



29 December 2011

Our ref: ICAEW Rep 124/11

Rufus Rottenberg
Spur 2, 3rd Floor
BIS
1 Victoria Street
London
SW1H 0ET

Dear Mr Rottenburg

Consultation on audit exemptions and change of accounting framework

ICAEW is pleased to respond to your request for comments on this consultation.

We support a deregulatory approach to stimulate sustainable growth and believe that audit plays a vital role in building the business confidence necessary. We continue to promote the benefits of an audit or independent assurance on financial statements, and would welcome further dialogue with you to develop cost-effective options for businesses and consumers to enhance business confidence.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

Henry Irving
Head of the Audit and Assurance Faculty

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ICAEW REPRESENTATION

CONSULTATION ON AUDIT EXEMPTIONS AND CHANGE OF ACCOUNTING FRAMEWORK

Memorandum of comment submitted in December 2011 by ICAEW, in response to the Department for Business, Innovation & Skills consultation paper on audit exemptions and change of accounting framework published in October 2011

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the *Audit exemptions and change of accounting framework* published by Department for Business, Innovation & Skills (BIS) on October 2011 a copy of which is available from this link [Audit exemptions and change of accounting framework](#).

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

MAJOR POINTS

The value of audit

4. Business confidence is vital for growth - effective financial management is crucial for this in any business. Strong financial controls and appropriate management oversight are important components for any organisation seeking to grow and build their business, no matter what their size. Audit is critical in this. It plays a vital role in the oversight and governance of companies. This is as true for many smaller businesses as it is for larger multi-nationals. It provides investors, shareholders and management with trusted independent verification of an organisation's financial statements and gives insight into how well it is being run.
5. Many small companies and subsidiaries will continue to choose to have an audit, even though they may qualify for exemption, because it provides confidence and peace of mind. It can be important to have audited accounts when selling a business, pitching for contracts or seeking finance. For those who choose not to have an audit, we continue to encourage them to seek third party assurance on their financial statements, because experience has shown that the quality and reliability of financial information can suffer when it has not been subject to an external assurance process. This is a service an ICAEW Chartered Accountant can provide.

Support for the initiative

6. We support a deregulatory approach to stimulate sustainable growth. We do not, however, believe that removing the UK's gold plating of the EU directives on audit will save UK businesses £612m per year. We have advised BIS on some of the potential percentage cost savings of not having an audit, but not on likely take-up rates or actual cost estimates on which the savings might be made. We received feedback from our members and held three regional fora which question these costs and the take-up assumptions. Some savings will be made however and would, we believe, be better re-invested in other accounting and assurance services which more closely fit the business needs of small companies and subsidiaries. There will also be some benefits lost, for example: the benefit to overall business confidence and the economy of mandatory audit for the exempted companies which do not continue with a voluntary audit. We also believe that without detailed legislation the proposed parent company guarantee will not be effective.
7. The Accounting Standards Board is currently proposing changes to UK GAAP, and one of these is a framework based on IFRS but with reduced disclosure requirements. Many of the

private companies who have previously opted to use IFRS will find this new framework better meets their needs. They will want to switch to it but, without a change to company law, will find it difficult to do so. We therefore agree with the proposed changes; relaxing the switch criteria would allow all of those companies wishing to take advantage of the new regime to move as well as offering relief to those currently trapped on IFRS.

8. Our detailed responses are set out in the appendix in the format defined for this consultation.

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CONSULTATION ON AUDIT EXEMPTIONS AND CHANGE OF ACCOUNTING FRAMEWORK

Response form

The Department may, in accordance with the Code of Practice on Access to Government Information, make available, on public request, individual responses.

Name: Henry Irving, Head of ICAEW Audit and Assurance Faculty

Organisation: The Institute of Chartered Accountants in England and Wales

Address: Chartered Accountants' Hall, Moorgate Place, London EC2R 6EA, UK

Please state YES in the box from the list of options that best describes you as a respondent. This allows views to be presented by group type.

Preparer: Large business (over 250 staff)	
Preparer: Medium business (50 to 250 staff)	
Preparer: Small business (10 to 49 staff)	
Preparer: Micro business (up to 9 staff)	
Preparer representative body	
Accountants: over 500 UK Partners	
Accountants: 200 – 500 UK Partners	
Accountants: 100 – 199 UK Partners	
Accountants: 50 - 99 UK Partners	
Accountants: under 50 UK Partners	
Accounting bodies	YES
Legal representative or professional legal bodies	
User representative bodies	
Academics	
Regulators and Government bodies	
Individuals	
Other (please describe)	

Question 1 (para 25)

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

Comments:

Business confidence is vital for growth - effective financial management is crucial for this in any business. Strong financial controls and appropriate management oversight are important components for any organisation seeking to grow and build their business, no matter what their size. Audit is critical in this. It plays a vital role in the oversight and governance of companies. This is as true for many smaller businesses as it is for larger multi-nationals. It provides investors, shareholders and management with trusted independent verification of an organisation's financial statements and gives insight into how well it is being run.

Many small companies and subsidiaries will continue to choose to have an audit, even though they may qualify for exemption, because it provides confidence and peace of mind. It can be important to have audited accounts when selling a business, pitching for contracts or seeking finance. For those who choose not to have an audit, we continue to encourage them to seek third party

assurance on their financial statements because experience has shown that the quality and reliability of financial information can suffer when it has not been subject to an external assurance process. This is a service an ICAEW Chartered Accountant can provide.

Statutory audit is the only professional service reserved to professional accountants alone, so there is a danger, if it is not mandatory that some companies will have fewer contacts with professional accountants, using alternative advisers instead. This may reduce the objectivity used in advising, as well as providing assurance, on company accounts. Less audit means less assurance, and a possible increase in fraud as a result. Taxation and law enforcement authorities may therefore need to dedicate more of their resources to combating corporate fraud.

This question is therefore wider than the proposals dealt with in the consultation. In summary, we support the alignment of the basis for audit exemption with the accounting definition of a small company. In principle, we can also see merit in the proposal to exempt subsidiaries from the audit requirement where certain conditions are met, primarily the provision of a guarantee from the parent company. In this case, however, we consider that the proposals are insufficiently developed to justify the major change they would entail and suggest that further consultation is needed, once the proposals have been more fully developed.

The overall principle of reducing audit requirements for unlisted companies involves balancing the benefits of audit with the cost it entails. This balance depends on the company or group's situation and directors should be encouraged to seek professional advice.

Question 2 (para 29)

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

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

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

A	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No	<input type="checkbox"/> Not sure
B	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No	<input type="checkbox"/> Not sure
C	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<input checked="" type="checkbox"/> Not sure

Comments:

We do not believe that removing the UK's gold plating of the EU directives for auditing small companies will save these businesses £205-292m per year. Due to the filing of abbreviated accounts, amongst other issues with the data, assumptions have been used to arrive at this number.

Feedback from our consultations with ICAEW members would suggest that a more prudent estimate of potential savings would be appropriate, with the cost of individual audit for small businesses and small subsidiaries more typically less than £4,000 rather than £9,500. Most of our members consulted do think that over 75% of these small private companies will take up the exemption. These savings, we believe, would be re-invested in other accounting and assurance services which more closely fit the business needs of small companies and subsidiaries, and therefore we do not agree that the whole of the audit fee will be saved.

It is difficult to estimate whether management time will be saved for small companies taking up the audit exemption. There may be some saving of management time but for the reasons given above we think that the savings are overstated when there will still be a requirement for the directors to prepare and file financial statements that comply with the Companies Act. If the company decides to prepare and file its own accounts then more management time may be spent. In this case the benefits of interaction with and external qualified accountant will be lost.

Question 3 (para 33)

Do you agree that the audit and accounting exemption for small companies should be aligned and a small company should be able to obtain the audit exemption if it meets two out of the three criteria?

☒ Yes ☐ No ☐ Not sure

Comments:

Question 4 (para 36)

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

☐ Yes ☐ No ☒ Not sure

Comments:

As we stated in our memorandum TECH 3/01 submitted in February 2001 in response to the consultation on 'Modern company law for a competitive economy: completing the structure':

"We believe that there may be limited benefits in a regime that would permit certain wholly-owned subsidiary companies to be exempt from the requirement to produce audited accounts. However the cost savings of such a regime must not be overstated and we fear that the costs of the regime may not be matched by the benefits....Subsidiary companies will still be required to prepare accounts that are acceptable to [HMRC] who may not be satisfied if the lack of audit reduced the reliability of the information for tax purposes. Subsidiary companies will also have to provide information to group auditors for the purposes of group audit.

The regime should only be available for wholly-owned subsidiaries and the parent company's guarantee must be completely effective and cover all actual and contingent liabilities existing at the time the election takes place and thereafter."

International Standards on Auditing (ISAs) require that all material "components", such as subsidiary companies, of a group are audited as part of the audit of the group's accounts, so it is correct to estimate that the whole of the audit fee will not be saved. In addition, many of our members consulted believe that less than 75% of subsidiary companies will take up this exemption with some being uncertain about how these subsidiaries may react, in part because it does not incorporate an exemption from filing.

We therefore advise government to consider in detail the method and effectiveness of implementing this in law (for reasons explained below and in responses to later questions, particularly question 20) and consult further before implementing this option, once the proposals have been more fully developed. At the moment, both the nature and extent of the proposed guarantee remain unclear.

The provision of an open-ended guarantee makes substantial changes to the nature of a limited liability company and blurs the distinction between a parent company and its subsidiaries. Such a change may also generate risks and liabilities for government. If a guarantee is not effective and consumers are affected (perhaps in household names, for example some utility companies) then government may be put under pressure to intervene. There are some similarities with the air travel organisers licensing scheme (ATOL) to protect travellers whose travel company fails. This risk was covered by the industry but is now underwritten by government as privately organised cover was not always effective. Similarly, we have concerns about the practical ability of parties potentially covered by the guarantee, such as consumers, to enforce the guarantee in other jurisdictions given the additional costs that this would involve.

We welcome further dialogue to develop effective options for groups and consumers in this area.

Question 5 (para 36)

Under Option C, what would be the effect of exempting qualifying non-dormant subsidiaries from mandatory preparation of accounts, mandatory filing of accounts and mandatory audit of accounts?

Comments:

The risk of fraud and error will increase adversely affecting business confidence which is vital for growth. Again, as we stated in TECH 3/01:

“We ...fear that were the regime to fail, it would undermine the...liberal rescue culture for companies”

However, as this is not what is being proposed and so accounts will still be filed we believe that other accounting and assurance services which more closely fit the business needs of small companies and subsidiaries will help maintain business confidence so long as the parent company guarantee is effective.

Question 6 (para 38)

Do you agree that the Government should exempt qualifying dormant subsidiaries of whatever size from mandatory preparation, mandatory filing and mandatory audit of accounts? What difference would this make to your business and to the wider economy?

☒ Yes ☐ No ☐ Not sure

Comments:

As stated in our answer to Q5, the risk of fraud and error will increase adversely affecting business confidence which is vital for growth. However, this is less likely to be case for dormant subsidiaries that, by definition, are not economically active. The main risk is that companies will take the exemption when they are not dormant.

Question 7 (para 40)

A Do you agree that in addition to the Article 57 exemptions, in order to qualify, a subsidiary company should be unquoted, not involved in financial services or insurance and not fall into the category of certain other companies under industrial relations legislation, in line with the existing exclusions from the audit exemption in UK company law?

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

A ☒ Yes ☐ No ☐ Not sure

B Comments:

More creditor and consumer protection is required for the companies excluded from the audit exemption proposals.

Question 8 (para 40)

What would be the consequences (e.g. to investors, depositors or lenders or to the wider economy) of allowing financial services subsidiaries to take advantage of this exemption?

Comments:

The risk of fraud and error in this area would increase for investors, depositors and lenders

Question 9 (para 41)

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

☒ Yes ☐ No ☐ Not sure

Comments:

Subject to our concerns on the proposals in relation to qualifying subsidiary companies, we can see no reason why LLPs or unregistered companies should be treated any differently from registered companies.

Question 10 (para 46)

Do you agree with our estimate of the savings of the cost of the audit as detailed in the impact assessment, and in particular the underlying assumptions:

A That the average cost of the audit is in the range of £8,000 to £83,000 per subsidiary?

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

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

A	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No	<input type="checkbox"/> Not sure
B	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<input checked="" type="checkbox"/> Not sure
C	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No	<input type="checkbox"/> Not sure

Comments:

Feedback from our consultations with ICAEW members would suggest that a more prudent estimate of potential savings would be appropriate, with the cost of individual audit for small businesses and small subsidiaries more typically less than £4,000 rather than £9,500.

Many of our members consulted believe that less than 75% of subsidiary companies will take up this exemption with some being uncertain about how these subsidiaries may react, in part because it does not incorporate an exemption from filing.

International Standards on Auditing (ISAs) require that all material “components”, such as subsidiary companies, of a group are audited as part of the audit of the group’s accounts, so it is correct to estimate that the whole of the audit fee will not be saved. We have previously advised BIS that 10-20% of the annual subsidiary audit fee might be saved if the proposals were implemented.

Question 11 (para 46)

Do you agree with our estimate of the saving of management time interacting with the auditor and in particular, with our underlying assumptions that for subsidiary companies the saving will be 5 hours of senior management time, which gives rise to £60 to £273 saving per company, depending on size of company?

☐ Yes ☐ No ☒ Not sure

Comments:

Feedback from our members was mixed on this question.

Question 12 (para 46)

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

☐ Yes ☐ No ☒ Not sure

Comments:

Feedback from our members was mixed on this question.

Question 13 (para 47)

Do you agree with our estimate of the cost of taking legal advice of £110 per subsidiary in the first year only, but that if the Government provided guidance on an acceptable form of the guarantee, this cost of legal advice would be zero?

☐ Yes ☒ No ☐ Not sure

Comments:

Feedback from our members indicated that legal advice would cost much more than £110 per subsidiary, would be needed more than once as companies circumstances change, and would be incurred notwithstanding the provision of an acceptable form of guarantee by government. Directors would need advice on whether implementing the guarantee was appropriate for their personal position and the group's circumstances.

Question 14 (para 49)

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

☐ Yes ☒ No ☐ Not sure

Comments:

Question 15 (para 49)

Do you agree with the Government's conclusions on the likely impacts that would have been involved in exempting non-dormant qualifying subsidiaries from either preparation or filing of accounts and that the costs of such a proposal would likely exceed the benefits?

☒ Yes ☐ No ☐ Not sure

Comments:

Question 16 (para 51)

Do you agree with the assumption that it is unlikely that the Government's proposals will have a significantly adverse impact on the number of small audit firms?

☐ Yes ☒ No ☐ Not sure

Comments:

Many small companies and subsidiaries will continue to choose to have an audit, even though they may qualify for exemption, because it provides confidence and peace of mind. Some companies will choose not to have an audit and small audit firms will be able to provide other accounting and assurance services which more closely fit the business needs of these companies and subsidiaries.

It is likely, though, that if these proposals were implemented this would reduce the number of small audit firms, as some would find that they were no longer dealing with any clients requiring an audit or would cease to undertake audits on the basis that the costs of maintaining authorisation to undertake audits would be greater than the benefits of doing so, given the small number of clients they would then have requiring audits. Some of these firms might retain status as registered auditors, however, in order to be able to undertake other work for which such status is currently required, for example under the Solicitors' Accounts Rules. There is no clear indication from our member feedback on how exactly these proposals will impact them, possibly due to a lack of information on what is proposed for subsidiaries.

The reduction in the number of smaller audits may also have an impact on the ability of smaller firms to provide sufficient training to auditors working with them on training contracts and smaller firms may have to give up their role as training firms, reducing the supply of qualified accountants, particularly into the smaller companies sector.

Question 17 (para 55)

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

☐ Yes ☒ No ☐ Not sure

Comments:

The issue of the quality of the unaudited financial statements is not addressed in the consultation. Experience has shown that first year audits of companies that have previously taken advantage of the audit exemption often identify inadequacies in the prior year accounts and in some cases this may lead to prior year adjustments. The government should not overlook the issue of the quality of the financial information that will be available to the market and the damage to business confidence that will result from reliance on poor quality or unreliable financial information.

For example, poor quality unreliable statutory accounts can be an indicator that the underlying management accounts which companies use to run their business are also flawed. These flaws could lead to going concern issues because the directors may be making decisions based on inaccurate information which, in turn, may not be disclosed. This would be very damaging to the company, and if repeated across many small or fewer large companies could affect business confidence more widely.

Question 18 (para 59)

Do you agree that the guarantee should be irrevocable and in respect of all debts in respect of that financial year? Until an audited set of accounts for the subsidiary is filed it will also be in respect of future debts incurred by the subsidiary

☒ Yes ☐ No ☐ Not sure

Comments:

If this exemption was enacted it would mean that major trading subsidiaries would be exempt from audit. So, companies like Thames Water or BAA, the airport operator, both of whom are part of groups consolidated in the EU would no longer need to file audited accounts so long as they had a parent company guarantee. The consolidated accounts of the group would, of course, still be audited.

The form of the guarantee has not been set out, but presumably to make this option attractive to business it would need to be well defined in scope and coverage. Arguably, an effective guarantee from a financially stronger parent company to its subsidiary offers better protection to the creditors of a subsidiary company than a set of audited accounts, perhaps over a year old at the time of a transaction with the company, but this public interest benefit needs to be balanced against the benefits to business of limited liability for subsidiaries.

In 2001 the company law review looked at whether the UK should enact the full exemptions available under article 57 of the 4th directive to exempt subsidiary companies from audit together with preparing and filing accounts. ICAEW's response was published in TECH 3/01 agreeing that there might be limited benefits of an elective regime which would replace audit and accounts with a guarantee but the guarantee would have to be effective though, both in a legal and business sense (the parent company should have access to assets to honour the guarantee for example) and this might make it costly, complex and unattractive to groups.

If the guarantee covered only the debts rather than all the liabilities of the subsidiary, this may simplify its implementation somewhat, but is arguably not in the public interest as trade creditors might have their debts covered whereas consumers who have third party claims might miss out.

Notification, certainty and coverage of the guarantee is key to protect creditors, who may also be consumers, who, for example, may have paid in advance for utility company supplies. Legislation

would therefore be necessary to implement this proposal and ensure fair treatment of claimants in the case of insolvency.

We advise government to consider in detail the method and effectiveness of implementing the guarantee in law (for reasons explained in responses to later questions, particularly question 20) and would be very willing to discuss the options developed

Question 19 (para 60)

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

☐ Yes ☒ No ☐ Not sure

Comments:

Limiting the guarantee to debts will be more attractive to groups, but may not be in the public interest, as mentioned in our response to question 18. In addition, contingent liabilities often arise out of contracts (for example in construction). The proposed exclusion of contingent liabilities is therefore inconsistent with the suggested definition of debts. Also, it should be considered whether, for public interest reasons, tort liabilities should be included to cover claims for damages. Finally, the guarantee may be difficult to justify in some circumstances where some claimants may have claims against the parent company, but others will only have claims against the subsidiary they have been dealing with. All classes of creditors may therefore not be treated fairly.

It is not clear to us that the intention of the EU directive was for the guarantee to cover only ‘debts’. The directive refers to ‘commitments’ and we are unable to comment on whether limiting the guarantee to ‘debts’ is consistent with EU law.

Question 20 (para 63)

A Do you agree with the proposals for the Guarantee?

B Do you think the form of the proposed guarantee will encourage its take-up in line with our assumptions above (75-90%)? If not, why not?

C Do you have alternative proposals that would not gold plate the Directive, provide adequate protection for those to whom the subsidiary owes a debt, but do not make it unlikely that the parent would issue such a guarantee?

A	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No	<input type="checkbox"/> Not sure
B	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No	<input type="checkbox"/> Not sure
C	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No	<input type="checkbox"/> Not sure

Comments:

We start from the position that an effective guarantee from a financially stronger parent company to its subsidiary offers better protection to the creditors of a subsidiary company than a set of audited accounts, perhaps over a year old at the time of a transaction with the company, but this public interest benefit needs to be balanced against the benefits to business of limited liability for subsidiaries. Notification, certainty and coverage of the guarantee would be key to protect creditors.

It should be noted that the exemption in Ireland and Germany includes an exemption from filing. So, take-up rates may be motivated by the desire for confidentiality as well as saving time and money in these countries. The take-up rates may, therefore, be much lower in the UK where accounts still need to be filed for non-dormant subsidiaries. The majority of feedback from our members consulted supports take-up rates of less than 75%, though around 20-25% are uncertain how these companies will react.

The introduction of guarantees to protect unaudited subsidiary company creditors is a major change to the company law framework in the UK. We are not qualified to comment on how such a change in the law can be made effective yet attractive to companies, but would be pleased to discuss the practical implementation and effects of options. The guarantee sought cannot, practically, be provided by a legally binding contracts between the guarantor and the multitude of beneficiaries of the guarantee (who are the ones to whom legal rights must accrue), so some other legal means of implementation, to make it legally effective for the beneficiaries, would need to be explored. We note, in particular, that the use of group comfort letters commonly used in group audits are not legally binding on the parent and do not involve the creditor so cannot be used.

We advise government to consider in detail the method and effectiveness of implementing the guarantee in law and would be very willing to discuss the options developed

Question 21 (para 65)

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

☒ Yes ☐ No ☐ Not sure

Comments:

Question 22 (para 76)

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

☒ Yes ☐ No ☐ Not sure

Comments:

We agree that there should be some restrictions but they should be kept to a minimum. As explained more fully below, the only restriction should be that the directors believe that there are good reasons for the change and that those reasons are disclosed. We do not favour the retention of a list of specified circumstances which can easily become out of date.

In principle it is important that consistency be maintained from one period to the next and as assets, liabilities or profits may vary when computed under different GAAPs it is clearly desirable to minimise changes. In practice we would not expect companies to alter their accounting basis without a strong reason for doing so and invariably this is likely to be linked to a change in circumstances. Making such a change is also likely to be costly. Therefore we do not agree with the phrase preceding paragraph 83, 'there are additional benefits of companies being able to move regularly between IFRS and UK GAAP'; companies may benefit from being able to move *when necessary* between GAAPs but it is not desirable for them to move *regularly*.

Nevertheless, there are circumstances where a change is clearly warranted. The current Companies Act sets out certain specified circumstances and permits the switch in these cases. Unfortunately this list is not exhaustive and there are other cases where a switch is also clearly desirable. As the paper recognises a common example involves AIM. One of the circumstances where the Companies Act currently permits a switch back to UK GAAP is where 'the company (or its parent) ceases to have its securities admitted to trading on a regulated market in an EEA state.. AIM is not a 'regulated market' and therefore companies delisting from this exchange, despite having been required to adopt IFRS on admission, are not permitted to move back to UK GAAP. This is unduly onerous and it is a situation that in our opinion should be remedied. In addition to this it will be necessary to allow companies the option of moving back to UK GAAP should the ASB's proposals to introduce a version of IFRS with reduced disclosures be introduced for subsidiaries. Many of the companies that opted to move to IFRS did so to achieve consistent recognition and measurement policies with their parent company. Once the reduced disclosure regime is introduced this rationale will no longer apply, and therefore these companies should be

offered the opportunity to move over to the new regime. Currently they would be prevented by section 395.

Therefore we believe there is a strong case for relaxation. The paper recognises that there are a number of ways in which this might be achieved and views vary as to which is most appropriate. We believe that the current list of circumstances is clearly incomplete and even if extended is vulnerable to becoming out-dated over time. It would be better to move away from a prescriptive list toward a more flexible methodology. This could be achieved in two ways.

Our preferred solution is option (d) under which companies that prepare their accounts under IFRS would be able to move to UK GAAP without restrictions. In practice, companies will not wish to incur the substantial costs of changing accounting frameworks frequently unless there are good reasons. We therefore suggest that the legislation is drafted to permit a change where the directors believe that there are good reasons for the change. The reasons should be disclosed in the accounts. Any concerns about companies seeking taxation benefits through frequent changes of accounting framework are better dealt with through tax legislation. It is noteworthy that the proposed new UK GAAP is derived from the IFRS for SMEs which, in turn, is based on the same underlying framework as IFRS. Therefore, the arguments that justified the original restrictions are no longer valid.

However, in the event that this deregulatory approach does not achieve acceptance, we believe that, as a minimum, a change from IFRS to UK GAAP should be permitted at least every five years.

Question 23 (para 76)

How frequently should a company be able to move from IFRS to UK GAAP, unless there is a relevant change in circumstances?

☐ Every year ☐ Once every 3 years ☒ Once every 5 years ☐ Never ☐ Not sure

Comments:

Please see our answer above. Change should be permitted where the directors believe that there are good reasons. If a time based criterion were to be used we would suggest that five years is appropriate. To change within three years is likely to damage consistency.

Question 24 (para 78)

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

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

A ☒ Yes ☐ No ☐ Not sure
B ☐ Yes ☒ No ☐ Not sure

Comments:

Our response assumes that the change takes place in conjunction with the ASB's proposed reduced disclosure framework. We believe that this framework provides a good solution for subsidiaries and will be warmly welcomed. Therefore take-up rates are likely to be high. The saving each company will achieve is likely to be significant. They may well exceed £569 per annum for some companies.

Question 25 (para 82)

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

☐ Yes ☒ No ☐ Not sure

Comments:

We have not conducted any research into the likely costs and these will vary from one company to another. Changing GAAP can be a complex exercise and costs will be significantly more than £390 in some cases. However, companies should be free to make this judgement and many are likely to conclude that the on-going benefits will exceed the one off costs.

Question 26 (para 86)

Do the proposed changes in any way increase the risk of financial irregularities? If so, what would you estimate the potential impact to be on investors?

☐ Yes ☒ No ☐ Not sure

Comments:

Please see our answer above. There is a small risk that without regulation in this area arbitrage could occur by switching GAAPs, although this is likely to be mitigated by the relatively high costs of transition. However, we believe the suggestions we set out above will mitigate this risk.

Question 27 (para 27)

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

☐ High risk ☒ Low risk ☐ Not sure

Comments:

Change should certainly be restricted in some way. As we set out above, comparability can be reduced by a change in accounting framework and therefore such changes should be minimised. However, we believe the suggestions we make above should serve to minimise this risk.

Question 28 (para 86)

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

☒ Yes ☐ No ☐ Not sure

Comments:

We agree with this assessment. It is not desirable for companies to change their accounting basis without good reason. However, there are some companies now inappropriately trapped on IFRS and many more that will need to change back to UK GAAP when the new reduced disclosure framework becomes available. Consequently it is necessary to make some change to the current regime.

Question 29 (para 87)

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

☒ Yes ☐ No ☐ Not sure

Comments:

Do you have any other comments that might aid the consultation process as a whole?

Please use this space for any general comments that you may have, comments on the layout of this consultation would also be welcomed.

Both the nature and extent of the proposed guarantee remain unclear in the consultation.

We therefore advise government to consider in detail the method and effectiveness of implementing this in law and consult further before implementing this option, once the proposals have been more fully developed.

Thank you for taking the time to let us have your views. We do not intend to acknowledge receipt of individual responses unless you tick the box below.

Please acknowledge this reply ☒

At BIS we carry out our research on many different topics and consultations. As your views are valuable to us, could we contact you again from time to time either for research or to send through consultation documents?

☒ Yes

☐ No

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