



**Proposed audit legislation**  
**Is it good for business?**  
Results of Baker Tilly's survey

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Only

34%

would want to be released  
from the requirement to have an audit

78%

did not believe  
reducing clutter  
would reduce the  
value of financial  
statements

## In brief

At Baker Tilly we're passionate about auditing and feel there is real value to be gained from what we do. However, we are aware that not everyone feels the same way. In the UK and mainland Europe, the audit (including its fundamental purpose, its scope, and its value to stakeholders) is under scrutiny. We decided to find out what businesses in the UK thought about the proposed legislation.

219 businesses across the UK responded to our survey with their thoughts on audits, reporting and the proposed changes.

### Thumbs up for audit

Far from everyone thinking the audit is a legislative burden only 34% of businesses which currently have an audit would like to be released from the requirement. The main benefit stated was that the audit helps ensure good governance. Whilst raising the audit threshold may be beneficial to certain businesses, others will continue to want some form of audit if only for their own comfort.

### Auditory commentary

Almost 60% of respondents thought that providing additional auditor commentary on matters significant to the users' understanding of the audited financial statements would not be a good idea, in particular if it increased costs. The main message was that auditors should steer clear of subjective comments or the value of audits would decrease.

### Keep costs low

Unsurprisingly, many comments focused on the need for legislation to be relevant to the size of a business and pointed out that any additional costs should not outweigh the advantages of any changes.

### Thumbs down for excessive financial reporting requirements

A whopping 78% did not believe that reducing the clutter in annual reports would devalue them. In fact one respondent felt it would increase their value. One comment summed up the sentiment of many businesses:

“

Audits are good, but some of the requirements of financial accounts are getting too irrelevant to smaller companies, therefore adding additional audit burden.

Company secretary,  
£10m-£19.9m turnover

”

It seems that for many businesses, increasingly complex accounting rules and the volume of information required are seen as the burden, rather than the audit itself.

I hope you find this report useful. For further information please contact us.



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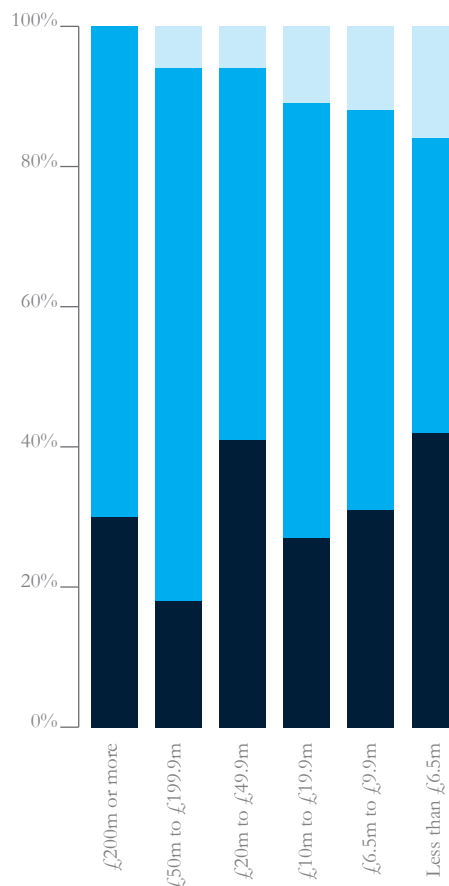
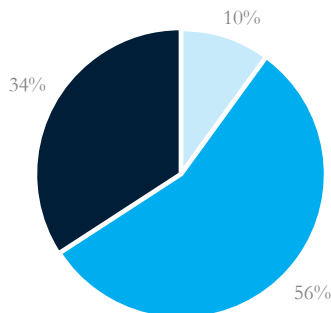
## The audit - a burden?

In March 2011, Vince Cable announced plans to remove the audit burden from 40,000 SMEs although there was then no clear indication of how this would be achieved. On 6 October 2011, the Department for Business, Innovation and Skills announced a formal consultation to increase audit exemptions for SMEs and subsidiaries of businesses registered in the European Union.

Our survey revealed that, of the businesses which currently have an audit, only 34% would want to be released from that requirement. Even businesses with a turnover under the £6.5 million current audit threshold could see no benefit in extending the exemption, with 42% agreeing and an equal number disagreeing with the proposition.

### Would you like to be released from the necessity of having a statutory audit?

■ Yes    ■ No    ■ Don't know



Respondents were asked for additional comments on the burden of audit. Love it or hate it, audit is obviously a topic people feel strongly about.

### Many respondents were positive about audit...

“An audit provides appropriate external scrutiny and one has to expect that comes with a burden.”

“Management accounts can contain an element of wishful thinking. An audit brings reality and hence more comfort to creditors and customers.”

“Audits do not have to be a burden if the company is efficient in its accounting management.”

“The cost is relatively equal for every business currently obliged to be audited, so does not damage business and in fact adds to financial stability.”

“It is a costly operation for our business but at least HMRC knows we are doing things correctly.”

“Audit is fine - simplified taxation system would be preferred.”

### ...but not everyone was complementary...

“In an efficiently run proprietor run private business the audit adds no value - indeed time spent with auditors increases management workload.”

“Audits can be very time consuming and providing the accountants do their job correctly in preparing accounts, not really needed.”

“Historic and relatively unhelpful for all but listed PLCs.”

“A more frequent statement of liquidity would be more useful than audited financial statements.”

“Turnover of audit staff means you have to ‘re-educate’ new people on how your business processes work all too frequently.”

### ...and some respondents made useful suggestions...

“Audits are not burdensome, but I would express a desire for a three year rotation of audit staff as familiarity can lead to complacency.”

“There could be different grades of audits depending on the size of the company, so in the case of SMEs they would still have an audit but it would be more suitable for their needs.”

“The annual cost of undertaking an audit is significant and would be more acceptable on a three year basis unless something significant happened during the year.”

## The audit - its role

Why is a statutory audit important to your business?

38%

Helps with good governance

27%

Provides comfort to other users

19%

Provides comfort to shareholders

9%

Provides comfort to management

7%

Makes the company more investable

Reasons people said audit was important to their business:

“If the audit is undertaken appropriately (i.e. looking at business risks rather than investigating the balance sheet) it can be of use to management.”

“Annual accounts are required for my purposes. There is no point in unaudited and/or abbreviated accounts.”

“It is a means of ensuring statutory compliance with all issues.”

“Satisfies the requirements of our overseas parent company.”

“[Provides] transparency for trade credit purposes.”

“

It would be a mistake to burden the audit with too many bells and whistles. My company chooses to be audited for the benefit of our customers and suppliers, and the comfort of the shareholders. This could quickly change if the audit process became more bureaucratic and burdensome, with little or no extra perceived benefit to my customers and suppliers.

”

**Business owner,**  
Less than £6.5m turnover



“

We don't believe in audit for audit's sake as we don't want our clients to be subject to any unnecessary workload. Many UK businesses seem to agree that the value of auditors' external scrutiny outweighs the time and cost burden. This does not mean we should rest on our laurels. We need to take on board feedback to ensure audit remains useful to the business and its users.

”

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## The reporting burden - auditor commentary

The International Auditing and Assurance Board recently closed its consultation on including auditor commentary in financial statements around directors' judgements and estimates. This would increase the amount of information available to the public and shareholders but also increase the time spent on and therefore the cost of the audit report.

Almost 60% of businesses in all turnover ranges did not think that providing auditor commentary on matters significant to the users' understanding of the audited financial statements was a good idea.

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57%

think the inclusion of  
auditor commentary  
is a bad idea

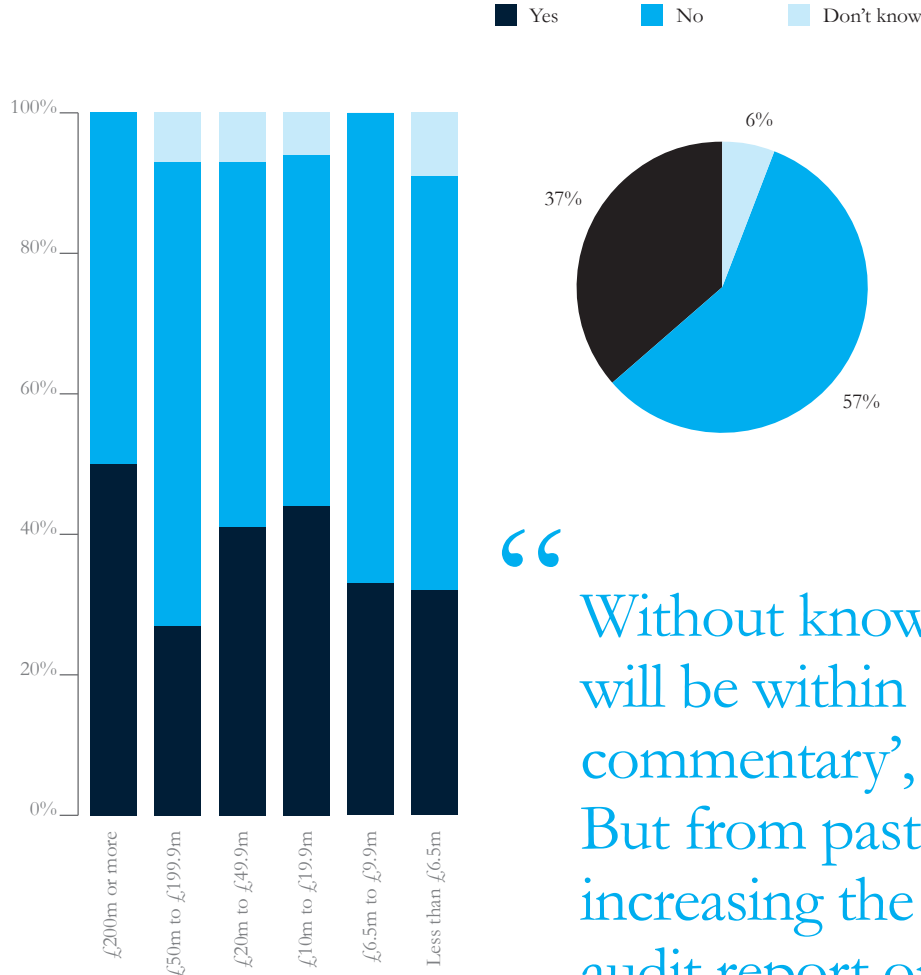
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“

Any auditor comments at all would result in increased suspicion about the company, even if favourable.

”

Do you think that providing auditor commentary on matters significant to the users' understanding of the audited financial statements is a good idea for your company?

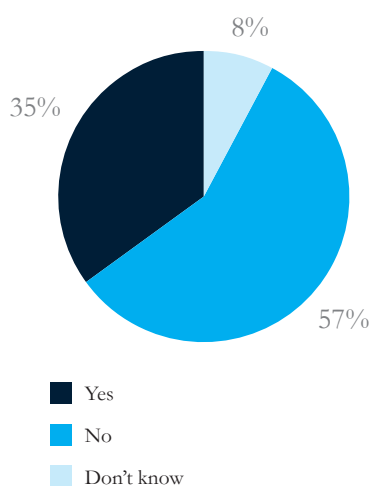


“ Without knowing exactly what will be within the ‘auditor commentary’, I cannot comment. But from past experience, increasing the length of the audit report or adding additional sections to the directors’ report has not achieved [the intended objectives]. ”

Only a third of businesses thought that audit reports should include more information on the auditors' perception of accounting policies, judgements and estimates.

In essence respondents felt that auditors should stick to what they do now; going public on their views of management's judgements would not be helpful and could potentially be damaging.

Is it appropriate for the audit report to include more information regarding the auditors' perception of accounting policies and of management's critical accounting judgements and estimates?



The validity of auditor commentary was questioned by many respondents:

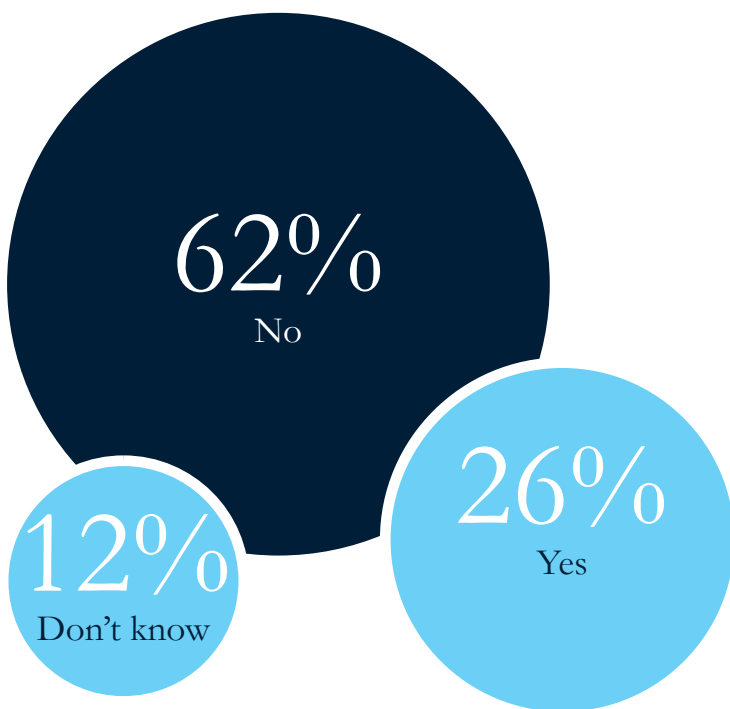
"The auditors' comments would be far too subjective and be applied differently by different auditors, so there would be inconsistency across the profession. That would leave us uncertain of where we stand and in the end, such comments would be discredited."

"The auditor's opinion on matters of added value would be entirely subjective and probably bring them into conflict with management on a more regular basis."

"Audits are only suitable to comment on internal controls and whether or not the accounting figures show a true and fair view. All other matters are the responsibility of the company's management."

"Of greater risk to a business are the benefits of such extended commentary to competitors."

Does the added value of the audit report becoming more transparent to shareholders and the public make up for the inevitable increase in cost?



Increasing cost was not popular with respondents:

“Why should costs increase? Two or three sentences on certain issues would be beneficial, but there should not be the need to write pages of information.”

“Country is skint - wasting resources on more compliance is not helpful.”

“Cut the red tape not increase it for SMEs.”

“Any additional commentary would place audit firms at a significant level of risk which may lead to costly litigation. From this perspective it is difficult to see how any additional commentary by auditors would add value to the financial statements.”

## The reporting burden - annual reports

There is a move to cut clutter in annual reports to reduce their length and increase clarity.

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73% voted to cut clutter

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78% did not believe reducing clutter would reduce the value of financial statements

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### What respondents said about which clutter to cut:

“Clutter such as to do with equal opportunities, corporate social responsibility and even related parties trading should be removed (or moved to a separate section at the end).”

“Disclosure notes should not be a one size fits all, a manufacturing entity will have different risks to a high street retailer or a bank.”

“Some of the notes are too restrictive in their content e.g. financial instruments.”

“Raise the thresholds for some types of disclosure e.g. wages and salaries disclosure, cash flow statements etc.”

The lengthy and detailed FRS17 disclosures are particularly unpopular.

### What respondents said about FRS17:

“Does anyone read the pensions note?”

“Much of the detail is undecipherable even by well informed readers.”

“The position on FRS17 needs a total re-think. The pension figures turn the whole set of accounts into nonsense and become the focal point of the AGM.”

“FRS17 disclosure takes up several pages and the provisions can distort the accounts. A quality note explaining the surplus/deficit would be more informative.”

“

Annual reports have too many requirements which are only relevant to large companies - the significance of relevant data is lost in smaller companies.

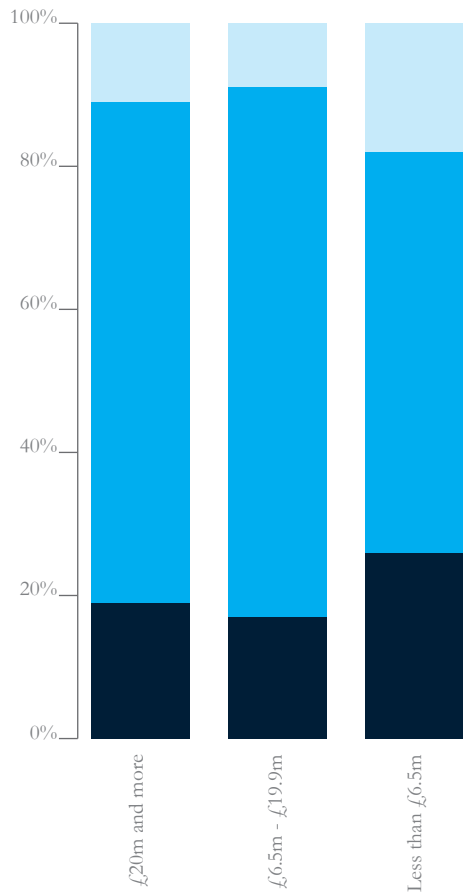
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# The reporting burden - real time reporting

There are proposals to develop 'Real Time Annual Reporting' involving directors publishing regular online management information reviewed by the auditor.

Should directors publish regular online financial information which has been reviewed by the auditors?

■ Yes    ■ No    ■ Don't know



**What respondents said about publishing regular management information:**

“More regulation, more obligations on directors, less time to effectively manage your business.”

“Too regular financial reporting would further encourage the already excessive short termism in company assessments.”

“As a general rule, my feeling is that more information is always better. However the benefits of the level and frequency of disclosure are proportional to the size of the company. It would be totally inappropriate to burden a six person company with the same reporting requirements of a 150 person company.”

“This is a huge distraction at a time when the economy needs a focus on growth, efficiency and productivity.”

66%  
against real time reporting

“

Some notes are now so confusing that even the accountants don't know how to produce them.

”

**Finance executive,**  
Public quoted company,  
£50m-199m turnover



“

Auditors don't write the financial reporting rules. Like companies, we have to interpret and comply with them. Simplification would be welcomed rather than rejected by most auditors as it would benefit our clients. Additional burdens such as subjective auditor commentary or real time reporting seem, particularly in the current climate, both unnecessary and unhelpful.

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## The audit crystal ball

One of the Financial Reporting Council's recent key criticisms of audits is that they are historical and do not provide enough information on impending as well as past performance. However, whilst 40% of respondents felt their directors would be comfortable predicting their companies' future performance, only 20% thought any comment given by the auditor on future predictions would be reliable.

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80%

doubt the validity of auditor  
comments on directors' predictions

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Many respondents were negative about the idea of auditors commenting on directors' predictions:

"An audit should be a question of reviewing factual accounts and looking at subjective issues. Any move towards reviewing forecasts distracts from this and could result in less trust in auditors if the forecasts prove inaccurate."

"A simple prognosis/diagnosis of company health would be useful."

"The emphasis should change to looking forward rather than purely historical. But legal liability would then need clarifying."

"Future predictions are difficult even for managers of businesses."

“

If auditors could predict the future they would be in the stock market. In the market place, auditors need to really understand a business.

Finance director,  
Less than £6.5m turnover

”



“

It is essential that auditors understand the business that they are auditing and, as such, they need to look at management's views of the future. However, much as our respondents suggest, apart from considering whether a company is a 'going concern', something already required, assessments of future predictions would be difficult, if not impossible.

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## And finally...

We hope you have found the survey useful.

There is no doubt that the way an audit is conducted will change. How significant this will be and what effect this will have on companies and audit firms remains to be seen. We await the outcomes of various European and UK consultations with interest but hope that the needs of businesses rather than politicians win out.

We have written to the offices of:

- Vince Cable, Secretary of State for Business, Innovation and Skills
- Mark Prisk MP, Minister of State for Business and Enterprise
- Chuka Umunna, Shadow Secretary of State for BIS
- Adrian Bailey MP, Chair of the BIS Select Committee
- Henry Baker, HM Treasury
- Marek Grabowski, The Auditing Practices Board, Financial Reporting Council
- Simon Walker, Institute of Directors (IOD)
- John Cridland, Confederation of British Industry (CBI)
- Mike Cherry and John Walker, the Federation of Small Businesses (FSB)
- John Longworth, British Chambers of Commerce

Look out for further updates on [twitter](#) 

Have your say; join our debating group on [LinkedIn](#) 

Sign up for future Baker Tilly news on audit issues or contact Baker Tilly at [info@bakertilly.co.uk](mailto:info@bakertilly.co.uk)

“

The ...rules and standards produce accounts that no longer resemble the fundamentals of many businesses - we need to look at the unnecessary and unhelpful (more complex) accounting standards, not throw out the auditors all together.

Finance executive,  
Public quoted company,  
£50m-£199m turnover

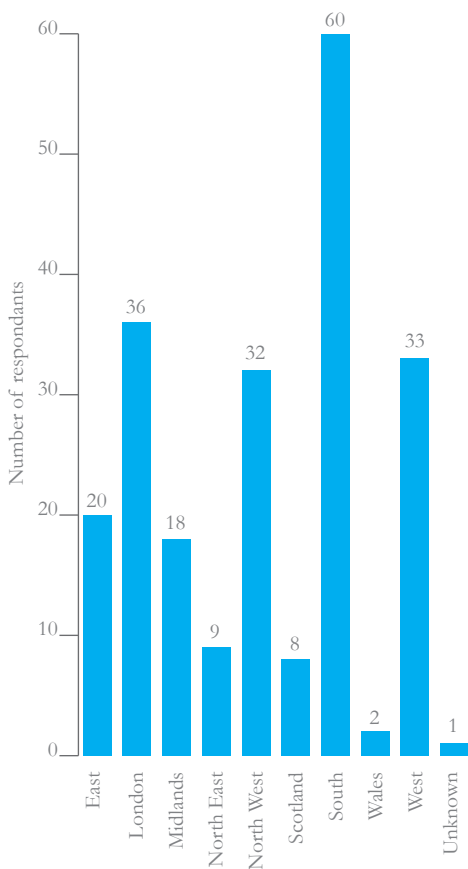
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# Methodology

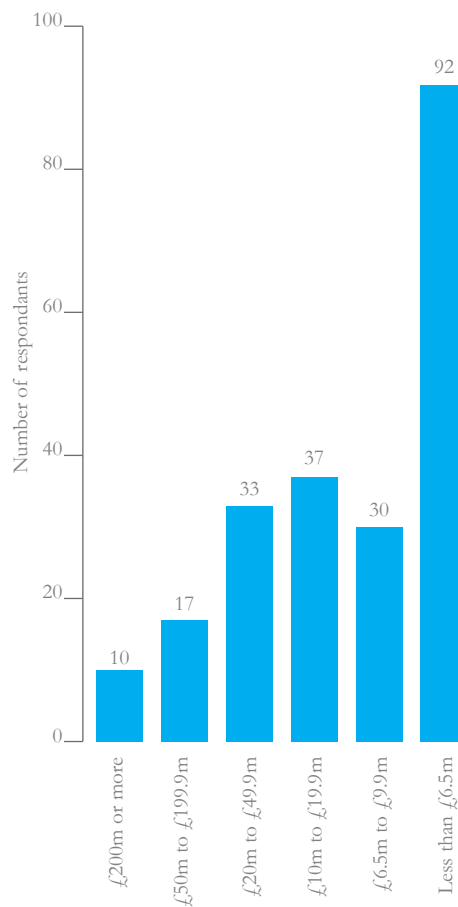
The research was conducted by an anonymous survey between 17 August and 9 September 2011.

- A total of 219 businesses responded to the survey from across the UK.
- Although 42% of respondents had a turnover less than £6.5m (the current audit threshold), only half of these were audit exempt. Overall 77% of respondents were required to have an audit under current legislation.
- Most of the respondents were directors, mainly finance directors. Of those that were not directors most held significant positions within the organisation such as company secretary or financial controller.
- 76% were UK private limited companies.

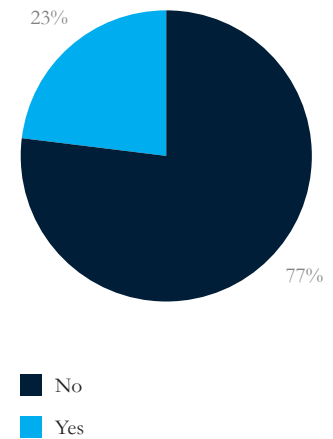
## Region



## Turnover



## Audit exempt





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