 Regulatory Policy Committee	Opinion	
Impact Assessment (IA)	Audit Exemptions	
Lead Department/Agency	Department for Business, Skills and Innovation	
Stage	Final	
IA number	BIS0301	
Origin	Domestic	
Expected date of implementation	SNR 4	
Date submitted to RPC	26 March 2014	
RPC Opinion date and reference	1 May 2014	RPC11-BIS-1004(3)
Departmental Assessment		
One-in, Two-out status	OUT	
Estimate of the Equivalent Annual Net Cost to Business (EANCB)	-£304.26 million	
RPC Overall Assessment	GREEN	
RPC comments		
<p>The IA is fit for purpose. The Department has addressed the Committee's concerns over the robustness of the assumptions underpinning the equivalent annual net cost to business (EANCB). In particular, the Department has (i) lowered its best estimate of the take-up rate of the exemption by subsidiary companies from 75% to 50%, and (ii) excluded the highest 2.5% of audit fees, reducing the mean audit fee from £9,500 to £7,700 for those that take up the exemption. This reduced the resulting estimated savings to business from £390 million each year to £304 million each year.</p>		
Background (extracts from IA)		
<p>What is the problem under consideration? Why is government intervention necessary?</p>		
<p><i>“Audit requirements in the UK do not allow as much flexibility to companies as currently available under EU requirements. This gold plating reflects government failure and creates a market inequality by restricting the ability of UK subsidiaries with a UK or EU parent from taking up a possible audit exemption and the associated cost savings.”</i></p>		
<p>What are the policy objectives and the intended effects?</p>		
<p><i>“There are three areas where the Government has decided to intervene: (a) align audit with accounting exemptions for small companies; (b) permit companies to reduce the costs of audit of subsidiary company accounts; (c) permit companies to reduce the cost of financial statement preparation and filing for subsidiary dormant companies. The policy objectives are: (a) to implement the Government’s commitments in the Plan for Growth, published in March 2011; (b) to be more</i></p>		

targeted in applying rules on company reporting, accounting and audit in order to reduce the burden of regulation on companies; (c) to recognise the public interest in having an amount of accounting information about active companies on the public register.”

Comments on the robustness of the OITO assessment

The IA says that this is a deregulatory proposal (an ‘OUT’) with an estimated equivalent annual net saving to business of £304.26 million. This is consistent with the current Better Regulation Framework Manual (paragraph 1.9.11). Based on the evidence presented, this provides a reasonable assessment of the likely impacts. The basis of this estimate is explained below.

Comments on the robustness of the Small & Micro Business Assessment (SaMBA)

The proposals reduce the scope of regulation on business. A SaMBA is, therefore, not required. The proposal will benefit small companies. An estimated additional 36,314 small companies will qualify for an audit exemption and, therefore, potentially make savings in audit fees. The IA considers (pages 24-25) potential adverse impacts on small audit companies resulting from reduced demand for their services. It provides evidence for why the impacts will be limited by continuing demand for their other services.

Quality of the analysis and evidence presented in the IA

The Department proposes to:

- align audit and accounting exemptions for small companies;
- exempt subsidiaries from mandatory audit where they fulfil certain criteria; and
- exempt dormant subsidiaries from all accounts preparation and filing requirements.

As a result of this, an estimated additional 36,314 small companies and 83,000 subsidiary companies will qualify for an audit exemption. Based upon available evidence and informed by consultation with stakeholders, the Department assumes that 60% of small companies (21,800 firms) and 50% of subsidiaries (41,500 firms) take up the exemption. Using analysis of audit fees recorded on the Financial Analysis Made Easy (FAME) database, the Department estimates that the average audit fee saved by small companies is £7,700. The average estimated saving for subsidiaries is lower, at approximately £3,360, using an assumption that only 17.5% of audit costs are saved. This lower fee estimate for subsidiaries is based upon discussions with stakeholders and reflects the fact that some audit work will still be required at subsidiary level for the purposes of the group audit. The savings of £167.8 million to small companies and £139.4 million to subsidiaries account for nearly all of the overall savings to business.

The Department has addressed the Committee's concerns, as first expressed in its opinion of 28 May 2012. These concerns were mainly around the limited evidence for the assumptions regarding:

- i) the take-up rate of the exemption by subsidiary companies;
- ii) the mean audit fee avoided by small companies.

On (i), the Department initially assumed a take-up rate in the range of 75-100%. The present IA assumes a range of 50-75%, with a best estimate of 50%. This appears to reflect better information from the consultation with stakeholders.

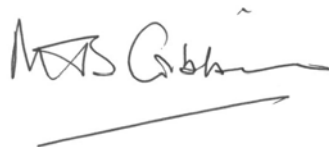
On (ii), the Department has excluded the highest 2.5% of audit fees (those above £37,000), reducing the mean audit fee from £9,500 to £7,700. This was informed by the sensitivity analysis requested by the Committee and appears to be a more robust assumption.

Overall, the EANCB of -£304.26 million represents a substantial revision from that originally submitted (-£390 million). The revised assumptions for subsidiary take-up and mean audit fee account for about 60% and 40% of the change to the EANCB, respectively.

Given the estimated savings to business rely on a number of untested assumptions about take-up of the exemption, it will be important for the Department to put in place arrangements to monitor take-up rates and changes in audit fee costs. These data can subsequently inform any post-implementation review of the policy in the future.

Upon request from the Committee, the Department provided further information on the calculations and assumptions underpinning elements of the EANCB. For example, this included the average audit fee for each subsidiary size band that is used in the calculation of the £139.4 million total saving to subsidiaries. It would be helpful if this information were included in the IA before its publication.

Signed



Michael Gibbons, Chairman