



THE COMPANY LAW REVIEW

THE BENEFICIAL IMPACT OF
RAISING AUDIT THRESHOLDS FROM £350,000 TO £1,000,000

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BY

THE SOCIETY OF PROFESSIONAL ACCOUNTANTS

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Whilst the views expressed in the report do not purport to be representative of all small practitioners, they are the views of a large and significant number of practitioners and, in the absence of any measurable negative attitudes to SPA, it may be reasonable to accept that they are representative of the majority.

THE BENEFICIAL IMPACT OF RAISING AUDIT THRESHOLDS

1. EXECUTIVE SUMMARY

1.1 SPA's 2002 and 2003 Surveys Provide Positive Feedback

The findings of recent surveys have reinforced SPA's earlier opinion that there was little to be feared from raising audit thresholds for private owner/managed limited companies where no public interest existed, conversely that real savings have been obtained:

1.1.1 Benefits to the Accountancy Practitioner (Section 3.1)

Introduction of the higher audit threshold of £1M has generally been warmly received by smaller practices, the large majority of whose fee income has risen despite fewer audits being undertaken.

1.1.2 Benefits to the Corporate Client (Section 3.2)

The transition has been unremarkable in terms of encountered difficulties, with corporate clients benefiting from lower annual professional charges and better use of managerial time.

1.1.3 Little Evidence of Detriment to Third Parties (Section 3.3)

Extremely few instances were noted of problems experienced by third party users of accounts of companies not now audited.

1.2 Opportunity to Increase Threshold to EU Level of £4.8m

There appear to be few persuasive commercial, professional or statutory arguments why the European threshold of £4.8m should not be introduced, together with the evident economic benefits that would then be provided to small companies affected of perhaps £100m pa in reduced professional charges (Section 4.6); the opportunity remains for statutory audit to be performed voluntarily or on demand for third party interests.

1.3 Benefit of Appointing a Professionally Qualified Accountant (PQA)

1.3.1 SPA would prefer that, to ensure continuity of compliance with Accounting Standards, Company and Taxation Law relating to small limited company accounts, a PQA should be appointed to every limited company before it commences trade and that this appointment should form part of Companies House Annual Return information.

1.3.2 Given the ethical and technical standards PQAs must maintain, together with adequate professional indemnity insurance and annual regulation, such an appointment should provide consistency and reliability of all corporate accounts whether audited or not.

1.4 Uneven Playing Field Remains

It appears to SPA that the general public remains largely unaware that unqualified or unregulated ‘accountants’ may be providing their accountancy or taxation services, which cannot be in their best interests, and SPA would prefer that all such ‘practices’ be licensed and subject to regulation to ensure acceptable minimum standards are maintained, namely:

- Liability insurance is maintained
- Continuous technical training is undertaken

1.5 Small Charities and Non-Profit Making Organisations

It appears that savings in avoidable audit fees may be more widely available should such organisations change their written rules or constitutions.

2. BACKGROUND TO SPA

- 2.1** SPA is a wholly independent association of professionally qualified accountants in practice, predominantly members of the Institute of Chartered Accountants in England and Wales. The Society was formed in early 1996 as ‘Small Practitioners Association’ because of concerns with the perceived effectiveness of that Institute’s support for such members, and that emerging legislation or regulations did not accommodate small business realities.
- 2.2** From January 2003 the current name of ‘The Society of Professional Accountants’ was adopted to reflect increasing activities beyond the ICAEW and provide a more recognisable public image.
- 2.3** Current membership stands at over 1500 practices representing more than 1800 partners or sole practitioners, of whom in excess of 1100 are registered to carry out statutory audit. Collectively they serve some 45,000 corporate clients of which the large majority are ‘small’ by the DTI’s definition.
- 2.4** The Society’s policy is to promote and improve the relationship between members and their Institute by providing constructive criticism together with practical proposals for improvements. Further to provide commentary and proposals to other authorities influencing our practising environment.

- 2.5** SPA responded to the DTI's previous discussion documents 'Developing the Framework' and 'Completing the Structure'. This report is also consistent with SPA's earlier views given to both the DTI and ASB on statutory audit and related issues.

3. COMMENTARIES

3.1 Impact on Practitioners

3.1.1 Whilst the absolute number of registered auditors is evidentially declining (Section 4.4), 75% of SPA practices remain registered, indicating a significant continuing population of organisations and corporate clients requiring or requesting audit.

3.1.2 90% of responding practices said that, following the increase of the audit threshold to £1m, their income level had not decreased or had gone up. Of the balance 6% said income had decreased with 4% in the process of retirement (Section 4.2.3).

3.1.3 SPA stated in earlier submissions that audit services were frequently uneconomically priced to clients, which the findings in 3.1.2 tend to support. Practitioners' time freed up through fewer audits being undertaken is being put to profitable use in providing other more valued client services.

3.1.4 The most frequently provided voluntary comments within the 2002 survey were that audit remained of negligible worth to owner-managed corporate clients, secondly the introduction of the EU threshold was urged.

3.1.5 As may be known SPA arranges a group Professional Indemnity Insurance scheme for its members, which provides ongoing access to the managing brokers and underwriters. It is of note that there has been no adverse trend detected in claims arising from companies whose accounts are now not audited, indeed, the incidence of claims arising from audited accounts is extremely low amongst SPA members.

3.2 Impact on Corporate Clients

3.2.1 Smaller practices generally provide a package of services to corporate clients to include accounts production, audit and taxation, for which single annual fees are frequently found.

Respondents reported that such annual fees had been reduced on average by 10% where audit had been removed following adoption of the £1M threshold.

3.2.2 The savings in fees found in 3.2.1 take no account of the freed up management time previously absorbed by audit issues, hence two sources of increased business productivity have been identified.

3.2.3 Respondents reported extremely few instances – a fraction of 1% of the total – where the lack of audited accounts had caused business difficulties:

- One prospective purchaser ‘put off’ by the lack of an audit certificate on a business that sold readily elsewhere
- One instance of a minority shareholder demanding an audit

3.2.4 The achieved reduction in annual professional fees found in 3.2.1 suggest that further savings to the small company community may be achieved of perhaps £100M pa should the audit threshold be raised from £1m to £4.8m (Section 4.5).

3.2.5 Various organisations, including small charitable bodies and non-profit making or membership associations, frequently have the requirement for an annual audit embodied in rules written many years ago, and where all they seek is an independent overview and report. SPA believes that savings in fees and time may be extended to such groups, and that they should be encouraged to amend their rules to provide instead for an independent examination by a PQA.

3.3 Impact on Third Parties

3.3.1 A stated reason provided by certain bodies arguing for maintaining the earlier audit threshold of £350,000 was that raising future finance would prove difficult, with banks and other financial institutions mistrusting unaudited company accounts. In its earlier submission SPA suggested this argument was flawed as:

- Audit information is by definition many months old, and can form only part of the picture to lenders, who are generally more interested in current activity, order books, profit forecasts and cash flows
- Lending to small corporate businesses is rarely unsecured, and a charge is frequently taken on the business assets together with a personal guarantee of the directors

3.3.2 SPA’s recent surveys found almost no evidence of difficulty experienced by client companies in raising finance where the accounts were now unaudited:

- A bank was statedly ‘uncomfortable’ with the £1m threshold and asked that an audit be performed before extending existing finance
- One instance of credit being denied by a supplier
- An audit was requested by an H.P. company

4. METHODOLOGY AND SURVEY RESULTS

4.1 The 2002 survey was undertaken within the Society's then 1000 member practices and some 8500 other ICAEW practices of up to 5 partners on a wide range of topics. Relevant questions posed were:

"i To the nearest 50 how many business clients do you serve?"

ii Since audit exemption was raised from £350K to £1M, has your total fee income

Gone down?

Stayed the same?

Gone up?

iii In the last 6 years have you suffered any paid professional indemnity claims?

iv Are you registered for audit?"

(1004 responses were obtained, 62% from SPA members and 38% from other ICAEW practitioners. No significant differences were noted between either group's replies.)

4.2 In 2003 a further survey amongst the now 1500 member practices (181 replied) followed up the specific impact of the higher threshold, asking:

"The audit threshold was increased from £350K to £1M in July 2000, when the requirement to audit a further band of our limited company clients was eliminated. Did this event have any material or adverse impact?"

1. Please tell us whether you are aware if any clients had difficulties because no audited accounts were available:

a With their banks or HP companies in raising finance or overdrafts? Yes/No

b. With credit agencies in securing credit from suppliers? Yes/No

2. To what extent were you able to reduce your charges for preparation of accounts where audit is not now provided?

By up to 5% ? (17%)

By up to 10% ? (33%)

By over 10%? (50%)

(With 50% achieving savings of over 10% it seems reasonable to adopt this figure for the purposes of this report.)

3. *To what extent has your practice income changed overall since July 2000?*

Gone up? (53%)

About the same ? (37%)

Gone down? (10%)

(Of whom 4% were in the process of retirement and were running down their practices.)

Please add other relevant comments you wish to make "

- 4.3** This report also incorporates relevant responses from the findings of earlier surveys carried out by the Society amongst its members:
- 1997 ‘Statutory Audit – A Service or Disservice’
 - 1999 ‘The Statutory Audit requirement for Smaller Companies’
- 4.4** Statistics for audit registration levels were found from the Society’s membership database which holds details of registration under the three restricted areas of work, namely Audit, Investment and Insolvency. For Audit this was over 90% in 1999 but had fallen to 75% by 2003.
- 4.5** SPA’s 2002 survey found that on average each member practice provided services to 100 business clients of whom at least 30% (a 1999 statistic) were incorporated.
- 4.6** Quantification of potential future savings in professional charges have been derived from the following data:
- 4.6.1** Absolute savings in £pa for affected clients determined via over 50 telephone interviews with members in 1999, which established savings as an average of £350 pa.
- 4.6.2** The population of limited companies, being 250,000, which would obtain exemption from audit should the threshold be raised to £1M (DTI statistic).
- 4.6.3** Allowing for price inflation since 1999 suggests a figure of £100M pa may be adopted for the purposes of this report as a reasonable target for potential savings.
- 4.7** Commentary was provided by individual members of the Society together with discussions amongst the Society’s Steering Committee and Regional Representatives under the Chairman’s guidance.



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