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Title: Notices of auditors leaving office - simplification for companies and auditors IA No: 0409 Lead department or agency: BIS Other departments or agencies: None	Impact Assessment (IA)		
	Date: 01/05/2013		
	Stage: Final		
	Source of intervention: Domestic		
	Type of measure: Primary legislation		
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Summary: Intervention and Options			RPC Opinion: Awaiting Scrutiny

Cost of Preferred (or more likely) Option			
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCBS on 2009 prices)	In scope of One-In, Measure qualifies as One-Out?
£6.5m	£6.1m	-£0.6m	Yes OUT

What is the problem under consideration? Why is government intervention necessary?

The current system for notifying the departure of an auditor is overly complex. Both companies and auditors, in certain circumstances, must send statements to the audit authorities and to Companies House. BIS has received feedback from the audit authorities that the current system is a significant administrative burden but provides only limited benefit. The problem was raised again in feedback in 2012, under the Company and Commercial Law theme as part of the Red Tape Challenge. The rationale therefore is one of the unintended consequences of a legislative change, which need to be addressed. Any amendments to simplify this process must be compatible with EU Directive 2006/43/EC, the "Audit Directive".

What are the policy objectives and the intended effects?

To simplify the notification and information requirements around the departure of auditors while retaining compatibility with EU Directive 2006/43/EC. This would be done by:

- Removing the requirement for companies to inform Companies House of auditors leaving office, while retaining the obligation for auditors to notify the company and Companies House if they believe circumstances require;
- Minimising the cases where notifications have to be sent to explain reasons for the auditor's departure that are of no interest to shareholders and creditors or the audit authorities

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

- Do nothing (option 0) - not summarised as this option would have no impact.
- Simplify the reporting requirements associated with the departure of auditors, removing burdens in relation to private and non-listed companies while maintaining compliance with EU Directive 2006/43/EC (option 1).

We have concluded there is scope to simplify the reporting requirements in line with option 1. The proposals outlined under this option in the November 2009 consultation document received broad support with respondents agreeing the proposals would reduce the burden on auditors and companies and improve the regulatory framework overall. In the light of the consultation response, some of the proposals (within option 1) have been refined. Some of the assumptions underlying their impact have also been revised.

Will the policy be reviewed? It will be reviewed. If applicable, set review date: 01/2020					
Does implementation go beyond minimum EU requirements?			No		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.		Micro No	< 20 No	Small No	Medium Yes
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)				Traded:	
				Non-traded:	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible SELECT SIGNATORY: _____ Date: _____

Summary: Analysis & Evidence

Policy Option 1

Description: Simplify the reporting requirements associated with the departure of auditors

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 3.0	High: 9.9	Best Estimate: 6.5

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0.2	0.004	0.2
High	0.3	0.012	0.4
Best Estimate	0.2	0.008	0.3

Description and scale of key monetised costs by 'main affected groups'

The costs of these changes are very limited as they are generally deregulatory. However, one proposal applies the current enhanced frameworks for "major audits" and "quoted companies" to a single new group of "listed companies". Though that group is smaller, there are a small number of companies that will be subject either to the "quoted companies" framework or the "major audit" framework for the first time and incur costs as a result (proposal (f)). There will be associated familiarisation costs, which we have monetised on the basis of assumptions about the time it would take an audit firm to familiarise itself with the changes during their first year of operation (£236K).

Other key non-monetised costs by 'main affected groups'

None.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	0.4	3.4
High	0	1.2	10.1
Best Estimate	0	0.8	6.8

Description and scale of key monetised benefits by 'main affected groups'

Exemptions for auditors of non-listed companies from notifying companies, audit authorities and Companies House on leaving office (proposals (a)+(e)+(f) = £352K per year). Exemptions for listed and non-listed companies from notifying audit authorities and Companies House, and circulating statements to members when their auditors leave office (proposals (a)+(c)+(f) = £385K per year). Savings to the audit authorities resulting from proposals ((a) + (b) + (f) = £47K per year).

Other key non-monetised benefits by 'main affected groups'

Key assumptions/sensitivities/risks

Discount rate (%)

3.5%

We have assumed that the new exemptions from sending notices, and the use of simplified and standardised notices, stating the auditor's reasons for leaving office, will not increase disputes between auditors and companies. This is based on feedback during and after the BIS 2009 consultation that, based on the experience of the relevant groups (Companies House, the audit authorities and the accounting authorities), the information sent is of very little interest to them.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 0	Benefits: 0.6	Net: 0.6	Yes	OUT

Evidence Base (for summary sheets)

Executive Summary

1. The proposals within this Impact Assessment are intended to address two **problems**.

- Firstly there are the unnecessary and duplicative actions when *both* the company and auditor notify *both* Companies House and the audit authorities that the auditor of a company has left office, and the reasons for their departure. Furthermore, the audit authorities are also required to notify the accounting authorities of all notifications they receive.
- Secondly there are two minor technical issues with the legislation which have the potential to create confusion and impose legal costs on companies, if their interpretation is challenged. These are a missing definition of the “quoted companies” that are in scope of part of the framework; and an apparent loophole in a requirement for special notice of a resolution to appoint a new auditor.

2. The **rationale for intervention** is the overly burdensome framework and potential for confusion. Together these impose unnecessary costs on companies which in turn lead to a cost inefficiency with resources being wasted.

3. This regulation was identified via the Red Tape Challenge as a key area for policy change. The **policy objective**, in the light of this, is to remove the unnecessary actions and duplication and address the technical errors, thereby reducing the cost to business, whilst retaining an appropriate level of corporate governance oversight for shareholders and audit authorities. The proposals are also intended to ensure that the UK continues to meet the requirements of the EU Audit Directive (2006/43/EC).

4. The IA takes the base case of the option to do nothing. It then proposes a **single option** which comprises a package of 7 proposals:

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Proposal	Description
(a)	To exempt companies undergoing non-major audits and their auditors from explaining to the audit authority why an auditor has left. This exemption will only apply when the auditor leaves office for reasons that are of no regulatory or shareholder interest.
(b)	To remove the requirement for the audit authorities to notify the accounting authorities of all notices of auditors leaving office they have received.
(c)	To remove the requirement for the company to file a notification with Companies House when the auditor resigns or is removed by resolution.
(d)	To simplify and standardise the notices that must be sent to the audit authority, Companies House, the company and its shareholders; and to facilitate electronic communication of these.
(e)	For non-quoted companies: <ul style="list-style-type: none"> • to require the auditor to explain their departure to the company only before the end of their term of office and where the exemption under proposal (a) does not apply; • to require the auditor to file the statement with Companies House only if the auditor considers the statement needs to be brought to the attention of the shareholders or creditors of the company.
(f)	For major audits: <ul style="list-style-type: none"> • to reduce the number of companies that are subject to the enhanced framework currently applied to major audits, so it no longer applies to subsidiaries of listed companies, and the same class of companies is covered by all the enhanced requirements. • to require companies to notify the relevant audit authority of the reasons for an auditor's departure only where the exemption under proposal (a) does not apply.
(g)	To correct the drafting of the requirement for a company to give special notice of a resolution to appoint a new auditor in place of an incumbent auditor.

5. These proposals were developed in the light of the 2009, BIS Consultation on Notices of Auditors Leaving Office, and feedback received as part of the company and Commercial Law theme under the Red Tape Challenge process conducted within BIS. Care has been taken to ensure that the UK remains compliant with the EU Audit Directive and that UK law continues to facilitate effective corporate oversight by shareholders. The structure of this Impact Assessment includes an analysis of the costs and benefits of each proposal in turn.

6. In 2012, 103,611 companies in the UK filed accounts that were audited under the Companies Act 2006. Such companies would be affected by these proposals if their auditor were to leave office before the end of their term of office, and in some cases at the end of that term. For most large and medium sized companies, and some small companies audit is a mandatory

requirement of the Act. For the large majority of small companies however (and some others), audit exemptions are available. These proposals also impact on auditors themselves. There are 7,375 registered audit firms in the UK.

7. The **costs of the package of proposals in Option 1** above are driven by two aspects of the changes. Firstly there are expected to be one-off familiarisation costs for the 7,375 audit firms. For the companies being audited, however, it is assumed that given the rarity of an auditor leaving office, all companies would need to familiarise themselves with the legal process they need to go through each time – thus little or no *additional* cost would be incurred. Secondly there are ongoing costs for both auditors and companies where some additional 40 companies are newly drawn into the “major audit” framework as a result of the changes to the definition of companies in scope. Together the Present Value of these costs is around £0.3m.

8. The **benefits** are somewhat more substantial. Here there are savings by both the auditors and companies, as well as the audit authorities, through the reduction in the flow of paper and hence labour cost savings (assumed to be made by accountants). In terms of the benefits to business, the Present Value of the savings is around £6.1m. Of this, around half of the benefit is from the company not having to notify Companies House that their auditor has left office if they are removed by the company or resign. There are also some non-business benefits; the audit authorities, which are professional institutes, accrue Present Value benefits of around 0.4m.

9. The **data** in this Impact Assessment on the number of notifications and number of auditors come primarily from the audit authorities. These figures are, however, just from one year (2012) – as far as we know, there is nothing particularly abnormal about this year in terms of the number of auditors leaving office. Other **assumptions** come from the consultations with companies, auditors, professional bodies and regulatory authorities. Key assumptions are around the amount of time taken to produce the notifications and that those newly able to take advantage of the changes choose to do so. Both of these assumptions drive the expected benefits and are based on discussions with the audit authorities.

10. Small and micro companies will not be in scope of these proposals as, with the exception of some financial services providers, they have access to audit exemption under the Companies Act 2006.

11. We believe that the proposals strike the right balance between facilitating shareholder and regulatory oversight, and minimising the burdens on business. Both the shareholders and the authorities will continue to be informed of the reasons for the auditor leaving office under specific circumstances to enable active engagement with and questioning of the company involved.

12. We will **evaluate** this policy 5 years after implementation (ie in 2020 assuming commencement of legislative changes in 2015). In this we would try to determine whether the expected reduction in notifications has been achieved through contact with Companies House and the audit authorities. We expect that the impact on shareholder engagement will be difficult to isolate, however company-specific press reports, case study evidence and discussions with stakeholder contacts and organisations should inform conclusions.

13. **Overall**, these proposals are driven by the need to address the unintended consequences of a legislative change resulting in overly burdensome regulation. They are deregulatory in nature and offer annual net benefits to business of some £0.6m.

Background – Requirements of the Companies Act 2006 on auditors leaving office

14. Chapter 4 of Part 16 to the Companies Act 2006 covers the removal, resignation and non-reappointment of auditors and provides a framework in which shareholders, audit authorities, Companies House, accounting authorities and creditors are informed, where necessary, of the circumstances in which an auditor has ceased to hold office.

15. This information is of interest because an auditor may have left office for reasons associated with the accounting or corporate governance practices of the company, its cooperation with the auditor or the auditor's independence, which leave the auditor unable to complete the audit or present an audit report which the company can accept. As the auditor's role is primarily intended to give assurance to the shareholders that the accounts present a true and fair view of the company's financial situation, the departure of an auditor may give rise to legitimate doubts about the company's accounting practices and can be of considerable interest to shareholders. A departure may also raise audit or accounting regulatory concerns, into which the audit and accounting authorities may wish to look.

Current requirements

16. Both auditors and companies have a role in providing information on auditors leaving office:

- **Auditors** are currently required to issue a statement to the company whenever they cease to hold office. This should either state that there are no circumstances that need be drawn to the attention of the company's shareholders; or set out those circumstances. For quoted companies, the statement should always set out the circumstances. The auditor should also file a copy of the statement at Companies House¹. The auditor must then send a statement to the relevant audit authority² of the reasons why they ceased to hold office. Where the auditor ceased to hold office at the end of their term of office, the statement to the audit authority is not required unless the audit is a major audit.
- **Companies** must notify Companies House whenever an auditor is removed or resigns from office. Whenever it receives a statement from the auditor setting out any circumstances associated with their departure that need be drawn to the attention of the company's shareholders or creditors, the company must circulate that statement to the shareholders and other parties entitled to receive copies the accounts. However, if the company considers that the statement is being used to secure needless publicity for defamatory matter, it may go to court for a ruling to that effect so that the statement need not be circulated. The company may also send that statement onto the audit authority as its statement of reasons. However, if it prefers, or if the auditor's statement does not state any circumstances that need to be

¹ The auditor must not file the statement if a court rules that it is being used to secure needless publicity for defamatory matter – see the bullet-point for companies below.

² The relevant audit authority differs depending on whether the audit is a "major audit", as defined in Chapter 4 of Part 16 of the Companies Act and in guidance issued by the audit authorities under the Act. For major audits, the relevant audit authority is the Financial Reporting Council. For non-major audits, the relevant audit authority is the particular Recognised Supervisory Body (several professional institutions are recognised by the FRC under Part 42 of the Companies Act 2006) that oversees the auditor's work. The auditor in this context is usually a firm and must have registered with the supervisory body and become subject to its regulatory oversight in order to provide statutory audit services

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drawn to the attention of shareholders or creditors, the company must provide the audit authority with its own statement of reasons.

- **The audit authorities** must notify the accounting authorities of all the statements they receive. The audit authorities may also send a copy of the statement to the accounting authorities where they think it appropriate. The accounting authorities are the Conduct Committee of the Financial Reporting Council, in its corporate reporting review capacity, and the Companies Investigations team at the Insolvency Service.

17. As can be seen from the explanation above, this framework currently contains enhancements for auditors of quoted companies in respect of their communications with the company, its shareholders and with Companies House (sections 519 to 521). It also contains enhancements to the framework deriving from the Audit Directive on communications with the audit authorities. Those enhancements (to sections 522 to 525) apply to "major audits", though the Directive itself doesn't provide for these.

18. Though some of these enhancements are of value, the groups of companies to which they are applied differ. This means that some companies can find that they are subject to the "quoted companies framework" but not subject to the "major audit framework" or vice-versa, or that they are subject to both of these frameworks. The group of companies covered by the "major audit" framework is also very large as it contains all subsidiaries of other companies subject to the "major audit" framework, as well as a large number of companies that are added to the definition via guidance from the audit authorities. The audit authorities now agree that these frameworks can be rationalised and the numbers of companies that are covered can be reduced to a smaller set of "listed companies".

Problem under consideration – the effect of the framework

19. The Companies Act 2006 increased the range of situations in which companies and auditors must issue a statement of why auditors have ceased to hold office. It did this in two ways:

- As part of a package of UK domestic measures on audit, the Companies Act 2006 created a standard rule for the first time that, upon leaving office, the auditor of a quoted company should always deposit a statement of circumstances for the company to circulate to its shareholders. This was done in recognition of investors' interests in the departure of auditors, and as part of a package of domestic UK measures to increase the scrutiny of auditors of quoted companies.
- As part of the implementation of EU Directive 2006/43/EC ("the Audit Directive"), for the first time, the Act made requirements for statements of the auditor's reasons for leaving office to be sent by the company and its auditor to the appropriate audit authority in parallel to the statements issued under the pre-existing domestic framework.

Feedback we have received on the overall effect of this framework, especially given the effect of implementing of the Audit Directive, suggests it has introduced additional administrative burdens, with only limited benefits, and that compliance is patchy, especially by companies.

20. We understand from the audit authorities that, between them, they receive in the region of 10,000 notices per year from auditors, though the number from companies is considerably lower. Meanwhile Companies House receives 8,700 notifications a year from companies, and a similar number from auditors. Analysis by audit authorities and the accounting authorities (including BIS) suggests that in many cases the reasons that the auditor has ceased to hold office are routine and of no significance from a regulatory perspective. Those statements that are of significance can easily be missed among the large amount of information that must be processed.

Problem under consideration – technical defects

21. We have also identified two technical defects with the current drafting of Chapter 4 of Part 16 of the Companies Act 2006, which have been brought to the attention of the Department for Business Innovation and Skills since the Companies Act 2006 was passed:

- Though there are specific requirements in Chapter 4 of Part 16 applying to “quoted companies”, the Act does not define the term for the purposes of that chapter.
- There is a technical loophole in what appears to be a requirement for special notice of a resolution appointing a new auditor to a public company in place of a previous auditor at the end of their term of office.

Both these defects have the potential to generate confusion and legal costs if an interested party were to challenge current practises that are based on assumptions as to the legislative intention.

BIS Consultation on Notices of Auditors Leaving Office

22. In November 2009 the Department for Business Innovation and Skills issued a consultation³ on measures that might be introduced to simplify the operation of Chapter 4 of Part 16 of the Companies Act 2006 for companies and auditors. That chapter (sections 510 to 526) sets out how an auditor can be removed from office, resign or be replaced at the end of their term of office and the requirements for notification and explanation by companies and auditors that then apply.

23. The consultation proposals were intended to reduce the numbers of notices needing to be sent to the audit authorities and Companies House where the reasons for the auditor’s departure were of little or no regulatory interest. Responses to that consultation were generally supportive, particularly of measures to reduce the burden of administration on non-quoted companies.

24. BIS published a summary of responses to the consultation in March 2010. The overall package of amendments that has resulted from the consultation in 2009 must be implemented through primary legislation.

³ The consultation, from November 2009, and the summary of responses, from March 2010, are available on the archived version of the former BIS website at <http://webarchive.nationalarchives.gov.uk/+/http://www.bis.gov.uk/Consultations/simplification-for-companies-and-auditors>. Consultations published before June 2011 have not been migrated to the new www.gov.uk site.

Rationale for intervention

25. The evolution of legislation in this area has led to duplication of administrative effort by business, as noted above, coupled with limited benefits to wider corporate governance. Thus the rationale for action here is to address the unintended consequences of what has, in practice, amounted to over-burdensome regulation leading to cost inefficiency.

26. Issues with the requirements for notices of auditors leaving office were raised with the Government through the Company Law Red Tape Challenge under the Company and Commercial Law theme. The Red Tape Challenge is intended to reverse the trend for “red tape” and to significantly reduce the overall burden of unnecessary regulation. The company law cross-cutting theme was the subject of a spotlight in 2012, which resulted in a commitment by the Government to bring forward amendments to the Companies Act on Notices of Auditors Leaving Office.

27. The Government, having experienced the operation of these provisions, agrees that there is value in streamlining their operation, so that unnecessary burdens can be removed, particularly for smaller businesses. Instead, the provisions can be focussed more effectively on information of real value.

Effect on micro-businesses, small companies and other companies that might be burdened disproportionately

28. These proposed changes apply to all companies under the Companies Act 2006 that are subject to statutory audit. This includes almost all medium sized and large companies and any small companies that either cannot⁴, or do not wish to, take up audit exemption under Chapter 1 of Part 16 of the Companies Act 2006. These proposals also apply to the auditors of those companies

29. As much of the framework on notices of auditors leaving office derives from EU law, it must continue to apply in the UK in any case. However the proposals that BIS has developed are intended to reduce the burden of administration for companies and their auditors, especially where the company is not subject to the “listed company” framework.

30. The proposals therefore differ in their application to companies subject to the “listed company” frameworks and to their auditors. Very few, if any, audit firms are micro-sized businesses. Even small audit firms have limited capacity to take on audits of listed companies.

31. As part of this package, the Government has proposed to provide an exemption from the notification requirements where the auditor leaves office because the company has taken up the audit exemption. This would include the small companies audit exemption, dormant companies audit exemption and the new audit exemption for subsidiaries which the Government introduced last year. Also, for subsidiaries, the Government has proposed a notification exemption where

⁴ Audit exemptions under the Companies Act 2006 are not generally available to financial services providers.

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an auditor of a subsidiary leaves to be replaced by the auditor of the subsidiary's parent company issuing consolidated accounts.

32. There are no groups of companies on which we would anticipate these changes having a disproportionate burden. Although the certain changes to the quoted companies / major audits framework will impose limited costs on some companies, these are proportionate to the policy objectives of:

- rationalising and effectively unifying the frameworks overall in the context of an otherwise deregulatory package of proposals; and
- making sure an appropriately focussed group of "listed" companies provide sufficient information to their shareholders and creditors.

Description of options considered

OPTION 0: Do Nothing – This is a viable option, but it retains the current duplication of notifications. The current technical defects would also need to be addressed at some stage.

OPTION 1: Simplify the reporting requirements associated with departure of auditors - This option consists of a package of measures to reduce the level notifications for non-listed companies, and to address current drafting problems. In combination, the following proposals form a package to address the current problems with the framework. However it would be possible to develop other options⁵ by selecting from within this package of proposals:

Proposal	Description
(a)	To exempt companies undergoing non-major audits and their auditors from explaining to the audit authority why the auditor has left. This exemption will only apply when the auditor leaves office for reasons that are of no regulatory or shareholder interest.
(b)	To remove the requirement for the audit authorities to notify the accounting authorities of all notices of auditors leaving office they have received.
(c)	To remove the requirement for the company to file a notification with Companies House when the auditor resigns or is removed by resolution.
(d)	To simplify and standardise the notices that must be sent to the audit authority, Companies House, the company and its shareholders; and to facilitate electronic communication of these.
(e)	For non-quoted companies: <ul style="list-style-type: none"> • to require the auditor to send explain their departure to the company only where this is before the end of their term of office and where the exemption under proposal (a) does not apply; • to require the auditor to file the statement with Companies House only if the auditor considers that the statement needs to be brought to the attention of the shareholders or creditors of the company.
(f)	For major audits: <ul style="list-style-type: none"> • to reduce the number of companies that are subject to the enhanced framework currently applied to major audits so it no-longer applies to subsidiaries of listed companies, and the same class of companies is covered by all the enhanced requirements. • to require companies to notify the relevant audit authority of the reasons for an auditor’s departure only where the exemption under proposal (a) does not apply.
g)	To correct the drafting of the requirement for a company to give special notice of a resolution to appoint a new auditor in place of the incumbent auditor.

⁵ A number of other options of this type have been considered and rejected during the course of the development of this package of proposals. In fact, for non-major audits and non-quoted companies this package introduces all available deregulatory measures under EU law apart from measures that would have limited shareholder knowledge of auditor departures where the auditor considered these were of interest to the shareholders. As the auditor is ultimately responsible to the shareholders under the Companies Act, we concluded such any limitation of this kind would be unacceptable. For quoted companies meanwhile the consultation response supported the retention of much of the enhanced framework introduced into the Companies Act 2006, though there was support for some deregulatory changes for companies (though not auditors) to the “major-audit” framework introduced with the implementation of the Audit Directive.

Risks and assumptions – Assumptions relating to the costs of preparing and sending a notices of auditors leaving office

33. When the Department consulted on proposals to simplify the framework of notices in 2009, we proposed that the probable cost of sending each notice was £50. Though some respondents to the consultation suggested this figure was too small, others supported it.

34. In the light of this we have now revised this cost according to the time spent and cost per hour of relevant personnel. The wage data used in these estimates were taken from The Annual Survey of Hours and Earnings (ASHE) published by ONS (2011)⁶. The headline statistics for ASHE are based on the median rather than the mean as this is less affected by a relatively small number of very high earners and the skewed distribution of earnings.

35. These estimates use the median wage for ‘Chartered and Certified Accountants’ (£18.53) given that the most likely employee to carry out the audit activities would be a professional accountant in middle management. We have not included estimates of the time taken for the relevant senior manager to sign-off the auditor’s statement. An EU estimate of about a 15% uplift for non-wage labour costs was then applied to the median wage estimate, bringing it to £21.30. The uplift accounts for national insurance, pension contributions, other payroll taxes and other non-statutory employee services such as transport and canteen provision.

36. We have made further assumptions as to the cost of sending it where a notice covers the auditor’s departure from more than one company. Such notices are currently provided to companies, Companies House and the audit authorities where the auditor of a number of companies in a group leaves office from some or all of those companies at the same time. Respondents to BIS’s 2009 consultation pointed out that there may well be economies of scale where such notices are produced. However we understand the bulk of the cost of preparing and sending a notice to relate to the assembly of the information necessary for inclusion in the notice. This work would need to be undertaken to some extent in relation to each company from which the auditor left office. Also, in complicated corporate structures the assembly of the notice for several companies in the group may well have some added costs. Finally, the majority of audit authorities only record the number of companies covered by the notices they receive. They do not all record how many notices they receive or how many relate to more than one company or how many companies each of them relates to. We have therefore assumed that the relatively low cost of assembling a notice as estimated above is multiplied according to the number of companies covered by the notice.

Risks and assumptions – Assumptions relating to projected take-up of the proposed exemptions and effects on compliance with the amended framework

37. We assume 100% take-up of the exemptions by all to whom they are available, based on the evidence of the audit authorities. Generally, compliance by auditors seems to be in response to their understanding of the requirements of the law and by a desire to act in compliance. Changes of this kind are also disseminated to auditors effectively by the audit authorities as professional institutes. As a result, we would not expect high levels of voluntary

⁶ The database is available at <http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings-pension-tables/2011-revised-results--soc-2010-/index.html>

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compliance where exemptions are available. Also, it appears that many of those companies that do comply, do so on the instruction of their auditor as to the company's legal obligations when the auditor leaves office. We would therefore not expect companies to comply voluntarily where exemptions are available as we would not expect them to send notices at-all without some element of compulsion and reminder.

38. Current compliance with the regulations is not 100%. Although making the changes and publicising them might remind auditors and companies of their existing obligations, and so indirectly increase compliance with the continuing regulations, we have no evidence to that effect and would, in any case, expect such behavioural changes to be short-lived. Note that the net benefits from the existing (and unchanging) obligations will have been recorded in the Impact Assessments undertaken when the requirements were originally introduced.

Risks and assumptions – possible unintended consequences of changes in statutory communications between auditors and companies when auditors leave office

39. We have assumed that the new exemptions from sending notices, and the standardisation of all notices, will not increase disputes between auditors and companies. This is based on feedback during and after the BIS 2009 consultation, which indicated that those affected thought the information sent was of very little interest to them.

40. In future, information will not be sent by the auditor to the company where the auditor leaves office for reasons covered by an exemption. This information is covered by an exemption in part because it is of little regulatory interest to shareholders. The absence of these notices would not be expected to harm auditor client relationships.

41. However the auditors' reasons for leaving office will be sent to companies in all other cases. For non-quoted companies this will mean more information will be sent to companies. We have assumed that, having sent this, auditor's advice as to whether it needs to be circulated to shareholders and creditors will be unchanged as compared to current practices, so that shareholder interest in what is sent will be unchanged.

Monetised and non-monetised costs and benefits of each option

Option 0: No changes to current costs and benefits arise

42. This option represents the status quo so there will be no costs or benefits associated with it.

Option 1: Simplify the reporting requirements associated with departure of auditors.

43. Costs and benefits are summarised below for each of the proposals:

Proposal (a) – To exempt companies undergoing major audits and their auditors from explaining to the audit authority why the auditor has left. This exemption will only apply when the auditor leaves office for reasons that are of no regulatory or shareholder interest

Costs

44. There are no ongoing costs associated with this proposal. We have dealt with familiarisation costs in aggregate for all the proposals at the end of this Impact Assessment when considering the overall costs and benefits of the proposals.

Benefits

45. The table below shows the numbers of notices received by the audit authorities during the 2012 calendar year:

Table 1: Numbers of notices received by the audit authorities from auditors and companies			
Audit authority⁷	Auditor departure notifications received by the audit authorities from auditors during the 2012 calendar year	Auditor departure notifications received by the audit authorities from companies during the 2012 calendar year	TOTAL for 2012
ICAEW	7,632	3,240	10,872
ACCA	580	169	749
ICAS	451	80	531
CARB	63	15	78
Sub-total (non-major audits)	8,726	3,504	12,230
FRC (major audits)	823	628	1,446
TOTAL	9,549	4,132	13,681
Sources: Audit Authorities			

46. As discussed under “risks and assumptions” above, where one notice covers the departure of the auditor from several companies in a group, we have counted these as separate notices.

47. As can be seen from Table 1 above, compliance by auditors appears to exceed considerably that by companies. For notices to the FRC (Financial Reporting Council) for major audits there are additional requirements on auditors that might account for some of this, but in fact FRC data suggests there is also some non-compliance by auditors⁸. Because of the inherent level of current non-compliance we have based estimates as to the impact of these proposals on the assumption that current compliance levels will remain unchanged. We do not view it as appropriate to claim savings to business at levels that business will not in fact experience.

48. We have attempted to assess the likely potential savings for companies and auditors that will result from applying the proposed new exemptions from sending notices to the audit authorities for non-major audits. The estimated savings are based on data collated by ICAEW

⁷ The table lists the audit authorities by their acronyms. They are the Institute for Chartered Accountants in England and Wales (ICAEW); the Association of Chartered Certified Accountants (ACCA); the Institute of Chartered Accountants of Scotland (ICAS); the Chartered Accountants Regulatory Board (CARB) established by the Institute of Chartered Accountants in Ireland and the Financial Reporting Council (FRC).

⁸ The FRC routinely attempts to match the notifications it receives from auditors leaving office with the notifications it receives from the companies that the auditor has left. It records all notifications on this matched basis so it is possible to see where company notifications have no accompanying auditor notification.

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(Institute of Chartered Accountants in England and Wales) from the 8,000 notices they have received and which they have categorised according to the reasons given in the notice for the auditor's departure.

49. The categorisation of reasons used by ICAEW in recording the notices they have received includes the following categories of reasons which correspond to exemptions we intend to provide via amendments to the Companies Act:

- auditor no longer auditing;
- company taking up audit exemption;
- subsidiary company changing auditor to the auditor of the consolidated group accounts;
- company insolvency.

Table 2: Numbers of auditor departure notifications received by ICAEW from auditors for exempt reasons during 2012	
Exempt reason	Auditor departure notifications received from auditors during the 2012 calendar year
No longer auditing	96
Take up audit exemption	342
Subsidiary change to group auditor	2,367
Company insolvency	75
Total with exempt reasons	2,880
Total ICAEW notices	7,632
% of ICAEW notices with exempt reasons	37.7

50. All the data above is based on actual numbers of notices sent in the year 2012. We have then extrapolated the ICAEW results to cover the numbers of notices sent to the other audit authorities for non-major audits and worked out the likely savings that would be made. There is an inherent assumption here that compliance is not affected in different ways among auditors registered with the various audit authorities. So although the total number of notices received by the audit authorities is known, we have assumed that the same percentage of notices will have been sent, for exempt reasons, to each authority.

51. We have used the following estimates for the costs of fulfilling the regulatory requirements that will be subject to the exemptions:

- **The costs to the auditor of preparing a statement for the company under section 519 of the Companies Act 2006 and sending a copy to the relevant audit authority –** We think this statement would take the auditor between 1 and 3 hours to prepare, depending on the content, with a best estimate of 2 hours. The range of costs is therefore of £21.30 to £63.90 with a best estimate of £42.60.

These savings are calculated in the table below:

Table 3: Auditor departure notifications received from auditors by all audit authorities during the 2012 calendar year	
% of ICAEW notices with exempt reasons	37.7
Total notices for non-major audits – all audit authorities	8,726
Applying % with exempt reasons	3,293
Minimum £ saved @ £21.30 per notice	£70,140
Best estimate £ saved @ £42.60 per notice	£140,280
Maximum £ saved @ £63.90 per notice	£210,400

52. Separately, the ICAEW’s analysis also covers company notices. We have used the following estimates for the costs of fulfilling the regulatory requirements that will be subject to the exemptions:

- **The costs to the company of preparing and sending a statement to the relevant audit authority –** We think this statement would take the company between 1 and 3 hours to prepare based on evidence from the audit authorities, depending on the content, with a best estimate of 2 hours. It is quite likely that the relevant personnel are paid the normal salary for a professional accountant in the UK as they are likely to work in the company’s accounts office⁹. Including a 15% overhead this gives a range of cost of £21.30 to £63.90 with a best estimate of £42.60.

The results are set out in the table below:

⁹ The £21.30 per hour median salary figure (including a 15% overhead) provided by the ASHE database for professional accountants is not dissimilar to the median figure for “managers”, which would be £22.70 per hour. Though either personnel may be performing this function, we prefer the lower figure partly to avoid any overestimate.

Table 4: Numbers of auditor departure notifications received by ICAEW from companies for exempt reasons during 2012	
Exempt reason	Auditor departure notifications received from companies during the 2012 calendar year
No longer auditing	36
Take up audit exemption	193
Subsidiary change to group auditor	768
Company insolvency	5
Total with exempt reasons	1,107
Total ICAEW company notices	3,240
% of ICAEW company notices with exempt reasons	34.2

Table 5: Auditor departure notifications received from auditors by all audit authorities during the 2012 calendar year	
% of ICAEW company notices with exempt reasons	34.2
Total company notices (non-major audits – all audit authorities)	3,504
Applying % with exempt reasons	1,198.3
Minimum £ saved for companies @ £21.30 per notice	£25,520
Best estimate £ saved for companies @ £42.60 per notice	£51,060
Maximum £ saved for companies @ £63.90 per notice	£76,570

53. This gives a total saving of:

Table 6: Total savings of proposal (a)			
	To auditors	To companies	Total
Minimum benefit per year	£70,140	£25,520	£95,660
Best estimate per year	£140,280	£51,050	£191,330
Maximum benefit per year	£210,420	£76,570	£286,990

Proposal (b) - To remove the requirement for the audit authorities to notify the accounting authorities of all notices of auditors leaving office they have received

Costs

54. None. Based on evidence from the audit authorities, these notices have not proved to be of use to the accounting authorities which means that the requirement can be repealed. The information that has proved to be of regulatory value is that contained in those statements that the audit authorities have specifically chosen to bring to the attention of the accounting authorities. The audit authorities will continue to have the ability to do this.

55. We are unsure what the original intended benefit was of the notification requirement for all the notices the audit authorities receive. It may have been to make sure the accounting authorities knew whether a particular notice had been provided in order to request a copy of the statement from the relevant audit authority if it was needed. However the requirements to send and receive the notices has proved only to be an unnecessary administrative burden.

Benefits¹⁰

56. The audit authorities for non-major audits have all advised us that they expect to make a considerable saving in administrative resources from the repeal of the requirement that they must notify the accounting authorities of all the notices they receive.

57. Combined within the estimates provided by the audit authorities was an anticipated saving which they also thought would result from proposals (a) and (f) due to the reduction in the number of notices the they would expect to receive when the exemptions under proposal (a) were made available. Under proposal (f) these exemptions would be made available to a number of companies subject to the major audit framework, particularly subsidiaries, which the audit authorities have also considered.

¹⁰ As explained further below, when these estimates were provided to BIS we understand that combined within them was an anticipated saving which they also thought would result from proposals (a) and (f).

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58. In providing these estimates the audit authorities also acknowledged that costs would continue to arise from the proposal to retain the provision for the audit authorities to send a copy of the auditor’s statement of their reasons for leaving office to the accounting authorities where they saw fit.

59. All of the audit authorities for non-major audits are professional institutes and therefore membership organisations for individuals and for audit firms. Much of the cost to the audit authorities of notifying the accounting authorities is therefore likely in practice to be passed on to the institute’s membership and passed on again indirectly to their clients. However any reduction in these costs is not a direct saving either to auditors or to businesses. The saving to the audit authorities is a saving to the relevant authority in fulfilling its statutory requirements in a public role and as such does not represent a saving to business.

60. However we have evaluated this saving and included it in the overall benefits of the proposals, though these are not benefits to business. Having consulted the audit authorities, we understand that they expect, between them, to save the time of between 1 and 2 full time equivalent staff in processing notices of auditors leaving office, with a best estimate of 1.5 full time equivalent staff. This time is relatively evenly split between supervisory staff, who are often qualified accountants and administrative staff. Using the standard hourly cost of £21.30 for a professional accountant and a cost of £12.00 for administrative support staff¹¹, this gives an average hourly rate of £16.65. We can then work out a typical annual saving in these staff costs. This calculation is set out below:

Table 7: Total savings of proposal (b)					
	Full time equivalent staff saved	Typical working week	Typical working year	Hourly rate	Total
Maximum	2	37.5	Monday to Friday with 8 bank holidays	£16.65	£62,937
Best estimate	1.5				£47,203
Minimum	1				£31,469

Proposal (c) - To remove the requirement for the company to file a notification with Companies House when the auditor resigns or is removed by resolution

Costs

61. None. These notices do not appear to add any information to the statement which is currently filed by the auditor in all circumstances (and will continue to be filed in certain circumstances after the proposed changes are implemented). Therefore, we do not think the loss of this information from the Companies House record carries any cost. Familiarisation costs

¹¹ This is based on a median hourly costs for administrative staff of £10.40 from the ASHE database and adding a 15% overhead.

are all dealt with in aggregate in the section at the end of this Impact Assessment on the total costs of these proposals.

Benefits

62. These requirements appear to create a situation where two notices are filed at Companies House when the auditor is removed by resolution of the company or resigns; the first notice is from the company and the second is from the auditor. We are proposing to rely on the auditor notice alone, which already has to be filed in some other circumstances where no other notice need be filed.

63. Companies House tell us that in the 2012 Calendar year, the relevant notices were filed in the following numbers:

- **Section 512** (removal of auditor by resolution of company) – **328 notices in 2012**
- **Section 517** (resignation of auditor) – **7,329 notices in 2012**

- **The costs to the company of filing a notification to Companies House that it has removed an auditor from office or the auditor has resigned** - We think this statement would take the company between 1 and 3 hours to prepare based on advice from the audit authorities, depending on the content, with a best estimate of 2 hours. It is quite likely that the relevant personnel are paid the normal salary for a professional accountant in the UK as they are likely to work in the company's accounts office¹². Including a 15% overhead this gives a range of cost of £21.30 to £63.90 with a best estimate of £42.60.

Table 8: Total savings for proposal (c)			
	Notice of removal of auditor	Notice of resignation of auditor	Total
Minimum benefit per year	£6,990	£156,110	£163,090
Best estimate per year	£13,970	£312,220	£326,190
Maximum benefit per year	£20,960	£468,320	£489,280

¹² The £21.30 per hour salary figure (including a 15% overhead) provided by the ASHE database for professional accountants is not dissimilar to the figure for "managers", which would be £22.70 per hour. We prefer the lower figure partly to avoid any overestimate.

Proposal (d) - To simplify and standardise the notices that must be sent to the audit authority, Companies House, the company and its shareholders; and to facilitate electronic communication of these.

Costs

64. Although there may be some initial familiarisation costs with the new requirements as to the content of the notice of an auditor leaving office, we think these will be sufficiently small as to be immaterial based on advice from the audit authorities. At present a statement of circumstances has to be prepared for the company, its shareholders and Companies House, while a statement of reasons has to be prepared for the audit authorities, though the statement of circumstances may serve this purpose. In future it is proposed that all statements should be of reasons, and any connected “matters” that the auditor or company considers need to be brought to the attention of shareholders or creditors, or the audit authorities. For the large majority of cases a statement prepared under the current framework would continue to be appropriate under the new framework.

Benefits

65. Some savings may also derive from the new approach as it will be clear that a statement prepared for the company and its shareholders will be sufficient for the audit authorities. However, again we think these will be sufficiently small as to be immaterial given that the format will broadly reflect the current framework.

Proposal (e) - For non-quoted companies:

- **to require the auditor to explain their departure to the company only before the end of their term of office and where the exemption under proposal (a) does not apply;**
- **to require the auditor to file the statement with Companies House only if the auditor considers that the statement needs to be drawn to the attention to the shareholders or creditors of the company.**

Costs

66. The revised statement of reasons and any connected matters will have to be prepared in all cases and sent to the company. So although the content of the statement will have changed, the requirement to send a statement will be unchanged from the present framework. We have dealt with the associated familiarisation costs in aggregate in the section on the total costs of these proposals at the end of this Impact Assessment.

67. A further change will mean the auditor will be able to say that the statement need not be brought to the attention of the company’s shareholders or creditors. We do not think this will impose any new burden on the auditor compared to the current framework. Currently, if the auditor does not think that any circumstances need be brought to the shareholders’ attention, they state this in the notice. However the auditor must also prepare a statement of reasons for the audit authorities.

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68. The more significant change in terms of administration is to allow the auditor not to file the statement at Companies House where he considers it need not be drawn to the shareholders' attention. Though this will reduce the quantity of filed information, we do not think it will be detrimental in its impact on shareholders or prospective investors or creditors. In all cases the information in the statement will be passed to the audit authorities, who will be able to pass it to the accounting authorities. In any case, under the current framework those statements that are filed at Companies House, and will not need to be in the future, simply state that "there are no circumstances that need to be brought to the attention of the shareholders or creditors of the company".

Benefits

69. We have not estimated any benefit to the auditor of not being required to send a statement to the company additional to that of not being required to send a statement to the audit authorities under proposal (a) above. Auditors are required to communicate with their clients as a matter of routine and there would not be any difference required between the two statements so one could be a copy of the other.

70. In our view the main benefit of this proposal comes from reducing the requirement to file at Companies House those statements which currently state "there are no circumstances that need to be brought to the attention of the shareholders or creditors of the company". Unfortunately neither Companies House nor the audit authorities keep records of how many statements currently include circumstances that the auditor considers should be brought to the attention of the shareholders or creditors of the company.

71. One possible way of estimating this is to look at the proportion of notices sent to the audit authorities that they consider need to be brought to the attention of the accounting authorities:

Table 9: Auditor departure notifications received from auditors during the 2012 calendar year which state circumstances that need to be brought to the attention of the accounting authorities	
Audit authority	Number of notices received
ICAEW	108
ACCA	0
ICAS	1
CARB	0
Total (non-major audits)	109

72. As can be seen from the table under proposal (a), the 109 notices stating circumstances which the audit authorities sent to the accounting authorities are drawn from a total of 8,726 auditor notices for non-major audits. As these notices are being sent to the audit authorities we

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assume they are also being filed at Companies House. We would therefore expect to see a reduction in the number of notices filed at Companies House of:

8,726 – 109 = 8,617 filings to Companies House per year where there are no circumstances that need to be brought to the attention of the accounting authorities

73. We estimate the cost of filing these notices as follows:

- **The costs to the auditor of filing a notification to Companies House that they have ceased to hold office** – We think the filing of the statement prepared by the auditor under section 519 would take the auditor an additional 30 minutes to 90 minutes to arrange, with a best estimate of 1 hour based on advice from the audit authorities. Assuming the relevant personnel are paid the normal salary for a professional accountant in the UK and adding an additional 15% for overheads, this gives an hourly rate of £21.30¹³. The range of costs is therefore of £10.65 to £31.95 with a best estimate of £21.30.

Minimum benefit per year	8,617 x £10.65	£91,770
Best estimate per year	8,617 x £21.30	£183,540
Maximum benefit per year	8,617 x £31.95	£275,310

Proposal (f) - For major audits:

- **to reduce the number of companies that are subject to the enhanced framework currently applied to major audits so it no-longer applies to subsidiaries of listed companies, and the same class of companies is covered by all the enhanced requirements.**
- **to require companies to notify the relevant audit authority of the reasons for an auditor's departure only where the exemption under proposal (a) does not apply.**

74. The first part of this proposal will effectively apply the framework for "major audits" under sections 522 to 525 to the audits of some "quoted companies" to which it doesn't already apply but which will be subject to the "listed companies" framework in the future. Similarly, it will apply the framework for audits of "quoted companies" under sections 519 to 521 to some "major audits" to which it doesn't already apply as some of these will also be "listed companies".

75. These extensions in the application of the two frameworks are very limited as compared to the disapplication of the quoted companies framework from audits of some quoted companies and the disapplication of the major audits framework from a large number of major audits. These disapplications will be achieved by replacing both categories with a new category of a

¹³ This is based on the £18.53 median figure for the salary of a professional accountant taken from the ASHE database.

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“listed company”. The effects of this are discussed under “benefits” below. The amendments will insert a new statutory definition of such a company, in place of the current definition of a major audit (which partly relies on guidance from the audit authorities) and in place of the (currently undefined) references to quoted companies.

76. The current framework for major audits under sections 522 to 525 applies to:

- companies whose securities are admitted to the official list (so that they are subject to the FCA’s Listing Rules and can be traded on a regulated market such as the London Stock Exchange; and,
- a range of other types of company which are included in guidance issued by the audit authorities¹⁴.

77. The definition used in the guidance is different in some respects from that used by the FRC for its major audit inspection framework under Schedule 10 to the Companies Act 2006. The most important of these differences is the inclusion of subsidiaries of other major audits in the definition used for the purposes of sections 522 to 525. However, for non-subsidiaries the differences are more minor and the FRC maintains comprehensive figures on the number of entities that are subject to its audit inspection framework. We have used these figures as set out below:

Table 11: Entities subject to the major audit framework¹⁵	Numbers
Shares admitted to the official list	806
Transferable debt securities admitted to the official list	43
Others	1,089
TOTAL	1,938

78. These figures do not include subsidiaries of companies that are subject to major audit as the FRC does not maintain figures on the size of this population. The “other” category in the table above also increases the size of the major audit population, as it contains unlisted banks, insurers and pension funds (particularly mutuals), building societies, other large charities, other mutuals, LLPs and AIM listed, PLUS quoted and some large unlisted companies.

79. This compares with the following numbers of companies that are quoted companies under the definition in section 385 of the Companies Act 2006, which is generally applied for the purposes of sections 519 to 521 of the Companies Act. Where possible, for consistency, we

¹⁴ The guidance published jointly by the FRC and ICAEW is available at: <http://www.frc.org.uk/Our-Work/Conduct/Professional-oversight/Oversight-of-Audit/Notification-of-change-of-auditor.aspx>

¹⁵ As explained above these figures are assembled by the Financial Reporting Council for the purposes of their monitoring of major audits under Schedule 10 to the Companies Act 2006. These figures were assembled for the financial year 2012 / 13. The scope of inspections by the FRC for that year is set out in the FRC publication at the following link: <http://www.frc.org.uk/Our-Work/Publications/AIU/Scope-of-Independent-Inspections-2012-13.aspx>. It is possible, by comparing the categories of company set out here with those set out in the guidance to companies at footnote 7 above to see the differences between the definition of a major audit and for the purposes of the framework on notices of auditors leaving office.

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have based these numbers on the same FRC figures. Otherwise, the figures below are based on data from the FAME database:

Table 12: Entities subject to the quoted companies framework	Numbers
Shares admitted to the official list	806
Shares officially listed in another EEA state	106
Shares listed on the New York Stock Exchange or the Nasdaq.	5
TOTAL	917

80. This proposal will replace both of these definitions with a new definition of a “listed company” which consists of the numbers of companies in the table below:

Table 13: Entities subject to the new “listed companies” framework	Numbers
Shares admitted to the official list	806
Transferable debt securities admitted to the official list	43
Shares officially listed in another EEA state	106
TOTAL	955

Costs

81. The costs arising from the first part of this proposal are assessed below:

Costs associated with becoming subject to the “major audit” framework

82. With this proposed change, a small number of companies that have shares officially listed in other EEA states will be included by statute in the enhanced framework of notices for the first time.

83. The FAME database suggests that 106 UK companies have shares officially listed in other EEA states but no securities listed in the UK. Of these companies some may have been covered by the audit authorities’ guidance in any case (as “other” companies table 11 above), so would already be subject to the major audit framework. However as we don’t have a list of the companies making up the FRC figures, so are unable to cross-refer it with a list from the FAME database, we think it prudent to base an assessment of the impact of these changes on the assumption that this number of companies is affected by the major audit framework for the first time.

84. The additional costs to these companies will arise from:

- **the requirement to notify the Financial Reporting Council as the relevant audit authority rather than the Recognised Supervisory Body with which the auditor is registered** (we think there are no costs associated with this change as auditor or company will just have to send the notice to a different address);
- **the requirement for auditors (though not companies) to notify the relevant audit authority that they have left office even where this is at the end of their term of office; and,**
- **the fact that the exemptions for auditors under proposals (a) and (e) will not be available for these audits** – Rather than a cost, this is actually a mitigating effect on the benefits to auditors¹⁶ discussed under proposals (a) and (e) above. The savings for auditors in respect of non-major audits discussed above are quite substantial but they did not take into consideration the fact that a small number of companies will become subject to the major audit framework and will not be able to take advantage of the savings envisaged.

85. The combined effect of these two changes for UK companies with shares officially listed in other EEA states will be to increase the numbers of notices submitted by auditors in proportion to the increase in the population of companies subject to the major audit framework that it causes. Decreases in the size of that population elsewhere will bring proportionate benefits in a similar way as discussed under the benefits of proposal (f) in the following section.

86. We have attempted to ascertain what would be the additional cost to an auditor of a company subject to major audit framework of having to notify when they have left office at the end of their term of office or having to send a notice that they would otherwise be exempt from sending. The FRC does not differentiate between those notices it receives where an auditor leaves office before the end of their term of office and those notices where the auditor has left at the end of their term. But there are a small number of notices where the reason given for the auditor's departure is that it is the end of their term of office. Combining these with the notices giving reasons that would have given rise to an exemption under proposal (a), we find that there are 90 notices in total.

87. Of the remainder, some or all of those for which the FRC did not receive an accompanying company notice may have been sent at the end of the auditor's term of office (when no company notice need be sent). There are 39 of these. This gives us a range for the number of notices relating either to the auditor's departure from a major audit at the end of their term of office or to a departure before the end of the auditor's term of office for an exempt reason.

88. As can be seen from Table 11, a population of 1,938 companies were subject to the major audit framework in 2012. This figure excludes subsidiaries, which are also subject to the major audit framework but will not be subject to the listed companies' framework in the future. The

¹⁶ There is no similar effect on the benefit to companies because the exemptions provided under proposal (a) will also be available to listed companies own notices to the audit authorities (see the final assessed benefit of proposal (f) in the following section).

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table below calculates the rate of notices per year from a population of 1,938 companies and applies this to the increase of 106 in the population of companies subject to the framework:

Table 14: Costs associated with entities becoming subject to the major audit framework				
	Number of notices per year (n)	(n / 1,938) x 106 = ... (additional notices per year)	@ Cost per notice of (£)	Cost (£)
Minimum	90	4.92	21.30	£105
Best estimate	109.5	5.99	42.60	£255
Maximum	139	7.60	63.90	£486

89. Costs associated with becoming subject to the framework for audits of quoted companies - The current framework for quoted company audits only applies to companies whose shares are admitted to the UK official list, are officially listed in another EEA state or are traded on the New York Stock Exchange or the Nasdaq. With this proposed change, some companies that only have debt securities admitted to the official list will be subject to the quoted companies framework in sections 519 to 521. The following requirements will then apply to all statements of the auditor's reasons for leaving office:

- Companies will have to circulate auditor statements of the auditor's reasons for leaving office to shareholders in all cases. This change will apply only to a small number of companies as those that already have shares admitted to trading on UK or EU regulated markets or the New York Stock Exchange or the Nasdaq must already comply with the enhanced framework.

90. FRC figures suggest 43 UK incorporated companies issued debt but not equities on the main market of the London Stock Exchange. Though some of these may already be quoted companies because they have shares admitted to the markets listed above, we propose to use this figure for the increase in the number of companies subject to the quoted companies framework. .

91. Although we don't know how many notices of auditors leaving office are generated by quoted companies in a year, we know that a population of approximately 1,938 companies were subject to the major audit framework in 2012. Of these, 172 notices were generated by auditors. Both these figures exclude subsidiaries, which are also subject to the major audit framework but will not be subject to the listed companies' framework in the future. A rate of 172 notices per year from a population of 1,938 companies suggests that each company is the subject of a notice with the following frequency:

1,938 / 172 = 11.26 years between each notice of an auditor leaving office from a company under the major audit framework

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92. The FRC data on Table 11 suggests that we could expect an increase of 43 in the population of companies subject to the quoted companies framework. This would represent an increase in the number of notices needing to be circulated to members or creditors of:

43 / 11.26 = 3.82 additional notices per year being required to be circulated to members and creditors on average.

93. As the notice has to be circulated to both shareholders and debenture holders, we have very little data on which to base an estimate of the cost of circulating such a notice to members or creditors. Furthermore stakeholders advise us that in general a cost such as this can differ considerably from one company to the next. In the absence of any available estimate and given that we are also amending the legislation to facilitate electronic communication between companies and their members under this chapter, we think that for this relatively specialised form of company it is appropriate to estimate a flat rate total cost for the circulation of the notice to members or creditors and of filing the notice of £1,000 to £3,000 with a best estimate of £2,000.

94. As this filing requirement will apply to all auditor departures we consider that included within it is the mitigating effect on proposal (e) above for those companies that have to file auditors' statements of their departure where they would not need to had they not been listed companies.

95. This gives the following total average cost per year of applying the quoted companies framework to UK debt only issuers on regulated markets:

Table 15: Costs associated with companies becoming subject to the "quoted companies" framework		
Minimum cost per year	3.82 x £1,000	£3,816
Best estimate per year	3.82 x £2,000	£7,633
Maximum cost per year	3.82 x £3,000	£11,449

Costs of requiring companies to notify the relevant audit authority of the reasons for their departure only where the exemptions under proposal (a) do not apply

96. We anticipate no costs arising from the second part of this proposal. This part of the proposal would apply the exemptions under proposal (a) to companies (though not auditors) in respect of their notices under the major audit framework. There may be some familiarisation costs, which are dealt with in aggregate in the total costs section at the end of this impact assessment.

Overall costs of proposal (f):

97. Summing the costs arising above gives the following total costs:

Table 16: Total ongoing costs associated with proposal (f)			
Proposal	Costs per year on average		
	Minimum cost	Best estimate	Maximum cost
Auditors of companies subject to the “major audits” framework for the first time will have to send a notice upon leaving office at the end of their term of office and will have the benefits of proposal (a) and (e) mitigated.	£105	£255	£486
Companies subject to the “quoted companies” framework will have to circulate and file statements of auditors leaving office even where the auditor considers that the reasons for the auditor leaving office do not need to be drawn to the attention of shareholders or creditors.	£3,816	£7,633	£11,449
TOTAL	£3,921	£7,888	£11,935

Benefits

Benefits arising from the application of the major audit framework to a newly defined and smaller group of “listed companies”

98. Though it is intended primarily to simplify the framework so that it applies in a more uniform way the other main benefit of this proposal is that it will make sure that some companies subject to the major audit framework, particularly the subsidiaries of other companies subject to the framework will not also have to comply with it.

- **Auditors of subsidiaries subject to the major audit framework that will now be able to take up the exemption under proposal (a) above** – This is a significant number of companies, which the Government intends should be able to take up the exemption. However the FRC does not have data on the numbers of subsidiaries of the companies subject to the major audit framework. To ascertain the benefits to these subsidiaries we have chosen to use the number of subsidiaries from the FRC’s data on the notices received. In 2012 the FRC received notices from auditors relating to 823 departures from companies under the major audit framework of which all but 172 related to subsidiaries:

823 – 172 = 651 subsidiaries that were the subject of notices of auditors leaving office under the major audits framework

99. Of these, in the case of 171 subsidiaries, the auditor had left office for reasons that would exempt the auditor from submitting a notice. The cost of submitting such a notice is estimated as £21.30 to £63.90. The benefit of this part of the proposal is therefore:

Table 17: Benefits of subsidiaries of “major audits” taking up the exemptions under proposal (a)		
Minimum benefit per year	171 x £21.30	£3,642
Best estimate per year	171 x £42.60	£7,285
Maximum benefit per year	171 x £63.90	£10,927

- **Auditors of subsidiaries subject to the major audit framework that will now be able to take the exemption under proposal (e) above** - Here, we can follow a similar methodology to that we used for proposal (e) above. In total, of the 823 companies that were the subject of a notice of auditor leaving office to the FRC, The number of auditor notices that needed to be sent by the FRC to the accounting authorities is set out below:

Table 18: Auditor departure notifications received from auditors for major audits during 2012 which were sent onto the accounting authorities	
Audit authority	Numbers of notices
FRC (major audits)	58
...of which subsidiaries	49

100. So the number of subsidiaries of major audits, which will not qualify as listed companies under the new definition and which are very unlikely to need to circulate a notice from an auditor to their shareholders or creditors is therefore:

651 – 49 = 602 subsidiaries which, once they are non-listed companies, will not be subject to the requirement on their auditor to file a statement at Companies House at a cost of £10.65 to £31.95 per notice. This will save:

Table 19: Benefits of subsidiaries of “major audits” taking up the exemptions under proposal (e)		
Minimum benefit per year	602 x £10.65	£6,411
Best estimate per year	602 x £21.30	£12,823
Maximum benefit per year	602 x 31.95	£19,234

- **Auditors of non-subsiidiaries subject to the major audit framework that will now be able to take up the exemption under proposal (a) above** - There will also be reduction in the overall size of the population of non-subsiidiaries covered by the listed companies framework as compared to that for major audits. FRC figures suggest this reduction will be from approximately 1,938 companies to 849 companies. This is a reduction of:

1,938 – 849 = 1,089 notices or 1,089 / 1,938 = 56%

101. We would therefore expect that a similar proportion of non-subsiidiary notices sent by auditors under the major audit framework would benefit from the exemption under proposal (a) as non-listed companies in the future.

102. Of the 172 non-subsiidiary notices sent by auditors, FRC records suggest that 61 have either been sent at the end of the auditor’s term of office or give reasons suggesting that the auditor would be exempt from sending the notice in the future, if the notice related to a non-listed company. A reduction of the numbers of such notices in proportion to the reduction in the size of the population covered by the listed companies framework gives:

56% x 172 = 97 notices per year at a saving of £21.30 to £63.90 per notice or:

Table 20: Benefits of non-subsiidiaries currently subject to the major audit framework now being able to take up the exemptions under proposal (a) above		
Minimum benefit per year	97 x £21.30	£2,066
Best estimate per year	97 x 42.60	£4,132
Maximum benefit per year	97 x 63.90	£6,198

- **Auditors of non-subsiidiaries subject to the major audit framework that will now be able to take the exemption under proposal (e) above** - We would also expect that a similar proportion of notices would benefit from the exemption under proposal (e) as non-listed companies in the future. Of the 172 non-subsiidiary notices sent by auditors, the audit authorities sent 9 onto the accounting authorities. We think it unlikely that the remainder would state circumstances that would need to be brought to the attention of members or creditors of the company. Those that in future will not be listed companies would therefore not have to file the auditor’s statement at Companies House. If this were a similar proportion of companies as above:

56% x (172 – 9) = 92 notices per year at a saving of £21.30 to £63.90 per notice, this would amount to the following savings:

Table 21: Benefits of non-subsidiaries currently subject to the major audit framework now being able to take up the exemptions under proposal (e) above		
Minimum benefit per year	92 x £21.30	£1,960
Best estimate per year	92 x £42.60	£3,919
Maximum benefit per year	92 x £63.90	£5,879

103. All of the above benefits arise in respect of notices from auditors. For company notices we have assessed the total benefits under the second part of this proposal below:

Benefits arising from the application of the exemption under proposal (a) to companies in respect of their notices under the major audit framework even where they are listed companies.

104. We have looked at the whole population of notices sent to the FRC by companies in 2012 and found that, of the total of 628 companies covered by notices, 198 were sent where the auditor had left office for a reason that would be covered by an exemption. Applying the exemptions that we are making available for non-major audits to companies subject to the major audit framework in respect of the notices that they send would save those companies £21.30 to £63.90 per notice or:

Table 22: Benefits of non-subsidiaries that continue to be subject to the “major audit” framework now being able to take up the exemption under proposal (a) above		
Minimum benefit per year	198 x £21.30	£4,217
Best estimate per year	198 x £42.60	£8,435
Maximum benefit per year	198 x £63.90	£12,652

Overall benefits of proposal (f)

105. Summing the benefits set out above gives the following total benefits:

Table 23: Total benefits of proposal (f)			
Proposal	Costs per year on average		
	Minimum benefit	Best estimate	Maximum benefit
(f) Making exemption under proposal (a) available to auditors of non-listed companies that were previously subject to the major audit framework (subsidiaries).	£3,642	£7,285	£10,927
(f) Making exemption under proposal (e) available to auditors of non-listed companies that were previously subject to the major audit framework (subsidiaries).	£6,411	£12,823	£19,234
(f) Making exemption under proposal (a) available to auditors of non-listed companies that were previously subject to the major audit framework (non-subsidiaries).	£2,066	£4,132	£6,198
(f) Making exemption under proposal (e) available to auditors of non-listed companies that were previously subject to the major audit framework (non-subsidiaries).	£1,960	£3,919	£5,879
SUB-TOTAL	£14,079	£28,159	£42,238
(f) Applying the exemption under proposal (a) to companies in respect of their notices under the major audit framework even where they are listed companies.	£4,217	£8,435	£12,652
TOTAL	£18,297	£36,593	£54,890

Proposal (g) - To correct the drafting on the requirement for a company to give special notice of a resolution to appoint a new auditor in place of the incumbent auditor

106. We have not assessed any costs or benefits in relation to this proposal as we do not think that in practice this change in the legislation will demand a change in practice by companies. This proposal corrects a technical flaw in the drafting of the sections 514 and 515 of the Companies Act 2006. However we understand that the small number of companies that have found themselves in circumstances where this has raised an issue in practice have felt sufficiently confident to continue to act in line with the Companies Act 1985, as was intended. The amendment to these sections is intended to make sure that the legislation is in line with this continued practice and to facilitate the smooth running of the system of deemed reappointment of auditors for private companies on a sound legal basis.

Overall costs and benefits of Option 1

107. **Ongoing costs per year** - The ongoing costs of these proposals all arise from proposal (f) and are summed at the end of the discussion of the costs of that proposal.

108. **“One-off” familiarisation costs** - Auditors leave office sufficiently infrequently for the companies affected almost certainly to have to familiarise themselves with the company law requirements each time that this occurs. This has been taken into consideration in the estimates under proposals (a) and (c) of the costs to companies of preparing a notice to the relevant audit authority and of filing a notice at Companies House.

109. We think auditors themselves will incur familiarisation costs if they are to take up the exemptions under these proposals as soon as they are available. On 31 December 2011 there were 7,375 audit firms registered in the UK. We estimate for each of these to familiarise themselves with the changes would require 1 to 2 hours of time for accounting personnel to obtain and read guidance that will be revised in the light of the changes and made available by the audit authorities. Based on the length of the current guidance, a best estimate might be 90 minutes. If we assume all audit firms will leave office from a company in the first year of operation of the regulations, or prepare for such an eventuality, the overall costs will amount to:

Table 24: Total costs of option 1		
	“One off” familiarisation costs	Ongoing costs per year - as set out in relation to proposal (f)
Minimum familiarisation cost	£157,087.50	£3,921
Best estimate	£235,631.25	£7,888
Maximum familiarisation cost	£314,175.00	£11,935

Benefits

110. The table on the following page summarises the overall benefits of the proposals.

111. On the basis of this Impact Assessment and given the support for the proposals under option 1 in the 2009 consultation on Notices of auditors leaving office and the Company and Commercial Law Red Tape Challenge, the Government intends to implement the proposals under option 1. As this will require primary legislation, the Government proposes to include

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these proposals in the Deregulation Bill announced in the Queen's speech at the 2013 state opening of Parliament.

Table 25: Total benefits of option 1			
Proposals generating benefits	Benefits per year on average		
	Minimum benefit	Best estimate	Maximum benefit
(a) Exemption for auditors of companies undergoing non-major audits from explaining to the audit authority why the auditor has left where the reasons are of no regulatory or shareholder interest	£70,140	£140,280	£210,420
(a) Exemption for companies undergoing non-major audits from explaining to the audit authority why the auditor has left where the reasons are of no regulatory or shareholder interest	£25,520	£51,050	£76,570
(b) Removing the requirement for the audit authorities to notify the accounting authorities of all notices of auditors leaving office they have received. ¹⁷	£31,469	£47,203	£62,937
(c) Removing the requirement for the company to file a notification with Companies House when the auditor resigns or is removed by resolution	£163,090	£326,190	£489,280
(d) Simplifying and standardising the notices that must be sent to the audit authority, Companies House, the company and its shareholders	No monetised benefits due to expected minimal impact		
(e) For non-quoted companies to require filing by the auditor with Companies House only where the auditor considers that the reasons need be brought to the attention of shareholders or creditors.	£91,770	£183,540	£275,310
(f) All aspects of the proposals to reduce the number of companies that are subject to the enhanced frameworks currently applied to major audits and quoted companies so they apply to the same class of “listed companies”.	£14,079	£28,159	£42,238
(f) To require listed companies only to notify the relevant audit authority of the reasons for an auditor’s departure where the exemption under proposal (a) does not apply.	£4,217	£8,435	£12,652
TOTAL	£400,290	£784,860	£1,169,410

¹⁷ As explained in the discussion of the benefits of proposal (b) above, though the benefits of this proposal are included here, we have not included them in the net benefits to business of equivalent annual net costs to business in the summary sheets.