up audit exemptions

Audit exemptions were expected to benefit UK companies by at least £4.6 billion in 2015. Most companies have benefited or expect to benefit from audit exemptions, although perceived savings are significantly higher than actual savings.

Most respondents taking up audit exemptions (65 per cent) felt that they had benefited from doing so. These benefits were particularly prevalent for respondents that had only become eligible in 2012, perhaps because these companies had, on average, more recent experience of undergoing audits and greater clarity on the savings of not undergoing audits.

There was little difference in the perceived and actual benefits of taking up audit exemptions. Most companies expected time and cost savings from not undergoing audits regardless of whether or not they had taken up audit exemptions. Despite the concerns of impacts on the confidence of investors, there were very few examples of this actually having an impact for those that had taken up audit exemptions and most companies had not taken on any alternative forms of assurance or scrutiny for their accounting processes.

However, there were significant differences in the perceived and actual scale of savings from taking up audit exemptions. Companies undergoing audits in 2015 reported expected savings of £8,680 per annum, on average, which is more than double the £3,960 average saving per annum reported by those already taking up audit exemptions[30]. The actual audit fees identified through the survey were between these two figures and averaged £7,470 per annum, while the impact assessment of the 2012 audit exemption changes suggested an average audit fee of £7,700 per annum. These findings suggest that:

- the reported savings of taking up audit exemptions are lower than the audit fees because they take account of the costs of additional forms of scrutiny; and
- the perceived savings of audit exemptions (among those undergoing audits) are higher than audit fees because they also take account of time savings.

Applying the estimated savings to the 1.8 million UK companies taking up audit exemptions in 2015 suggests that audit exemptions may have saved UK companies £4.6 billion in 2015[31]. However, this is likely to be a conservative estimate as this is based on perceptions of savings rather than the actually money saved from not undergoing audits. An alternative estimate

[30] The average savings were slightly higher amongst companies that were ineligible before 2012 (£4,500 per annum) compared to those that were eligible before and after 2012 (£3,600 per annum).
[31] If we assume that 65 per cent of the 1,815,000 UK businesses taking up audit exemptions in 2015 (based on Companies House data) had experienced benefits and 98 per cent of those businesses had saved money, this suggests that 1,156,000 businesses had saved money from audit exemptions. If these businesses are assumed to have each saved £3,960 per annum, this suggests that audit exemptions may have saved UK companies £4.6 billion in 2015.

based on actual audit fees reported by survey respondents (£7,470 per annum) suggests that audit exemptions could have saved UK companies as much as £8.6 billion in 2015[32].

The most common uses for the savings included reinvesting in the business, increasing cashflow or working capital, repaying debts, increasing other savings and improving business profitability. However, one-in-three respondents reported not doing anything, or not knowing what they had done, with the savings. This suggests that sometimes the savings are not considered to be significant in scale. The survey also found that very few respondents have experienced, or would expect to experience, any impact on the growth of their business. Relatively few companies reported expecting either a positive or negative impact on business growth.

4.1.5 Implications for future policy development

There is strong support for audit exemptions to continue with similar eligibility criteria, although thresholds should be monitored over time.

The research findings provide strong support for audit exemptions to continue in the UK. Audit exemptions were widely considered to be a valuable resource in helping to reduce burdens for small businesses, even amongst companies that continue to undergo audits.

The evidence also suggests that the 2015 thresholds for the eligibility criteria appeared appropriate and relevant. However, there were calls for these thresholds to be monitored over time to ensure they remain consistent with wider definitions of small companies, remain at an appropriate level to capture all small companies, and are adjusted periodically to account for inflation.

[32] This estimate assumes that the 1,156,000 businesses that had saved money from audit exemptions had each saved £7,470 per annum, resulting in estimated total savings for UK companies of £8.6 billion in 2015.

Annex 1. Detailed study methodology

Introduction

The study involved three main research methods:

- desk-based research;
- a quantitative CATI (computer-assisted telephone interviewing) survey of 410 UK companies; and
- semi-structured depth interviews with 17 companies that responded to the survey.

Quantitative telephone survey

The quantitative survey was designed to explore company views and decisions relating to audit exemptions. The survey included questions on the factors that influence company decisions about whether or not to take up audit exemptions, the impact of these decisions and what more the Government can do to improve the effectiveness of audit exemptions and reduce burdens for businesses.

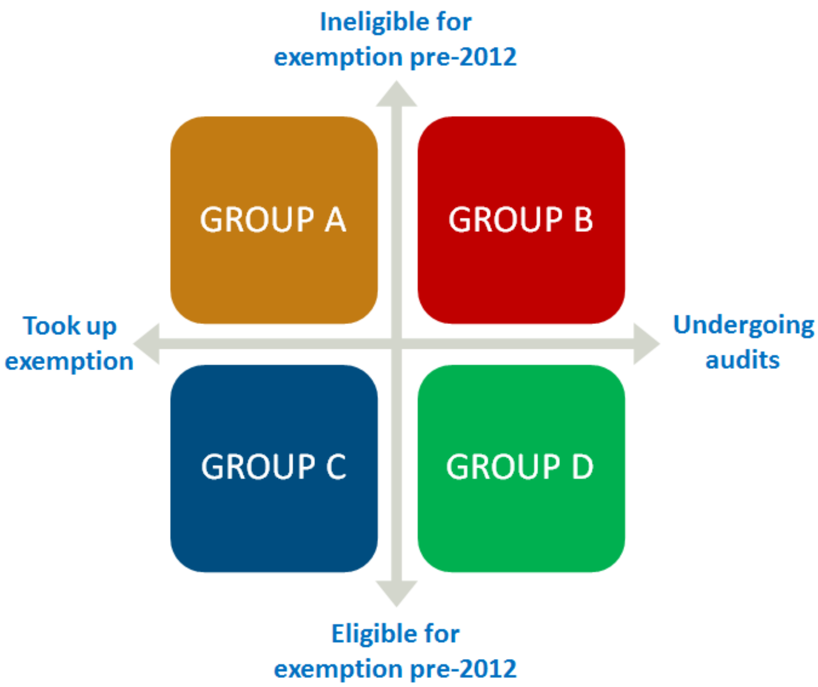
Sample design

The survey was targeted at UK enterprises (i.e. head offices or single sites) that were eligible for the small companies audit exemption at the time of the survey. It aimed to explore and compare the views of companies that had taken up audit exemptions with those that had not. An overall sample size of 400 was selected on commencement of the study, targeting 200 companies that had taken up audit exemptions and 200 that had not. A sample size of 400 was chosen to be sufficiently robust to allow analysis between these two sub-groups. The sample error for an overall sample of 400 companies (split between two sub-groups of 200 companies) on a survey result of 50 per cent (the worst case from a reliability point of view) is +/- 9.8 per cent. This suggests that if 50 per cent of one sample reported a particular view or experience, the proportion of the other sample that reported the same view or experience would need to be either 40 per cent or less, or 60 per cent or greater, for there to be a significant difference between the two sub-groups.

The company contacts were sourced by BEIS from the FAME database. The FAME database was selected because it provides data relating to each of the three criteria of turnover, asset values and number of employees. It also provides data on audit fees, which were used to indicate whether or not a company had taken up audit exemptions (i.e. assuming that companies with a zero or missing audit fee had taken up audit exemptions, while those with a positive audit fee had undergone audits).

The original approach intended to focus the survey exclusively on companies that were ineligible for audit exemptions prior to 2012 but then became eligible when new criteria were introduced in 2012. However a pilot of the survey found that it was not possible to accurately identify just these companies from the available data. It was therefore agreed that the approach would be revised and the sample would be split into four groups, depending on eligibility for audit exemptions prior to 2012 and whether or not eligible companies had taken up audit exemptions. The four groups are defined in Figure 40 below.

Figure 40: Defining the four sub-groups of the sample



The target and achieved number of interviews for each of the four groups are presented in Table 4 below. A total of 410 interviews were undertaken. These were split relatively evenly between those that were ineligible for audit exemptions before 2012 (197 interviews) and those that were eligible before 2012 (213 interviews). However, the interviewed sample was more focused on those that had not taken up audit exemptions (243 interviews) compared to those that had taken up an exemption (167 interviews). This was due to difficulties in predicting whether companies had undergone an audit. As a result the sample was slightly skewed towards those that did not take up audit exemptions.

The final column in the table below includes the total number of competed interviews after excluding charities. An initial analysis of the survey results showed a relatively large number of charities in the sample and, since charities are exempt from undergoing audits, it was decided that they should be removed from the sample prior to the analysis. The analysis included in this report is therefore based on the 361 interviews undertaken with companies and organisations that did not hold charitable status at the time of interview. Since charities are exempt from audits, the removal of charities from the sample produced a more even distribution of interviews across the four groups. There was a fairly even distribution of interviews across groups B, C and D, while there were still fewer interviews with companies in group A due to the difficulties of identifying companies that became eligible for audit exemptions in 2012, having previously been ineligible, and had taken up audit exemptions.

Table 4: Target sample structure and achieved interviews, by group

Group	Eligible pre-2012	Eligible post-2012	Took up exemption?	Target	Total Achieved	Achieved (excluding charities)
A	No	Yes	Yes	100	68	66
B	No	Yes	No	100	129	102
C	Yes	Yes	Yes	100	99	98
D	Yes	Yes	No	100	114	95
TOTAL				400	410	361

Data collection method

A total of 4,614 contacts were made available for the pilot and mainstage surveys, following de-duplication of the original sample and the removal of companies for which a telephone number was not available and could not be matched. Potential respondents were contacted using CATI.

A pilot of ten interviews was conducted between the 5th and 9th of February 2015. Following analysis of the results of the pilot, further changes were made to the questionnaire. The mainstage survey commenced on 16th February 2015 and continued until 27th March 2015.

Response rates

Table 5 provides a summary of outcomes and response rates. The 410 completed interviews represented 9 per cent of the 4,614 contacts approached during the pilot and mainstage surveys. A further 22 per cent of contacts were 'still live' on completion of the survey. In these cases, contact had been made and no refusal had been received, but it had not been possible to complete the interview. The main reasons were because of companies failing to reply to calls and answerphone messages.

The overall refusal rate of 54 per cent is high for a research study. A total of 51 per cent refused to do the interview, and 3 per cent terminated the call. A further 11 per cent were 'non-qualifiers'. The main reasons for this were contacts not being available before the survey deadline and not being able to speak to contacts because of inaccuracies in telephone numbers and other contact details.

The overall response rate was 14 per cent in terms of the number of achieved interviews as a percentage of those who were interviewed or refused/quit. As a percentage of all contacts still in scope at the end of the fieldwork, the response rate was 11 per cent. The relatively low response rate increases the risk of non-response bias (i.e. that the answers of respondents differ from the potential answers of those who did not answer). The reasons for non-response are not known although feedback from interviewers suggested that the subject matter was a key reason as many contacts were simply not interested in undertaking a survey about audits and exemptions. In other cases it was not possible to speak to someone in the finance team of the company because the company was using an external accountant who could not be interviewed because they are not decision-makers for the companies.

Table 5: Summary of interview/survey outcomes and response rates

Outcome	Number	Percentage of all
Completed	410	8.9%
Refused/quit	2,476	53.7%
Refused	2,349	50.9%
Quit	127	2.8%
Still live	998	21.6%
Appointment made with named respondent	6	0.1%
Soft appointment (e.g. spoke to colleague who indicated when named respondent would next be free)	380	8.2%
Answer phone	476	10.3%
No reply	81	1.8%
Engaged	22	0.5%
Requested information - email sent	33	0.7%
Non-qualifier	494	10.7%
Named contact not available before survey deadline	244	5.3%
Wrong number or contact/enterprise not known	179	3.9%
Unobtainable	66	1.4%
Language barrier	5	0.1%
Screened out	236	5.1%
Ineligible due to current turnover, employment or asset levels	134	2.9%
Ineligible due to being part of a corporate group	78	1.7%
Eligible for exemption prior to changes in 2012 (pilot only)	24	0.5%
Total numbers called	4,614	100.0%
Response rate (completed vs refused)		14.2%
Response rate (still eligible)		10.6%

Data weighting

Analysis undertaken by BEIS (to inform this study) produced estimates that around 44,700 companies in the UK became eligible as a result of the 2012 changes to the eligibility criteria for audit exemptions, having previously been ineligible. This was assumed to be the wider population for the survey sample in groups A and B. However, this population was significantly smaller than the wider population of UK companies for groups C and D that were eligible for audit exemptions both before and after 2012 (around 1.65 million companies). It was therefore decided that the datasets should be separated into two parts, with groups A and B weighted against the characteristics of the 44,700 companies that became eligible as a result of the changes introduced in 2012, and groups C and D weighted against the overall population of companies that are eligible for audit exemptions.

By linking the data in the FAME database (containing information on eligibility for audits) with the Inter-Departmental Business Register (IDBR, containing full information on business size and sector), BEIS was able to provide profiles of the size and sector characteristics of the wider business population for groups A and B. A 12 cell grid was produced based on these profiles (six size and sector cells for group A and six for group B), and the data were weighted to this profile.

BEIS also supplied information, based on data from the FAME database, that 38 per cent of UK registered companies were undergoing audits in 2015. By using estimated counts of all UK companies that were eligible for audit exemptions and subtracting those that were ineligible for exemption pre-2012, it was possible to calculate size and sector profiles for those that were eligible for audit exemptions pre-2012 (i.e. groups C and D combined). However, it was not possible to use the data to create separate size and sector profiles for groups C and D (i.e. separate profiles for companies that had, and those that had not, taken up audit exemptions). Random Iterative Method (RIM) weights were therefore used to weight the survey data for groups C and D. RIM weighting is a statistical technique used when some characteristics of the target population are known, but the relationship between the characteristics is unknown (e.g. when the disaggregation of companies between groups C and D was known, but size and sector profiles could not be disaggregated between the two groups). RIM weighting allowed size and sector profiles to be estimated for each group using a statistical approach that aims to distort each variable as little as possible. Two separate RIM weights were then applied to groups C and D: one based on calculated targets for size and sector, the other on whether the company had undergone an audit or not. The survey data for groups C and D were then weighted against the respective size and sector profiles.

Qualitative depth interviews

Qualitative semi-structured depth interviews were designed to unpack individual responses to the telephone survey and explore in more detail some of the key issues, which included:

- company views of audits and audit exemptions;
- company awareness and take-up of audit exemptions;
- the reasons and motivations for company decisions to take up or not take up audit exemptions; and
- the impacts of company decisions to take up or not take up audit exemptions.

The qualitative interviews were undertaken with companies that had already participated in the CATI survey and had agreed to participate in further research. The sample for the qualitative interviews focused exclusively on companies that were ineligible for audit exemptions before 2012 but became eligible when the criteria were changed in 2012 (i.e. companies in groups A and B). Having only recently become eligible for audit exemptions, these companies were considered likely to have a better awareness of their motivations and decisions about whether to take up audit exemptions and the resulting impacts. A total of 17 interviews were undertaken and included:

- 9 interviews with companies that had taken up audit exemptions; and
- 8 interviews with companies that had not taken up audit exemptions.

The interviewees were randomly selected from those that had and had not taken up audit exemptions and had agreed to be re-contacted. The interviews were conducted by telephone and lasted around 30 minutes on average. The interview topic guide is provided in Annex 3.

Annex 2. Survey questionnaire

Introduction

Good morning/afternoon, my name is XXX and I am calling from BMG Research, an independent research organisation. We are undertaking a survey on behalf of the Department for Business, Innovation and Skills (BIS) as part of a study to better understand business views and decisions relating to audit exemptions.

QA: Can I just check, is this the telephone number for [INSERT COMPANY NAME FROM DATABASE]?

Yes – CONTINUE

No – THANK AND CLOSE

Can I please speak to the Finance Director or a senior member of the finance team for [COMPANY NAME]?

READ OUT IF PASSED TO A DIFFERENT CONTACT:

Good morning/afternoon, my name is XXX and I am calling from BMG Research, an independent research organisation. We are undertaking a survey on behalf of the Department for Business, Innovation and Skills (BIS) as part of a study to better understand business views and decisions relating to audit exemptions.

The purpose of the survey is to better understand the factors that influence business decisions about whether or not to take up audit exemptions, the impact of these decisions and what more Government can do to improve the effectiveness of audit exemptions and reduce burdens for businesses.

This survey takes the form of a telephone interview lasting approximately 20 minutes. Any information you provide will be treated in strictest confidence, and the answers you give will not be attributed to you or your organisation in our reporting.

Would it be convenient to conduct the interview now?

Yes – CONTINUE

No – MAKE APPOINTMENT OR CODE OUTCOME OF CALL

REASSURANCES TO USE AS NEEDED

We work strictly within the Market Research Society Code of Conduct.

The contact at BMG Research is Gemma Baker on 0121 333 6006.

Your company details have been obtained from the FAME database, which is based on records filed at Companies House.

If you would like to confirm that this research is genuine you can call Jay Patel at BIS on 020 7215 3027.

OUTCOME CODES

CONTINUE	1
TRANSFER TO APPROPRIATE RESPONDENT	2
INELIGIBLE (INELIGIBLE FOR AUDIT EXEMPTIONS – REVISED 2012 CRITERIA)[33]	3
INELIGIBLE (SUBSIDIARY NOT TAKING UP SMALL BUSINESS AUDIT EXEMPTION)	5
REFUSED	6
HARD APPOINTMENT	7
SOFT APPOINTMENT	8
UNOBTAINABLE NUMBER (DEAD LINE)	9
OTHER (SPECIFY)	10

Before we start, could I just take your full name and job title?

Respondent name: ____

Respondent job title: ______________________________________

Section A: Screening

READ OUT: I would like to begin by asking you some questions to understand if your business has become eligible for audit exemptions since the changes in 2012.

Please answer the questions on behalf of [INSERT COMPANY FROM DATABASE] rather than on behalf of any wider group that it may be part of.

ASK ALL

Firstly, did [COMPANY] have a turnover of more than £6.5 million in the last financial year for which your business filed accounts? IF NECESSARY, DEFINE TURNOVER AS 'TOTAL ANNUAL TURNOVER OF YOUR COMPANY IN ALL ITS OPERATIONS'.

[33] NB: these codes would not appear to the interviewer, but will be coded automatically according to responses at Q1-7

Yes

No

Don’t know

ASK ALL

Did [COMPANY] have assets worth more than £3.26 million in the last financial year for which your business filed accounts?

Yes

No

Don’t know

ASK ALL

Did [COMPANY] employ 51 or more employees at the end of the last financial year for which your business filed accounts?

Yes

No

Don’t know

IF ANSWER ‘YES’ TO MORE THAN 1 OF THE ABOVE, THANK AND CLOSE (Thank you but we need to speak to businesses who are eligible for audit exemptions).

ASK ALL

3a. Was [COMPANY] eligible for the small companies audit exemption in every accounting year ending between April 2008 and October 2012 for which the business filed accounts?

Yes

No

Don’t know

ASK ALL

Did the annual business turnover of [COMPANY] exceed £6.5 million in any accounting year ending between April 2008 and October 2012? IF NECESSARY, DEFINE TURNOVER AS ‘TOTAL ANNUAL TURNOVER OF YOUR COMPANY IN ALL ITS OPERATIONS’. SINGLE CODE ONLY

Yes

No

Don't know

ASK ALL

Has [COMPANY] owned assets worth more than £3.26 million in any accounting year ending between April 2008 and October 2012? SINGLE CODE ONLY

Yes

No

Don't know

ASK ALL

Is [COMPANY] part of a group?

Yes - CONTINUE

No - SKIP TO Q7a

ASK Q7 IF Q6/1

Is [COMPANY] eligible to take up the small company exemption from undergoing an audit, despite being part of a group?

IF RESPONDENT QUERIES THE EFFECT OF BEING PART OF A GROUP, PLEASE EXPLAIN THAT THE COMPANY WOULD NOT BE ELIGIBLE TO TAKE UP THE SMALL COMPANIES AUDIT EXEMPTION IF THE GROUP (AS A WHOLE) IS NOT CLASSED AS SMALL OR IF ANOTHER GROUP MEMBER IS A PUBLIC COMPANY OR FINANCIAL SERVICES PROVIDER.

Yes - CONTINUE

No - THANK AND CLOSE

Don't know - THANK AND CLOSE

IF ANSWER 'NO' TO QUESTION 7, THANK AND CLOSE (Thank you but we need to speak to businesses that are eligible to take up the small company exemption from undergoing an audit despite being part of a group)

ASK ALL

7a. Did [COMPANY] undergo an audit in the last financial year for which it filed accounts?

Yes

No

Don’t know

Refused

MONITORING QUOTA

	SCENARIO	Q4	Q5	Q7A
A	Companies eligible post-2012 and ineligible pre-2012 that took up the exemption	YES (to one or both of these)		NO or DON’T KNOW or REFUSED
B	Companies eligible post-2012 and ineligible pre-2012 that did not take up the exemption	YES (to one or both of these)		YES
C	Companies eligible pre-2012 and post-2012 that took up the exemption	NO or DON’T KNOW	NO or DON’T KNOW	NO or DON’T KNOW or REFUSED
D	Companies eligible pre-2012 and post-2012 that did not take up the exemption	NO or DON’T KNOW	NO or DON’T KNOW	YES

Section B: Business background

READ OUT: I would now like to ask you some general questions about your business which will help to classify your answers. Please remain assured that all responses will be treated as confidential

ASK ALL

In what year was [COMPANY] established?

TYPE IN YEAR BELOW. IF UNSURE, ASK RESPONDENT TO PROVIDE BEST ESTIMATE.

____

Don’t know

Refused

ASK ALL

How many employees did [COMPANY] employ across all sites at the end of the last financial year, excluding owners and partners? WRITE IN

IF DON'T KNOW/NOT WILLING TO PROVIDE EXACT FIGURE, READ OUT RANGES UNTIL ANSWER GIVEN. SINGLE CODE ONLY

0-4

5-10

11-50

51-250

251+

Don't know

Refused

ASK ALL

What, approximately, was the annual turnover of [COMPANY] in the last financial year? WRITE IN

IF NOT WILLING TO PROVIDE EXACT FIGURE, READ OUT RANGES UNTIL ANSWER GIVEN. IF NECESSARY, DEFINE TURNOVER AS 'TOTAL ANNUAL TURNOVER OF YOUR COMPANY IN ALL ITS OPERATIONS'. SINGLE CODE ONLY

Less than £35,000

£35,000 to £72,999

£73,000 to £249,999

£250,000 to £499,999

£500,000 to £999,999

£1 million to £1.99 million

£2 million to £4.99 million

£5 million to £6.5 million

More than £6.5 million

Don’t know

Refused

ASK ALL

ASK Q11 IF SECTOR IS INCLUDED IN THE SAMPLE DATA, OTHERWISE SKIP TO Q12

I have [READ OUT SECTOR DESCRIPTION FROM SAMPLE[34]] as a general classification of [COMPANY]’s principal activity. Bearing in mind this is a general classification only, does this sound about right?

Yes – SKIP TO Q13

No – CONTINUE

ASK Q12 IF Q11=No (OR IF SECTOR IS MISSING FROM SAMPLE DATA), OTHERWISE SKIP TO Q13

What is the principal activity of your organisation? PROBE AS NECESSARY AND TYPE IN BELOW:

What is the main product or service of this organisation?

What exactly is made or done at this organisation?

What material or machinery does that involve using?

____

Refused	X

ASK ALL

Does [COMPANY] hold membership of any trade bodies or industry associations? SINGLE CODE ONLY

Yes	CONTINUE
No	SKIP TO Q15
Don’t know	SKIP TO Q15
Refused	SKIP TO Q15

ASK Q14 IF Q13=Yes, OTHERWISE SKIP TO Q15

[34] We will add this based on SIC

Which trade bodies or industry associations does [COMPANY] hold membership with? TYPE IN BELOW.

____

Don’t know

Refused

ASK ALL

Does [COMPANY] have shareholders?

Yes

No

Don’t know

Refused

ASK ALL

Does [COMPANY] have any loans from banks or other lenders?

Yes

No

Don’t know

Refused

ASK ALL

Does [COMPANY] have any other external investors (i.e. investors of capital who are not shareholders in the business or lenders via banking services)?

Yes

No

Don’t know

Refused

ASK ALL

Do you expect that in the next three years, your business will: READ OUT. MULTICODE OK (a-c)

Employ more than 50 people?

Generate an annual turnover of more than £6.5 million?

Own assets worth more than £3.26 million?

No/none of these

Don't know

Refused

Section C: Take-up of audit exemptions

READ OUT: I would now like to ask you some questions about the exemptions from undergoing audits of annual accounts.

ASK ALL

Are you aware that changes introduced by the Government in 2012 may mean that your business is eligible for an exemption from undergoing an audit of its annual accounts?

Yes

No

Don't know

Refused

ASK ALL

Do you think [COMPANY] is currently eligible to take up the exemption from undergoing an audit?

Yes SKIP TO FILTER ABOVE Q23

No CONTINUE

Don't know SKIP TO FILTER ABOVE Q23

Refused SKIP TO FILTER ABOVE Q23

ASK Q21 IF Q20=No, OTHERWISE SKIP TO FILTER ABOVE Q23

Why do you believe [COMPANY] is not eligible to take up the exemption from undergoing an audit? READ OUT. MULTICODE OK (a-f)

Because [COMPANY] is a financial services provider

[IF PART OF A GROUP – I.E. Q6=a] Because another group member is a financial services provider

Because [COMPANY] is a listed entity or public company

[IF PART OF A GROUP – I.E. Q6=a] Because another group member is a listed entity or public company

[IF PART OF A GROUP – I.E. Q6=a] Because the group of which [COMPANY] is a part is large or medium sized

Other reason (SPECIFY)

Don't know

Refused

MOVED TO Q7a

Section D: Reasons for, and impacts of, taking up audit exemptions

ASK Q23 IF Q7a=No/DK/Ref (I.E. HAVE TAKEN UP AUDIT EXEMPTIONS), OTHERWISE SKIP TO Q40

Has [COMPANY] ever undergone an audit?

Yes CONTINUE

No SKIP TO Q26

Don't know SKIP TO Q26

Refused SKIP TO Q26

ASK Q24 IF Q23=Yes, OTHERWISE SKIP TO Q26

When did [COMPANY] last undergo an audit? TYPE IN YEAR BELOW. IF UNSURE, ASK RESPONDENT TO PROVIDE BEST ESTIMATE.

____

Don't know

Refused

ASK Q25 IF Q23=Yes, OTHERWISE SKIP TO Q26

Do you know whether [COMPANY] was eligible to take up the exemption from undergoing an audit at the time?

Yes

No

Don't know

Refused

ASK SUBSIDARIES THAT HAVE TAKEN UP AUDIT EXEMPTIONS (Q6=Yes AND Q7a=No/DK/Ref), OTHERWISE SKIP TO Q27

You said that [COMPANY] took up the exemption from undergoing an audit in the last financial year for which it filed accounts. Was this because of the small company audit exemption or because of a parent company guarantee? SINGLE CODE ONLY

Small company audit exemption

Parent company guarantee

Other reason (SPECIFY)

Don't know

Refused

ASK Q27 IF Q7a=No/DK/Ref, OTHERWISE SKIP TO Q40

Why did you decide to take up the exemption from undergoing audits in the last financial year for which [COMPANY] filed accounts? READ OUT. MULTICODE OK (a-e)

Save money spent on auditors

Save time spent interacting with auditors

Find the audit process overly complicated / confusing

Do not see value in undergoing an audit

Other (Please specify)

Don't know

Refused

ASK Q28 IF Q27 MULTICODED, OTHERWISE SKIP TO Q29

What would you say was the main reason for taking up the exemption from undergoing an audit? READ OUT LIST OF THOSE MENTIONED AT Q27. SINGLE CODE ONLY

Save money spent on auditors

Save time spent interacting with auditors

Find the audit process overly complicated / confusing

Do not see value in undergoing an audit

Other (Please specify)

Don't know

Refused

ASK Q29 IF Q7a=No/DK/Ref, OTHERWISE SKIP TO Q40

Would you say [COMPANY] has benefited from taking up the exemption from undergoing an audit? SINGLE CODE ONLY

Yes CONTINUE

No SKIP TO Q33

Don't know SKIP TO Q33

Refused SKIP TO Q33

ASK Q30 IF Q29=Yes, OTHERWISE SKIP TO Q31

How has [COMPANY] benefited? READ OUT. MULTICODE OK (a-c)

Saved money that would have been spent on an audit CONTINUE

Saved management time that would have been spent dealing with auditors SKIP TO Q33

Other (Please specify) SKIP TO Q33

Don't know SKIP TO Q33

Refused SKIP TO Q33

ASK Q31 IF Q30/1=Saved money, OTHERWISE SKIP TO Q33

How much do you think [COMPANY] has saved per annum from not undergoing audits? WRITE IN

IF NOT ABLE TO PROVIDE EXACT FIGURE, READ OUT RANGES UNTIL ANSWER GIVEN. SINGLE CODE ONLY

Less than £1,000

£1,001 to £2,500

£2,501 to £5,000

£5,001 to £10,000

£10,001 to £15,000

£15,001 to £20,000

More than £20,000

Don't know

Refused

ASK Q32 IF Q30=SAVED MONEY, OTHERWISE SKIP TO Q33

Can you identify what [COMPANY] has done with the money saved from not undergoing audits? WRITE IN

Don't know

Refused

ASK Q33 IF Q7a=No/DK/Ref, OTHERWISE SKIP TO Q40

Has the exemption from undergoing an audit had any positive or negative impact on the growth of [COMPANY]? IF POSITIVE OR NEGATIVE, PROBE WHETHER THIS WAS A SIGNIFICANT OR SMALL IMPACT. SINGLE CODE ONLY

Yes, significant positive impact on growth

Yes, small positive impact on growth

No

Yes, small negative impact on growth

Yes, significant negative impact on growth

Don't know

Refused

ASK Q34 IF Q7a=No/DK/Ref, OTHERWISE SKIP TO Q40

Have there been any negative consequences for [COMPANY] from taking up the exemption from undergoing an audit? SINGLE CODE ONLY

Yes CONTINUE

No SKIP TO Q37

Don't know SKIP TO Q37

Refused SKIP TO Q37

ASK Q35 IF Q34=Yes, OTHERWISE SKIP TO Q37

Can you please describe these negative consequences? WRITE IN UP TO THREE, IN SEPARATE BOXES

a.

b.

c.

Don't know

Refused

ASK Q36 IF MULTIPLE RESPONSES TO Q35 (MORE THAN ONE BOX CODED), OTHERWISE SKIP TO Q37

Which of the negative consequences that you have just mentioned was the most significant for your business? SINGLE CODE ONLY

[ANSWER AT Q35a]

[ANSWER AT Q35b]

[ANSWER AT Q35c]

Don't know

Refused

ASK Q37 IF Q7a=No/DK/Ref, OTHERWISE SKIP TO Q40

Did you obtain any of these alternative forms of assurance or scrutiny of your accounting processes following take-up of the audit exemption? READ OUT. MULTICODE OK (a-e)

You increased internal accounting or book-keeping capacity CONTINUE

You contracted additional external accounting or book-keeping support CONTINUE

You increased internal audit capacity CONTINUE

You contracted internal audit support from external accountancy provider CONTINUE

other (Please specify) CONTINUE

No SKIP TO Q39

Don't know SKIP TO Q39

Refused SKIP TO Q39

ASK Q38 IF Q37=a/b/c/d/e, OTHERWISE SKIP TO Q39

Has [COMPANY] made overall time and cost savings from not undergoing audits (or have the savings been offset by the introduction of these alternative forms of assurance or scrutiny)? READ OUT. SINGLE CODE ONLY

Yes, still made savings from not undergoing an audit

No, savings have been offset by the time and cost of alternative forms of assurance or scrutiny

No, time and cost of introducing alternative forms of assurance or scrutiny have exceeded savings

Don't know

Refused

ASK Q39 IF Q7a=No/DK/Ref, OTHERWISE SKIP TO Q40

Assuming you continue to be eligible to do so, will [COMPANY] continue to take up the exemption from undergoing an audit in the future?

Yes

No

Don't know

Refused

Section E: Reasons for, and impacts of, not taking up audit exemptions

ASK Q40 IF Q7a=Yes (I.E. NOT TAKEN UP AUDIT EXEMPTIONS), OTHERWISE SKIP TO Q49

Approximately how much was the most recent audit fee paid by [COMPANY]? WRITE IN.

IF NOT ABLE TO PROVIDE EXACT FIGURE, READ OUT RANGES UNTIL ANSWER GIVEN. SINGLE CODE ONLY

Less than £1,000

£1,001 to £2,500

£2,501 to £5,000

£5,001 to £10,000

£10,001 to £15,000

£15,001 to £20,000

More than £20,000

Don’t know

Refused

ASK Q41 IF Q7a=Yes, OTHERWISE SKIP TO Q49

Has [COMPANY] always undergone an annual audit (i.e. in each year since its incorporation as a company or at least in respect of at least the last three to five annual accounts [COMPANY] has filed)?

Yes

No

Don’t know

Refused

ASK Q42 IF Q7a=Yes, OTHERWISE SKIP TO Q49

Why did you decide not to take up the exemption from undergoing an audit in the last financial year for which [COMPANY] filed accounts? WRITE IN UP TO THREE, IN SEPARATE BOXES

a.

b.

c.

Don’t know

Refused

ASK Q43 IF MULTIPLE RESPONSES TO Q42 (MORE THAN ONE BOX CODED), OTHERWISE SKIP TO Q44

Of the reasons you have just mentioned, what would you say was the main reason for not taking up the exemption from undergoing an audit? SINGLE CODE ONLY

[ANSWER AT Q42a]

[ANSWER AT Q42b]

[ANSWER AT Q42c]

Don’t know

Refused

ASK Q44 IF Q7a=Yes, OTHERWISE SKIP TO Q49

Do you think [COMPANY] could benefit in any of these ways from taking up the exemption from undergoing an audit? If so, how? READ OUT. MULTICODE OK (a-c)

by saving cost of undergoing an audit

by saving management time spent dealing with auditors

Other benefits (Please specify)

None of these/No benefits

Don’t know

Refused

ASK Q45 IF Q44=a/b/c, OTHERWISE SKIP TO Q46

How much do you think [COMPANY] could save per annum from not undergoing audits? WRITE IN

IF NOT ABLE TO PROVIDE EXACT FIGURE, READ OUT RANGES UNTIL ANSWER GIVEN. SINGLE CODE ONLY

Less than £1,000

£1,001 to £2,500

£2,501 to £5,000

£5,001 to £10,000

£10,001 to £15,000

£15,001 to £20,000

More than £20,000

Don’t know

Refused

ASK Q46 IF Q7a=Yes, OTHERWISE SKIP TO Q49

Do you think that taking up the exemption from undergoing an audit could have any positive or negative impact on the growth of [COMPANY]? IF POSITIVE OR NEGATIVE, PROBE WHETHER THIS COULD BE A SIGNIFICANT OR SMALL IMPACT. SINGLE CODE ONLY

Yes, significant positive impact on growth

Yes, small positive impact on growth

No impact expected

Yes, small negative impact on growth

Yes, significant negative impact on growth

Don’t know

Refused

ASK Q47 IF Q7a=Yes, OTHERWISE SKIP TO Q49

Do you expect to take up the small companies exemption from undergoing an audit in the future (i.e. in the next three years assuming no further changes are made to the small companies audit exemption)?

Yes	CONTINUE
No	SKIP TO Q49
Don't know	SKIP TO Q49
Refused	SKIP TO Q49

ASK Q48 IF Q47=Yes, OTHERWISE SKIP TO Q49

When do you expect to take up the small companies exemption from undergoing an audit? READ OUT. SINGLE CODE ONLY

For the next accounts due to be filed

For the accounts due to be filed in the year after that

After that but within the next three years

Don't know

Refused

Section F: Views of audit exemptions, follow-up and close

ASK ALL

In your view, has the market for audits changed at all in the last two years (i.e. since the criteria for audit exemptions were changed)?

Yes

No

Don't know

Refused

ASK Q50 IF Q49=Yes, OTHERWISE SKIP TO Q51

How would you say the market for audits has changed in the last two years? WRITE IN

Don't know

Refused

ASK ALL

Finally, to what extent do you agree/disagree with the following statements about audit exemptions? READ OUT SCALE AND EACH STATEMENT IN TURN. SINGLE CODE ONLY PER STATEMENT. FOR EACH PROBE WHETHER STRONGLY (DIS) AGREE OR TEND TO (DIS) AGREE. DISPLAY AS GRID.

The audit exemptions help to reduce burdens for small businesses

The audit exemptions provide an unfair advantage to small businesses

The take-up of audit exemptions creates uncertainty for shareholders and prospective shareholders

The take-up of audit exemptions creates uncertainty for lenders, prospective lenders and other potential investors

The take-up of audit exemptions creates uncertainty for suppliers

The take-up of audit exemptions creates uncertainty for customers

The audit exemptions have helped to create alternative market solutions

The thresholds for audit exemptions should be increased

The thresholds for audit exemptions should be decreased

Strongly disagree

Tend to disagree

Neither agree nor disagree

Tend to agree

Strongly agree

Don’t know (DO NOT READ OUT)

ASK ALL

Thank you for participating in this survey. Your participation in this research is extremely valuable and helps to ensure that Government policies are able to meet the needs of businesses more effectively. Would you be happy to be contacted for follow up interviews to gain more detailed understanding of some of these issues? SINGLE CODE ONLY.

Yes CONTINUE

No THANK AND CLOSE

ASK Q53 IF Q52=Yes, OTHERWISE THANK AND CLOSE

Could you please tell me your email address and confirm your contact number for this purpose? TYPE IN BELOW.

Email address: ________________________________

Telephone number: ________________________________

Thank you, those are all the questions I have. If you are concerned about whether BMG is a genuine market research agency, you can call the Market Research Society on 0500 396 999 during office hours.

Annex 3. Topic guides for qualitative interviews

Note to interviewer:

This topic guide is designed to be semi-structured and therefore provides a framework of themes to be explored. The questions are provided as a guide but are not designed to be read out verbatim. The semi-structured interview should be open in nature allowing new ideas to be brought up during the interview as a result of what the interviewee says. Answers provided by interviewees should also be probed fully to ensure rich and detailed responses.

Introduction:

My name is XXX and I'm calling from ICF. We are an independent research company and we are undertaking research on behalf of the Department for Business, Innovation and Skills (BIS).

You were recently involved in a survey, conducted by our partners BMG Research, which focused on the small companies audit exemption. The survey covered the factors that influence decisions about whether or not to take up the audit exemption and the impacts for your business. You indicated in the survey that you would be happy for us to follow-up with some more in-depth questions to help explore some of your answers further. The results of the survey will be fed back to government and will be used to inform Government policy on improving the effectiveness of the audit exemption and reducing burdens for businesses. A report will also be published in 2015 which we can email to you.

General information – ASK ALL

Name of Interviewee

What is your position in the business?

I understand that the main sector and activity of your business is [INSERT CLASSIFICATION FROM QUANT SURVEY – Q12Q and SIC_DESC] – is this correct?

I understand that you employed [INSERT NUMBER FROM QUANT SURVEY – Q9/Q9DUM] employees at the end of the last financial year– is this correct?

I understand that your business turnover was approximately [INSERT NUMBER FROM QUANT SURVEY – Q10/Q10BND] at the end of the last financial year – is this correct?

I understand that your business has been trading for [INSERT NUMBER FROM QUANT SURVEY – Q8AGE] years – is this correct?

General views of audits – ASK ALL

Has your business been audited before?

If yes, approximately how much did your business pay for its most recent audit?

Can you estimate roughly how much of your staff's time was spent dealing with your most recent audit?

Why did your business have its accounts audited?

Do you think there are benefits to your business from undergoing audits? If so, what? (Probe: provides trust and confidence in the business for shareholders, lenders, investors, suppliers, customers; provides good basis for sound decision-making; helps to secure finance; helps to secure contracts with customers/suppliers; anything else?)

Are there negative impacts for your business from undergoing audits? If so, what? (Probe: cost of audit; time spent dealing with audits and auditors; anything else?)

Awareness of the audit exemption – ASK ALL

When did you become aware that your business might be eligible for the small companies audit exemption?

Do you know whether your business became eligible for the small companies audit exemption following changes made in 2012 to the Companies Act 2006?

How did you become aware that your business might be eligible for this audit exemption?

Take-up of the audit exemption – ASK THOSE WHO TOOK UP THE AUDIT EXEMPTION – SCENDUM = 1

When did your business first take up the exemption from audit?

How many times has your business taken up the small companies audit exemption?

[FOR SUBSIDIARIES – Q6=1] When your business has taken up an audit exemption has this always been because of the small companies audit exemption or because of a parent company guarantee? Why was this?

[FOR SUBSIDIARIES – Q6=1] Do you think you would continue to take up an audit exemption (through the parent company guarantee) if your business was no longer eligible for the small companies audit exemption? Why/Why not?

What were the key motivations for your business in taking up the audit exemption? (Probe: save money; save time; change of management; change in the business size/structure; no benefits from undergoing audits; audit process is too confusing/complicated, something else)

Who, if anyone, did you consult in your decision to take up the audit exemption? (Probe: management team, directors, shareholders, lenders, investors, suppliers, customers, others)

Were there any conflicting views within the business and/or amongst shareholders, lenders and investors as to whether to take up the audit exemption? If so, please describe the different views?

Impact of audit exemptions – ASK THOSE WHO TOOK UP THE AUDIT EXEMPTION – SCENDUM = 1

You mentioned that your business [had/had not - INSERT FROM QUANT SURVEY – had benefited (Q29 = 1) / had not benefited (Q29=2)] benefited from taking up the audit exemption.

[If no benefits] Why do you think that your business did not benefit from taking up the audit exemption? Did your business not experience any savings in the costs and time associated with undergoing an audit?

[If benefits] Please describe all of the benefits for your business from taking up the audit exemption. Please describe how these benefits were realised in practice and, where possible, please try to quantify the scale of the benefits in terms of cost savings, time saved.

[WHERE RELEVANT – if Q34=1] You mentioned that there had been some negative consequences from taking up the audit exemption (See Q35_1_other, Q35_2_other and Q35_3_other). Please can you describe these consequences in a little more detail? Will these consequences affect the likelihood of your business taking up the audit exemption in the future?

[WHERE RELEVANT – if Q37_1 or Q37_2 or Q37_3 or Q37_4 or Q37_95 = 1] You mentioned that your business had introduced some new activities as a result of taking up the audit exemption. Please can you describe these activities in a little more detail? Why did you think that these activities were necessary?

Overall, considering any savings from not undergoing an audit, and any additional costs from introducing new activities and any negative consequences, would you say that the audit exemption has saved money for your business?

If yes, how much do you think your business has saved from taking up the audit exemption?

If No, do you think that taking up the audit exemption has created costs for your business? If so, why is this and would you be able to estimate the scale of these costs?

[IF THE AUDIT EXEMPTION GENERATED OVERALL SAVINGS] How would you say your business has used the money saved from taking up the audit exemption? (Probe: increased profits; reduced business debts; invested in new equipment; invested in innovation/developing new products or services; employed additional staff, anything else?)

[WHERE RELEVANT – positive impact if Q33=1 or 2 / negative impact if Q33 = 4 or 5] You mentioned that the audit exemption had had an impact on the growth of your business. Please can you describe this impact in a little more detail. Did the audit exemption have a positive or negative impact? What was the scale of the impact? How and to what extent did it affect the growth of your business? Have these impacts on growth made your business more or less likely to take up the audit exemption in the future?

Reasons and impacts for not taking up the audit exemption – ASK THOSE WHO DID NOT TAKE UP THE AUDIT EXEMPTION – SCENDUM = 2

Has your business ever taken up an exemption from audit?

If yes, how many times has your business taken up an exemption from audit?

Was this always the small companies audit exemption or the parent company guarantee?

You described your reasons for not taking up the audit exemption as being [INSERT FROM QUANT SURVEY - Q42_1_other and Q42_2_other and Q42_3_other]. Please can you describe these reasons in more detail.

Who, if anyone, did you consult in your decision not to take up the audit exemption? (Probe: management team, directors, shareholders, lenders, investors, suppliers, customers, others)

Were there any conflicting views within the business and/or amongst shareholders, lenders and investors as to whether to take up the audit exemption? If so, please describe the different views?

You mentioned that your business [could/would not - INSERT FROM QUANT SURVEY – Could benefit (if Q44_1 or Q44_2 or Q44_95 = 1) / would not benefit (if Q44_96 = 1)] benefit from taking up the audit exemption.

[If would not benefit (Q44_96 = 1)] Why do you think that your business would not benefit from taking up the audit exemption? Would your business not benefit from savings in the costs and time associated with undergoing an audit?

[If could benefit (Q44_1 or Q44_2 or Q44_95 = 1)] Please describe the ways in which you think your business could benefit from taking up the audit exemption. If possible, please try to quantify the scale of the benefits in terms of cost savings, time saved.

[WHERE RELEVANT – positive impact if Q46=1 or 2 / negative impact if Q46 = 4 or 5] You mentioned that taking up the audit exemption could have an impact on the growth of your business. Please can you describe these potential impacts in a little more detail. Do you think that taking up the audit exemption could have a positive or negative impact? Are you able to estimate the scale of the impact? How and to what extent do you think it might affect the growth of your business?

Taking up the audit exemption in the future – ASK ALL

You mentioned that you [intend/do not intend - INSERT FROM QUANT SURVEY – Q39 OR 47] to take up the audit exemption in the future. Please can you explain why this is the case.

[IF DO NOT INTEND TO TAKE UP THE AUDIT EXEMPTION] Is there anything that would make you more likely to take up the audit exemption in the future?

Views of the audit exemption – ASK ALL

You mentioned that you [agreed/disagreed - INSERT FROM QUANT SURVEY – Q51_1] that the audit exemption helps to reduce burdens for small businesses. Please can you explain your response in more detail.

You mentioned that you [agreed/disagreed - INSERT FROM QUANT SURVEY – Q51_2] that the audit exemption provides an unfair advantage to small businesses. Please can you explain your response in more detail.

You mentioned that you [agreed/disagreed - INSERT FROM QUANT SURVEY – Q51_3 and Q51_4] that the audit exemption creates uncertainty for shareholders, lenders and/or other investors. Please can you explain your response in more detail.

You mentioned that you [agreed/disagreed - INSERT FROM QUANT SURVEY – Q51_5 and Q51_6] that the audit exemption creates uncertainty for suppliers and/or customers. Please can you explain your response in more detail.

You mentioned that you [agreed/disagreed - INSERT FROM QUANT SURVEY – Q51_7] that the audit exemption has helped to create alternative market solutions. Please can you explain your response in more detail.

You mentioned that you felt that thresholds for the audit exemption should [increase/decrease - INSERT FROM QUANT SURVEY – Q51_8 and Q51_9]. Can you say a little more about why you think the thresholds for the audit exemption should [increase/decrease - INSERT FROM QUANT SURVEY – Q51_8 and Q51_9]

Are there any (other) ways in which the audit exemption could be improved in the future? If so, how?

Do you have any other comments that you would like to make about the audit exemption?

Thank and Close

Annex 4. Background and context

This annex presents background and contextual information relating to audit exemptions in the UK.

Introduction

The UK Government's 'Better Regulation' agenda seeks to promote a business-friendly environment by finding more effective ways of designing and enforcing regulation, without placing unnecessary burdens on business[35]. A key objective is to streamline bureaucracy in order to provide a level-playing field for businesses to compete and, in so doing, support their productivity and growth.

Over the years, the UK Government has taken advantage of various derogations available under Europe's Accounting Directives to simplify or, where possible, remove accounting requirements for certain categories of businesses.

Nevertheless, in its 'Plan for Growth'[36], the Coalition Government recognised that, "over time, both the volume of reporting requirements for UK business, and the associated costs, have increased," which led to general consensus on the need for UK audit requirements to be applied in "a more targeted and flexible manner to reduce compliance costs without significant impacts on disclosure […]."[37]

The Government therefore committed itself to reduce the number of UK SMEs required to undertake an audit. Specifically, proposals for regulatory reform in this area involved:

- amending UK legislation (by relaxing eligibility requirements) to enable a larger number of small companies to qualify for audit exemptions; and
- exempting qualifying subsidiaries from the requirement to prepare, audit and publish annual accounts where certain conditions are met[38].

Rationale for audit reform

Although the UK has adopted many of the available exemptions set out in Europe's Fourth Directive[39], some stakeholders had expressed concerns that "audit requirements in the UK do not allow as much flexibility to companies as currently available under EU requirements"[40]. The section below describes key legal developments in EU laws surrounding accounting/auditing requirements and how the UK adapted national legislation to allow more

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[35] www.gov.uk, 'Regulation Reform', https://www.gov.uk/government/topics/regulation-reform
[36] BIS and HM Treasury, 2011. 'The Plan for Growth'
[37] BIS, 2014. 'Impact assessment: audit exemptions'
[38] These conditions are set out in full in the impact assessment carried out by BIS (please see: BIS, 2014. 'Impact assessment: audit exemptions')
[39] The Fourth Directive hereby referring to Fourth Council Directive 78/660/EEC on the annual accounts of certain types of companies.
[40] BIS, 2014. 'Impact assessment: audit exemptions'

flexibility and further reduce the burden associated with financial reporting for small businesses.

Creating greater synergies between European and national priorities and actions in the area of annual accounts/company law

In early 2007, the European Commission launched the ‘Action Programme for Reducing Administrative Burdens’ (ABR Programme). The goal of the programme was to measure the costs imposed by information obligations on companies and to reduce administrative burdens across thirteen selected priority areas by an overall 25 per cent by 2012[41]. Among these reduction measures were two initiatives aimed at simplifying accounting/auditing rules for SMEs, notably:

- “Allowing more small and medium-sized companies to benefit from simplified accounting/auditing regimes.” This measure was implemented at a European level via Directive 2006/46/EC, amending Accounting Directives 78/660/EEC and 83/349/EEC.
- The amendment allowed for a higher proportion of SMEs to benefit from simplified accounting/auditing regimes, notably by reducing their financial reporting obligations (in particular, having to report off-balance-sheet arrangements) and by exempting them from preparing and filing audited accounts. Directive 2006/46/EC brought about an increase in audit exemptions thresholds for SMEs and parent undertakings as detailed in Table 6.
- “Allowing Member States to exempt micro-enterprises from accounting directives.” This measure was implemented at a European level via Directive 2012/6/EU (amending Council Directive 78/660/EEC) in view of creating a simple financial reporting environment for micro entities.
- Member States can exempt micro entities from one or more of the following obligations: (1) the obligation to present “prepayments and accrued income” and “accruals and deferred income”; (2) the obligation to draw up notes on the accounts; (3) the obligation to prepare an annual report; (4) the obligation to publish annual accounts; and/or allow micro entities: (5) to draw up an abridged profit and loss account and balance sheet. Revised thresholds defining micro entities were also announced as part of the new Directive (Table 6).

[41]Commission Staff Working Document, 2012. ‘Action Programme for Reducing Administrative Burdens in the EU Final Report.’ *European Commission*

Table 6: New exemption thresholds for micro, small and medium sized companies as laid out in Directives 2006/46/EC and 2013/34/EU (repealing Directive 2012/6/EU)*

	Micro companies	Small-sized companies	Medium-sized companies
Balance sheet total	€350,000	€4,000,000	€20,000,000
Net turnover	€700,000	€8,000,000	€40,000,000
No. of employees	10	50	250

Note: * A company must meet two of the three criteria relating to employees, turnover and balance sheet values to be classified as either a micro, small or medium sized company.

Directive 2013/34/EU

More recently, the European Commission adopted a new Accounting Directive - Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings. This new Directive combines the existing Fourth (single companies) and Seventh (consolidated accounts) Accounting Directives and is aimed at[42]:

- consolidating, modernising and updating Council Directives 78/660/EEC and 83/349/EEC on annual individual and consolidated financial statements and reports;
- amending Directive 2006/43/EC on statutory audits of individual and consolidated accounts; and
- repealing, and incorporating the provisions of, Directive 2012/6/EU on the annual accounts of certain types of companies as regards micro-entities ("the Micros Directive").
- Directive 2013/34/EU provided the definitions for micro, small and medium-sized companies as presented in Table 6 but also stated that Member States could define their own thresholds for balance sheet totals and net turnover. It stated that thresholds may exceed those in Table 6 but should not exceed €6 million for the balance sheet total and €12 million for the net turnover.

[42] BIS, 2014. 'Chapters 1-9: Annual financial statements, consolidated financial statements, related reports of certain types of undertakings and general requirements for audit'

UK’s stance on audit exemptions for ‘small undertakings’ and ‘small groups’

Mandatory audit thresholds have been aligned with accounting thresholds for small undertakings and small groups

In accordance with Directive 2006/46/EU, the UK implemented the maximum thresholds that are used to define a “small company” to allow a greater number of entities to classify as “small” and access a less burdensome financial reporting regime. However, prior to October 2012, an entity had to meet the turnover and balance sheet total criteria in order to qualify as “small”.

The UK Government then amended national legislation in October 2012 to enable smaller undertakings to take up audit exemptions if they meet any two of the three criteria (number of employees; balance sheet total; and turnover) (Box 1). This brought the small company audit criteria into line with the small company accounting criteria.

Box 1 - Amendments to Companies Act 2006 – ‘individual (small) undertakings’

Provisions set out in the ‘Small and Limited Liability Partnerships (Accounts and Audit Exemptions and Change of Accounting Framework) Regulations 2012’, amending the ‘Companies Act 2006’, stipulate that from 1 October 2012 individual (small) companies were entitled to an audit exemption if they met any two out of the three mandatory criteria:

- no more than 50 employees;
- assets worth no more than £3.26 million; and
- less than £6.5 million in turnover.

An individual company does not however qualify as “small” if, at any time within the financial year to which their accounts relate, they were: (1) a public company or (2) a banking or insurance company .

The UK Coalition Government subsequently increased the thresholds for turnover and asset values, as permitted under Directive 2013/34/EU. UK companies are now eligible for the small companies audit exemption if, for accounting years beginning on or after 1 January 2016, they met at least two of the following three criteria:

- no more than 50 employees;
- assets worth no more than £5.1 million; and
- less than £10.2 million in net turnover.

However, the fieldwork for this study was undertaken in 2015 and this research report therefore focuses on the thresholds that operated between 1 October 2012 and 31 December 2015.

Certain subsidiary companies have been exempted from mandatory audit

The transposition of Directive 2006/46/EU into the UK’s national legislation also allowed subsidiary companies to dispense with an audit, provided certain conditions are met – principally, parent undertakings are established under the law of a European Economic Area (EEA) state and declare that the parent company guarantees all outstanding liabilities to which subsidiary companies are subject at the end of the financial year to which the guarantee relates[43].

Box 2 - Amendments to Companies Act 2006 – 'small groups'

As above, from 1 October 2012, a group must meet any two out of the following three mandatory criteria to qualify:

- Number of employees: 50;
- Assets: net: £3.26 million; gross: £3.9 million; and
- Turnover: net: £6.5 million; gross: £7.8 million.

A (small) group can satisfy the relevant requirements on either a 'net' or 'gross' basis or a combination of both (where 'net' means after consolidation adjustments).

The thresholds for turnover and asset values have also been increased for 'small groups', for accounting years beginning on or after 1 January 2016. Small groups must now meet two of the following three criteria:

- Number of employees: 50;
- Assets: net: £5.1 million; gross: £6.1 million; and
- Turnover: net: £10.2 million; gross: £12.2 million.

However, as stated above, this research report focuses on the thresholds that operated between 1 October 2012 and 31 December 2015.

Certain dormant subsidiary companies have been exempted from preparing/filing accounts and mandatory audit

Dormant subsidiaries have also been exempted from an audit. The rationale for relaxing financial reporting requirements for dormant subsidiary companies is that the preparation and filing of accounts for the public record provides little additional information given the lack of trading activity[44].

Exemptions are, however, conditional on receipt of a guarantee from parent companies that they are willing to guarantee all of their subsidiaries' outstanding liabilities (until they are satisfied in full). Dormant subsidiaries with such a guarantee are additionally exempt from preparing and filing financial statements[45].

Implementing the Coalition Government's commitments outlined in the 'Plan for Growth'

In the 'Plan for Growth,' published in March 2011, the UK Coalition Government recognised that complying with regulation places a disproportionate burden on SMEs in terms of cost, time and resources.

The Government therefore pledged to reduce the regulatory burden on UK businesses by: (1) reducing the number of UK SMEs required to undertake an audit; (2) reducing the burden of

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[43] For a more detailed list of conditions, see: BIS, 2014. 'Impact assessment: audit exemptions'
[44] BIS, 2014. 'Impact assessment: audit exemptions'
[45] Deloitte, 2013. 'ICAEW publishes guidance on the audit exemption by parent guarantee'

financial accounting for UK businesses (by bringing forward legislation in 2012 to exempt many small companies and small groups from producing audited accounts); and (3) furthering lobbying efforts with the European Commission to remove the audit requirement for most medium sized companies.

The justification for the aforesaid initiatives lies in the evidence produced on the numerous challenges experienced by companies in the face of onerous compliance requirements. A broad discussion of the literature evidence on the nature of regulatory burdens on companies (especially small businesses) is provided below. This is followed by a discussion of the impacts of regulatory burden on company operations as evidenced in the literature.

Business perceptions of regulatory burden

Just over half (51 per cent) of UK companies reported that the overall level of regulation in the UK is an obstacle to business success[46]. In addition, an increasing proportion (from 38 per cent in 2012 to 43 per cent in 2014) expected regulatory burdens to increase in the next 12 months.

London First and the Federation of Small businesses (FSB) co-commissioned research to show how London fares as a location for small businesses compared with other major cities[47]. The report considered six areas regarded as burdensome by small businesses, including the business and regulatory environment. It was found that London’s business and regulatory environment presented more challenges to small businesses than Singapore and New York largely due to its “higher burden of government regulation and more rigid employment regulation.” Although London’s performance was well ahead of other major European cities (e.g. Paris), measures to curb the overall burden of government regulation were recommended by the authors to enable London to compete for business internationally.

Similarly, the latest figures from Grant Thornton’s ‘Agents of Growth’ report indicated that 43.5 per cent of mid-sized businesses in the UK considered their compliance activities to be burdensome[48].This constituted an increase of 5 per cent from the previous year and it was estimated that new regulations currently before Parliament could deteriorate perceptions further.

This concern was also shared by Nielsen and Parker (2008) who argued that uncertainty from the pace of regulatory change constitutes an important source of regulatory burden for businesses[49]. Similarly, Harries and Sawyer (2014) attributed the regulatory challenges faced by businesses to the complexity of the overall regulatory landscape, often generated by: (1) overly complex and/or excessive regulation; (2) poor enforcement; and (3) unnecessary duplication and inconsistency of regulation[50]. Their findings were in line with other literature evidence which suggests that, in addition to direct and indirect quantifiable costs of compliance, regulatory burden also includes other “less easily quantifiable aspects such as the anxiety generated by the threat of litigation, increased complexity of legislation, uncertainties about regulatory requirements, worries about not keeping abreast of current legislation […], the psychological effects on businesses of some legislation that is perceived as unfair or poorly

[46] Jigsaw Research, NAO and BIS, 2014. ‘Business Perceptions Survey’
[47] Volterra, London First and the FSB, 2013. ‘The Small Business Cities Burden Index’
[48] Grant Thornton Media Centre, 2015. ‘Regulatory burden increasing for mid-sized businesses’
[49] Nielsen, V. L. and Parker C., 2008. ‘To what extent do third parties influence business compliance?’, Journal of Law and Society, 35(3), pp.309-40.
[50] Harries, R. and Sawyer, K., 2014. ‘How to run a country the burden of regulation.’ Reform

targeted"[51] and "the moral pressures […] to adopt certain practices under pressure from various third parties including customers and business partners"[52].

Cost of regulation and resulting challenges faced by businesses

There have been various attempts at measuring the burden of regulatory requirements or the costs associated with regulatory compliance. Renda et al. (2013) identified three main areas of regulatory costs to businesses: (1) direct costs; (2) enforcement costs; and (3) indirect costs[53]. These are described in Table 7 below.

Table 7: The cost of regulation to businesses

Direct costs		Enforcement costs	Indirect costs	
Direct compliance costs	Hassle costs	Enforcement costs	Indirect compliance costs	Other indirect costs
Regulatory charges (e.g. fees, levies, taxes); Substantive compliance costs (e.g. investments / expenses faced by businesses in complying with obligations); Administrative costs / burdens.	Costs associated with waiting time and delays, redundant legal provisions, etc.	Costs associated with monitoring, enforcement and adjudication.	Costs transmitted through changes in the prices and / or availability and / or quality of the goods or services (i.e. welfare impacts)	Costs related to substitution (e.g. reliance on alternative sources of supply); Transaction costs; Negative market impacts (e.g. reduced competition or market access, or reduced innovation or investment).

Source: Adapted from Renda, A. et al., 2013. 'Assessing the Costs and Benefits of Regulation.' European Commission

Other studies have confirmed the findings set out in Renda et al. (2013). In a study of SME retailers in the UK, Schmidt et al (2007) measured the burden of new legislation. Their survey showed that business growth and staffing arrangements can be obstructed by burdens that can be measured in terms of management time and information costs[54]. Similarly, Gray (2008) used data from a quarterly survey of regulatory compliance and attitudes among 850 SMEs across all sectors in the UK. They reported that regulation "costs" an average of 5.4 hours per person per month, ranging from 9.7 hours for self-employed to 2.8 hours for small (10-24 employees) firms[55].

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[51] Centre for Regional Economic Development (University of Cumbria), 2012. 'Business perceptions of regulatory burden'

[52] Nielsen, V. L. and Parker C., 2008. 'To what extent do third parties influence business compliance?', Journal of Law and Society, 35(3), pp.309-40.

[53] Renda, A. et al., 2013. 'Assessing the Costs and Benefits of Regulation.' European Commission

[54] Schmidt R.A., Bennison D., Bainbridge S. and Hallsworth A., 2007. 'Legislation and SME retailers – compliance costs and consequences', International Journal of Retail & Distribution Management, 35 (4), pp. 256-70.

[55] Gray C., 2008. 'Do regulations really inhibit small firm entrepreneurship and growth?'. Paper presented at the ISBE Conference, Belfast.

The Economist Intelligence Unit conducted a survey of senior professionals (with responsibility for risk) across the globe[56]. When asked about the categories of regulations that consume the greatest time and resources, 75 per cent of respondents mentioned auditing and reporting regulations. Additionally, 23 per cent of UK respondents indicated that the current regulatory environment places a high burden on their business, placing the UK ahead of France (19 per cent) and Germany (18 per cent) in that respect.

More recently, the Swedish Agency for Growth Policy Analysis carried out a survey of the impact of regulation on companies[57]. In addition to direct costs (in the form of administrative costs), they found that regulations and regulatory burdens often entail a significant increase in fixed costs for businesses. These adverse changes to business cost structures may result in entry barriers, negatively affecting competition and entrepreneurship. The authors further argued that regulations can also have substantial adverse impacts on production dynamics if they reduce businesses' ability to adapt to changes in their environment, leading to "considerable allocation losses" and "negative repercussions on investment." Altogether, in the long-term, these negative effects can result in lower economic growth.

Box 3 - Evidence of the impact of regulatory burden on production dynamics

Through an empirical analysis, the Swedish Agency for Growth Policy Analysis found that production dynamics are poorer and yield requirements are higher in countries that have heavy regulatory burdens. The authors found that the negative effects on production dynamics manifest themselves in the form of enterprises being less able to adapt quickly to external changes. The effects on entrepreneurship were also investigated – a key finding was that regulatory burdens mainly affect innovation-driven entrepreneurship.

Conversely, the authors found that countries with a light regulatory burden exhibit more rapid economic growth in GDP per capita.

Source: Swedish Agency for Growth Policy Analysis (2010)

Impact of the audit reforms

Take-up of audit exemptions

BIS' impact assessment of the 2012 audit exemption changes estimated that more than 100,000 additional 'active' companies (or an estimated 36,000 additional small companies and 83,000 UK subsidiaries) would qualify for audit exemptions and benefit through reduced accountancy and administrative costs as a result of the changes introduced in 2012[58]. A further 87,000 dormant UK subsidiaries were estimated to qualify for exemptions from the requirement to prepare and file accounts[59].

The increased take-up of audit exemptions is also likely to have implications for the firms undertaking audits. The Financial Reporting Council recently reported that the "number of firms

[56] Economist Intelligence Unit, 2008. 'From burden to benefit: making the most of regulatory risk management'. ACE, KPMG, SAP and Towers Perrin
[57] Swedish Agency for Growth Policy Analysis, 2010. 'The Economic Effects of the Regulatory Burden'
[58] BIS, 2014. 'Impact assessment: audit exemptions'
[59] BIS, 2014. 'Impact assessment: audit exemptions'

registered to carry out statutory audit work continues to fall" in the UK[60]. The number of registered audit firms fell by nearly 11 per cent between 2008 and 2012 and by 2 per cent in 2012.

Potential benefits

BIS' impact assessment of the 2012 audit exemption changes also estimated that the audit reforms would generate significant cost savings for newly qualifying companies of between £168 million and £240 million for small companies and between £80 million and £299 million for qualifying subsidiaries in terms of unspent audit fees[61]. A possible reduction in the cost of capital for (small) companies who choose voluntarily to have an audit was also expected.

As regards newly qualifying dormant companies, savings of about £19 million were expected on an annual basis[62]. These savings were expected to mainly stem from a reduction in management time spent on the preparation and filing of accounts.

Many companies that are eligible for audit exemptions continue to undertake voluntary audits. Evidence from the literature suggests that there are various reasons explaining business decisions to undertake voluntary audits. Dedman et al. (2013) examined the determinants of voluntary audit in a sample of 6,274 companies that recently dispensed with audits[63]. Their results indicated that companies are more likely to purchase voluntary audits if: (1) they have greater agency costs[64]; (2) they are riskier (measured as those with poorer accounting performance and riskier types of balance sheet assets); (3) they wish to raise capital; and (4) they purchase non-audit services from their auditor. Overall, their results strongly support the idea that companies choose to be audited when it is in their interests to do so.

Similarly, research conducted by Collis (2010) indicated that a large proportion of audit-exempt entities still choose to have an audit – voluntary auditing was estimated to be undertaken by about 40 per cent of audit-exempt entities in 2008[65]. The author found that some companies may voluntarily pursue audits "for the discipline it imposes, the continuity it provides […] and to keep everyone honest."[66] The author also reported that about 50 per cent of the companies that have taken advantage of audit exemptions do not think there have been significant cost savings.

Additionally, under UK legislation, shareholders may still request that accounts be audited if they own at least 10 per cent of shares (by number or value)[67].

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[60] Financial Reporting Council, 2013. 'Key Facts and Trends in the Accountancy Profession'
[61] BIS, 2014. 'Impact assessment: audit exemptions'
[62] BIS, 2014. 'Impact assessment: audit exemptions'
[63] Dedman, E. et al., 2013. 'The Demand for Audit in Private Firms: Recent Large-Sample Evidence from the UK'
[64] Agency costs usually refer to the conflicts between shareholders and their company's managers. A shareholder, for instance, would want the manager to make decisions which will increase the share value. Managers, instead, would prefer to expand the business and increase their salaries, which may not necessarily increase share value (source: investinganswers.com).
[65] Collis, J., 2010. 'Directors' views on accounting and auditing requirements for SMEs (small to medium-sized enterprises)'
[66] Collis (2014) cited in Bagshaw,K., 2014. 'Checks and balances: audit exemptions for small business'
[67] Insight strategic associates, date unknown. 'Audit exemptions'

Potential costs

Companies taking up audit exemptions, following the changes to the eligibility criteria in 2012, were estimated to face transitional costs of between £60 million and £150 million in the first year[68]. These costs were expected to largely take the form of one-off legal costs, especially to those companies who choose to seek external advice about the operation of the parent company guarantee in the first year of operation. Ongoing costs (such as annual internal legal costs) at the group level were also expected for about 30,000 groups.

In addition to direct (business) costs, other evidence from the literature suggests that simplification measures, such as audit exemptions, could potentially lead to a loss of transparency in information-sharing[69]. A major concern raised is that reduced financial information could adversely impact on companies – it could become more difficult for exempt companies to obtain third-party finance if their financial accounts are not subjected to audit as they might be perceived as being less credible by providers of finance.

Updated estimates of the take-up of audit exemptions

BIS' impact assessment of the 2012 audit exemption changes[70] stated that, according to data from Companies House, the number of non-audited companies was 1,398,400 in 2009/10. This represented 86 per cent of all non-dormant companies that had registered annual accounts at Companies House. This was significantly higher than the earlier Collis study from 2008, which had estimated take-up of the small companies audit exemption to be lower at around 60 per cent, although this was based on research with slightly larger small firms[71]. The impact assessment of the 2012 audit exemption changes therefore assumed a take-up range of between 60 and 85 per cent.

Companies House provides annual reports and data based on the Companies Register, the latest of which is the 'Companies Register Activities: Statistical Release 2014/2015'. Replicating the analysis from the 2012 impact assessment with the latest data from Companies House suggests that, in 2014/15, 1,814,900 companies in the UK did not have their individual (non-group) accounts audited[72]. These companies represented 90 per cent of all non-dormant companies that had registered annual accounts at Companies House in 2014/15. This suggests an additional 416,500 companies have taken up an exemption from audit compared to 2009/10. This represents an increase of 30 per cent, which is greater than the 25 per cent growth in the overall number of non-dormant companies over the same period[73].

BEIS also provided an analysis of company data, using data from the FAME database, to inform this study. It estimated there to be 3,200,200 active / live companies in the UK in 2015, of which 1,997,900 were recorded as having unaudited accounts. This information suggests that 62 per cent of UK companies had not undergone an audit in 2015.

These findings suggest that the take-up of the small companies audit exemption was between 62 and 90 per cent of registered UK companies in 2015. This is broadly consistent with the

[68] BIS, 2014. 'Impact assessment: audit exemptions'
[69] BIS, 2013. 'Simpler financial reporting for micro entities: The UK's proposal to implement the 'Micros Directive'
[70] BIS, 2014. 'Impact assessment: audit exemptions'
[71] Collis, J (for BERR), 2008. 'Directors' Views on Accounting and Auditing Requirements for SMEs'
[72] Companies House, 2015. 'Companies Register Activities 2014/15' (Table F2: Annual Accounts Registered at Companies House by Accounts Type 2010-11 to 2014-15)
[73] BIS, 2014. 'Impact assessment: audit exemptions'

range quoted in the impact assessment of the 2012 audit exemption changes. It suggests that take-up may have increased slightly over time, which could be due to the changes to the eligibility criteria in 2012. This remains a fairly wide range, although the experience of this study suggests that the Companies House data is likely to provide a more accurate and robust estimate of take-up.

These figures relate to registered companies. There are also a large number of unregistered companies in the UK, which are typically small companies that are unlikely to submit audited accounts. Additionally, the above information does not describe:

- the number of companies eligible for the small companies audit exemption (based on turnover, asset values and number of employees);
- the characteristics of eligible companies taking up or not taking up an exemptions; and
- the number and characteristics of companies that became eligible following the changes to the eligibility criteria in 2012 (having previously been ineligible).

Addressing these issues requires more comprehensive data than is currently available. However, to inform this study, BEIS also undertook analysis using a combination of FAME and IDBR data (matched using company numbers) to estimate the number of companies that became eligible for audit exemptions in 2012, having previously been ineligible under the previous criteria. This analysis used IDBR data for business turnover and employment to fill gaps in the FAME data and to provide historic data to assess eligibility before the changes to the eligibility criteria in 2012. This provided a more comprehensive dataset with which to assess eligibility and take-up both before and after the changes that were introduced in 2012.

The analysis estimated that there are around 44,700 companies in the UK that became eligible as a result of the 2012 changes to the eligibility criteria for audit exemptions, having previously been ineligible. This figure is larger than the 36,300 additional companies that were estimated in the impact assessment of the 2012 audit exemption changes. The data on take-up suggests that most (70 per cent) of the additional 44,700 companies had still undergone an audit despite becoming eligible for audit exemptions. The findings therefore suggest a relatively low take-up rate of 30 per cent amongst this population.

Table 8 summarises the above estimates of take-up. It shows the high and low estimates of overall take-up rates of 62 per cent (based on FAME data) and 90 per cent (based on Companies House data). It also shows the results of BEIS' analysis of FAME and IDBR data and uses these to disaggregate the FAME estimate of overall take-up between those that were ineligible for audit exemptions until the eligibility criteria were changed in 2012 (30 per cent) and those that were eligible before and after 2012 (63 per cent).

Table 8: Summary of different estimates of take-up of audit exemptions

Source	Total number of companies taking up exemptions	Total number of companies in the population	Description of population	Take-up rate
Companies House	1,814,900	2,025,300	All 'live' (non-dormant) UK companies registering annual accounts at Companies House	90%
BEIS analysis of FAME data	1,999,700	3,200,200	All 'live' companies with a main address in the UK	62%
BEIS analysis of FAME & IDBR data	13,200	44,700	Companies ineligible for audit exemptions pre-2012 but eligible post-2012	30%
Analysis of FAME & IDBR data	-	-	Estimate of companies eligible for audit exemptions pre and post 2012	63%*

Sources: Companies House, 2015. 'Companies Register Activities 2014/15' (Table F2: Annual Accounts Registered at Companies House by Accounts Type 2010-11 to 2014-15); and BEIS analysis of FAME and IDBR data

Note: * The take-up rate for companies that were eligible for audit exemptions pre and post 2012 has been estimated from the FAME data in the above rows (as the difference between take-up rates for all registered companies and those that were previously ineligible for audit exemptions but became eligible in 2012).

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