



BIS
Spur 2
1 Victoria Street
London
SW1H 0ET

December 2011

Dear sirs

The British Private Equity and Venture Capital Association (“BVCA”) is the industry body for the UK private equity and venture capital industry. With a membership of over 450 firms, the BVCA represents the vast majority of all UK-based private equity and venture capital firms and their advisers. This submission has been prepared by the BVCA’s Legal & Technical Committee, which represents the interests of BVCA members in legal, accounting and technical matters relevant to the private equity and venture capital industry.

The BVCA welcomes the opportunity to respond to the Consultation on audit exemptions and change of accounting framework on behalf of our members.

We support the Government’s “*Plan for Growth*” and the overarching principle to remove regulatory burdens and improve corporate governance, to this end we have listed the answered the questions raised in the consultation paper below.

- **Question 1**

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

In general we are supportive of the proposed changes. Whilst in many instances there will be a legitimate business need for an audit to be carried out, the added flexibility from the proposals is welcome, and will act to reduce costs for those companies for whom a full audit is not appropriate – the crucial point here being that it will be a business decision by the company, and no longer a one-size-fits-all mandatory requirement.

- **Question 2**

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

We believe that many companies will take up the audit exemption however we are unable to comment on the impact assessment presented.

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

In the case of a stand-alone company the entire audit fee would be saved. However where a subsidiary company takes advantage of the exemption there will continue to be an audit cost associated with the work required on the subsidiary to meet the reporting requirements of the consolidated accounts. This will save a significant proportion of the fee particularly when it is part of a much larger group of companies.

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



We do not agree that there is no saving of management time for companies that take up the audit exemption.

Where an audit is carried out, the management of a company will work closely with the auditors to provide all necessary information. Therefore, to the extent that the small company would no longer be required to carry out an audit, there will be a significant time saving to management.

- **Question 3**

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?

We agree that the audit and accounting exemption should be aligned, and small companies should be able to obtain the exemption if they meet two out of the three criteria. We do not believe that this would add significant risks, since companies meeting two of the three criteria will still be small, and as the consultation notes, HMRC has powers to request further explanation and information on accounts.

The move would increase flexibility at the margins, ensuring that some companies that would otherwise be mandated to audit their accounts will no longer have to do so. This would put small UK companies on an equal footing to their European counterparts, meaning that they would no longer face a competitive disadvantage in terms of their business costs.

- **Question 4**

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

We agree that qualifying non-dormant subsidiaries should be exempt from mandatory auditing of their accounts. Where a company is a subsidiary and the consolidated accounts of their parent company are audited, then this will add the same value and safeguards as an audit of the subsidiary accounts. Therefore, the audit of the subsidiary accounts adds no value but does add an additional cost, and we agree with the removal of the mandatory requirement.

- **Question 5**

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?

Exempting qualifying non-dormant subsidiaries from the mandatory requirements listed would create significant time and cost savings as any necessary audit work required would be to the level of the parent company rather than the individual subsidiary.

- **Question 6**

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?



We agree that qualifying dormant subsidiaries should be exempted from the mandatory preparation, filing and auditing of accounts. The information presented in the annual return to Companies House and in the consolidated accounts of the parent company provide sufficient information to ensure that there are no wider economic implications of not producing, filing and auditing these accounts, whilst at the same time removing the administration burden that these accounts provide.

- **Question 7**

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?

We do not agree that additional requirements should have to be met to qualify, and that the Article 57 exemptions alone are sufficient.

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

We believe that appropriate safeguards are contained within Article 57 (including the requirement that the parent company guarantee the commitments entered into by the subsidiary and the requirement that the consolidated audited accounts include those of the subsidiary), such that further requirements around the nature of the business are not necessary in order to provide increased protection, and would act to reduce the number of subsidiary companies for whom the increased flexibility will bring benefits.

The aim of this consultation is to bring the UK further into line with the law that applies in other EU member states, decreasing any market inequalities. As such, we believe that the requirements that are put forward should remove inasmuch as is possible any attempts at gold-plating to level up to current UK law.

- **Question 8**

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?

- The consequences of allowing Financial services subsidiaries to take advantage of the exemption are unlikely to be significant as the entity would already need to meet the requirements of their regulatory status which should provide the necessary safeguards given the nature of their activities. **Question 9**

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

We agree that the same rules should broadly apply to LLPs and unregistered companies, as these are corporate entities classified as legal persons, and it would introduce market inequalities between the types of entity if they were disqualified from the exemptions relative to their peers.

- **Question 10**

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?

The BVCA is not in position to comment on the respective cost savings.

- **Question 11**

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?

Management spend a significant amount of time in preparation for and dealing with the necessary information required to undertake an audit. We would expect the amount of senior management time that is occupied with an audit to be significantly in excess of 5 hours and the resultant saving vastly greater than £60 - £273.

- **Question 12**

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?

Please see the answer to question 12

- **Question 13**

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?

We would envisage that the estimate of the cost of legal advice of £110 per subsidiary appears very low and the actual cost would be significantly higher. We would welcome any guarantee from the government that would reduce costs.

- **Question 14**

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

The BVCA has no comment on the changes to this question.

- **Question 15**

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?



We believe that the benefits of such an exemption would outweigh the costs and therefore we support the proposed exemption.

- **Question 16**

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?

The BVCA has no comment on this question.

- **Question 17**

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

The BVCA has no comment on this question.

- **Question 18**

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.

If a guarantee were to be provided it would need to be irrevocable in order to provide sufficient creditor protection.

- **Question 19**

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

Within private equity and venture capital transactions, debts, liabilities and warrants are dealt with by separate legal contract between the relevant parties and therefore do not present a significant issue.

- **Question 20**

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?

The guarantee should be structured with sufficient flexibility in order to allow companies to make their own informed decision as to how it should be used.

- **Question 21**

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



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

- **Question 22**

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

We agree that there should be increased flexibility in terms of allowing companies to move from IFRS to UK GAAP. However, we agree that there should be restrictions imposed on this move, to ensure that there is no potential for arbitrage.

- **Question 23**

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

We support the Government's proposal that companies should be able to move from IFRS to UK GAAP and vice versa. However, we believe that the period of change should be reduced to every year, given that a 5 year lock in period may cause companies significant issues in some instances. If companies are able to move from one accounting framework to another we would expect it to be under the proviso that the comparatives are restated accordingly with an appropriate reconciliation highlighting the impact of the changes between accounting frameworks.

- **Question 24**

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

The BVCA has no comment on this question.

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

The BVCA has no comment on this question.

- **Question 25**

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

The BVCA has no comment on this question.

- **Question 26**

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?

We believe that the proposed changes, as drafted, do not increase the risk of financial irregularities. Under company law the directors of a company are charged with the fiduciary responsibility for the entity, these changes do not alter that. Therefore any financial irregularities would remain the responsibility of the directors.

- **Question 27**



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

The risk that investors will be misled or confused by a company switching accounting frameworks will be minimal if the appropriate procedures and requirements are put in place. The reconciliation between accounting frameworks was used for the first time adopters of IFRS in 2005 and created very little investor confusion.

- **Question 28**

Do you agree with the Government's assessment of the risks of this proposal? The BVCA has no comment on this question.

- **Question 29**

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

The timetable as presented is encouraged.

Please do not hesitate to contact me should you wish to discuss the BVCA response in further detail.

Yours faithfully

A handwritten signature in black ink, appearing to read 'S. Witney', with a stylized flourish at the end.

Simon Witney

Chairman, Legal and Technical Committee, BVCA