Title:	Impact Assessment (IA)
Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) (Amendment) Regulations 2011	**IA No:** BIS0292
	Date: 01/07/2011
Lead department or agency: BIS	**Stage:** Final
	Source of intervention: Domestic
Other departments or agencies: Auditing Practices Board of the Financial Reporting Council (APB)	**Type of measure:** Secondary legislation
	Contact for enquiries: Paul Smith, Tel: 020 7215 4164, Email: pauld.smith@bis.gsi.gov.uk

Summary: Intervention and Options

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

(1) The administrative burden of the two disclosure frameworks for non-audit services using two different classifications;
(2) The information asymmetry for shareholders as to the auditor's compliance with the ethical standards on provision of non-audit services;
(3) The absence of a clear linkage of the disclosure under the 2008 regulations to the classification under the 4th and 7th Company Law Directives;
(4) The information asymmetry resulting from absence of disclosure of services provided by auditors to parties connected to the company.

What are the policy objectives and the intended effects?

The objective of the proposed changes, outlined above, is to address the information issues associated with the current classification of non-audit services that must be used for disclosure in the notes to accounts of large companies. This will:
- ensure clearer disclosure, improving insight for shareholders into the non-audit services the auditor has provided and the questions around their independence that arise, including what steps the auditor has taken to ensure their independence in accordance with the revised ethical standards;
- link more clearly to the classification of non-audit services under the 4th and 7th Company Law Directives making reporting easier and company records easier to follow.

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

Option 1 [preferred option]: replace the classification in the regulations to create a clear connection to that in the APB ethical standards, and to that in the 4th and 7th Company Law Directives, simplifying where possible. **Option 2:** Do nothing. **Option 3 [non-regulatory option]:** APB to produce guidance on how to reconcile the disclosures under the regulations and the ethical standards, including their existing reconciliation pro forma, to also cover 4th and 7th Company Law Directive requirements. **Option 4:** replace the classification in the regulations (in line with option 1) and require additional disclosure under the regulations of services provided to parties connected to the company.
BIS has concluded that Option 1 above is its preferred option. Legislation is justified to remove the unnecessary burden of different classifications of non-audit services in the regulations and APB ethical standards. We do not think further regulation on additional disclosure (option 4) is justified.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 10/2016
What is the basis for this review? PIR. **If applicable, set sunset clause date:** Month/Year

Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	Yes

SELECT SIGNATORY Sign-off For final proposal stage Impact Assessments:

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) the benefits justify the costs.

Signed by the responsible Minister: Edward Davey Date: 19 August 2011

URN 10/1268 Ver. 2.0 12/10

Summary: Analysis and Evidence

Policy Option 1

Description:

Replace the classification in the regulations to create clear connections to that in the APB ethical standards, and to that in the 4th and 7th Company Law Directives.

Price Base Year 2011	PV Base Year 2011	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 7.99	High: 21.91	Best Estimate: 14.95

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	NA		NA	**NA**
High	NA		NA	**NA**
Best Estimate	0		0	**0**

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

None to either auditors or companies. Disclosures are based on data supplied by the auditor, who would probably pass the cost onto companies through their fees. These will be unchanged. The new classification of non-audit services is already in use in the revised ethical standards. Comments on the draft amendments to the 2008 regulations have not raised any additional complexity or ongoing cost to auditors involved in using it in place of the current one.

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

Negligible for both auditors and companies. Any transitional costs have already been expended by auditors with the commencement of the revised ethical standards to analyse the non-audit services they have provided, including using the new classification. Further transitional costs are unlikely to arise.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0		1.05	**7.99**
High	0		2.88	**21.91**
Best Estimate	0		1.97	**14.95**

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

Estimated benefit to auditors and companies developed in consultation with APB. There will be a benefit from removing the requirement for auditors to use two different classifications and to have to produce a reconciliation between them. The reduced annual cost is based on estimates of the time required and the cost per hour of appropriate personnel for 5,000 to 9,000 disclosures per year. This benefit to auditors will be transferred in part to companies.

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

The main non-monetised benefit will result from the additional transparency shareholders and other users of the published accounts will have as to the auditor's analysis of threats to their independence, enabling shareholders to ask questions about the safeguards in place, improving confidence of investors. Also there are marginally fewer classes of non-audit services in the new schedule and some classes of service are defined so as to remove some of the problems of classification that arose previously.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

The analysis above assumes that the suggested benefits will be realised in full and that no further or unanticipated costs will arise.

Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as
Costs: 0	**Benefits:** 1.68	**Net benefit:** 1.68	Yes	OUT

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?	United Kingdom				
From what date will the policy be implemented?	01/10/2011				
Which organisation(s) will enforce the policy?	Financial Reporting Review Panel (part of the Financial Reporting Council) / Companies House				
What is the annual change in enforcement cost (£m)?	0				
Does enforcement comply with Hampton principles?	Yes				
Does implementation go beyond minimum EU requirements?	No				
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)	**Traded:**	**Non-traded:**			
Does the proposal have an impact on competition?	Yes/No				
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?	**Costs:** 0	**Benefits:** 0			
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	**Micro** 0	**< 20** 0	**Small** 0	**Medium** 0	**Large** 100
Are any of these organisations exempt?	Yes	Yes	Yes	Yes	No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on…?	Impact	Page ref within IA
Statutory equality duties[1] Statutory Equality Duties Impact Test guidance	No	18
Economic impacts		
Competition Competition Assessment Impact Test guidance	No	18
Small firms Small Firms Impact Test guidance	No	18
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	18
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	18
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	18
Human rights Human Rights Impact Test guidance	No	18
Justice system Justice Impact Test guidance	No	18
Rural proofing Rural Proofing Impact Test guidance	No	18
Sustainable development Sustainable Development Impact Test guidance	No	18

[1] Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Summary: Analysis and Evidence

Policy Option 2

Description:

Do nothing.

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£0m)		
2011	2011	10	**Low:** 0	**High:** 0	**Best Estimate: 0**

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	0		0	**0**
High	0		0	**0**
Best Estimate	0		0	**0**

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

There will be no associated additional costs (or benefits) as this option presents the status quo. Given the different disclosures that are required under the regulations and the ethical standards, auditors (who must provide the necessary data for companies to disclose) generally also have to provide a reconciliation between the two, this situation will not change under this option. The APB has already produced a template to help auditors carry out this reconciliation.

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	**0**
High	0		0	**0**
Best Estimate	0		0	**0**

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

None.

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

None.

Key assumptions/sensitivities/risks | **Discount rate (%)** 3.5

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

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?	United Kingdom				
From what date will the policy be implemented?	01/10/2011				
Which organisation(s) will enforce the policy?	Financial Reporting Review Panel (part of the Financial Reporting Council) / Companies House				
What is the annual change in enforcement cost (£m)?	0				
Does enforcement comply with Hampton principles?	Yes				
Does implementation go beyond minimum EU requirements?	No				
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)	**Traded:**		**Non-traded:**		
Does the proposal have an impact on competition?	No				
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?	**Costs:** 0		**Benefits:** 0		
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	**Micro** NA	**< 20** NA	**Small** NA	**Medium** NA	**Large** NA
Are any of these organisations exempt?	Yes	Yes	Yes	Yes	Yes

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on…?	Impact	Page ref within IA
Statutory equality duties[1] Statutory Equality Duties Impact Test guidance	No	NA
Economic impacts		
Competition Competition Assessment Impact Test guidance	No	NA
Small firms Small Firms Impact Test guidance	No	NA
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	NA
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	NA
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	NA
Human rights Human Rights Impact Test guidance	No	NA
Justice system Justice Impact Test guidance	No	NA
Rural proofing Rural Proofing Impact Test guidance	No	NA
Sustainable development Sustainable Development Impact Test guidance	No	NA

[1] Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Summary: Analysis and Evidence

Policy Option 3

Description:

APB produce guidance on reconciling disclosures under the regulations and the ethical standards, including the existing reconciliation pro forma, to also cover 4th and 7th Company Law Directive requirements

Price Base Year 2011	PV Base Year 2011	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: NA	High: NA	Best Estimate: - 0.006

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	NA		NA	**NA**
High	NA		NA	**NA**
Best Estimate	0.006		0	**0.006**

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

Cost to the Auditing Practices Board of producing guidance. The APB already produces a template for auditors to reconcile the disclosures required by the regulations and the revised ethical standards. BIS could ask them to expand this into a guidance document also including discussion on how the disclosure under the regulations should be given in order to comply clearly with the 4th and 7th Company Law Directives.

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

One possible cost would arise from the fact that the guidance would articulate an interpretation of the disclosure requirement in the 4th and 7th Company Law Directives. Doing so could expose difficulties that arise at the margins between "assurance services" and "other non-audit services" where the distinction under the Directive and the 2008 regulations is somewhat unclear, though broadly consistent under the two instruments.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	NA		NA	**NA**
High	NA		NA	**NA**
Best Estimate	0		0	**0**

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

It isn't clear what benefit there would be for users of this additional guidance. Though the current compliance of the 2008 regulations with the 4th and 7th Company Law Directive requirement is not as clear as it might be, we do not think that in practice this imposes a burden on auditors and companies preparing accounts.

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

There would also be almost no benefit to the UK government in using guidance to ensure disclosure under the regulations complies with the Directives. European law requires implementation of Directive requirements to be clear in legislation. Non-legislative guidance to address any lack of clarity cannot resolve this problem.

Key assumptions/sensitivities/risks | **Discount rate (%)** | 3.5

This non-legislative option would not affect the requirement for the auditor to produce a reconciliation of disclosures required by the regulations and by the ethical standards. In some cases the auditor may have to revise or add to the reconciliation they would prepare using the template currently in the ethical standards. But as with option 2 (do nothing) we do not think the requirement to produce a reconciliation arises from this option. It has already arisen from the revised ethical standards.

Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as
Costs: 0.006	Benefits: 0	Net benefit: - 0.006	Yes	IN

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			United Kingdom			
From what date will the policy be implemented?			01/10/2011			
Which organisation(s) will enforce the policy?			Financial Reporting Review Panel (part of the Financial Reporting Council) / Companies House			
What is the annual change in enforcement cost (£m)?			0			
Does enforcement comply with Hampton principles?			Yes			
Does implementation go beyond minimum EU requirements?			No			
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:**		**Non-traded:**	
Does the proposal have an impact on competition?			No			
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			**Costs:** 0		**Benefits:** 0	
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	**Micro** 0	**< 20** 0	**Small** 0	**Medium** 0	**Large** 100	
Are any of these organisations exempt?	Yes	Yes	Yes	Yes	No	

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on…?	Impact	Page ref within IA
Statutory equality duties[1] Statutory Equality Duties Impact Test guidance	No	NA
Economic impacts		
Competition Competition Assessment Impact Test guidance	No	NA
Small firms Small Firms Impact Test guidance	No	NA
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	NA
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	NA
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	NA
Human rights Human Rights Impact Test guidance	No	NA
Justice system Justice Impact Test guidance	No	NA
Rural proofing Rural Proofing Impact Test guidance	No	NA
Sustainable development Sustainable Development Impact Test guidance	No	NA

[1] Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Summary: Analysis and Evidence — Policy Option 4

Description:

Replace the classification in the regulations (in line with option 3) and require additional disclosure under the regulations of services provided to parties connected to the company

Price Base Year 2011	PV Base Year 2011	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -107.17	**High:** -28.04	**Best Estimate: --67.61**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0.5		6.5	**49.95**
High	1.5		14.94	**115.16**
Best Estimate	1.0		10.72	**82.55**

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

Estimates developed in consultation with the APB. The average annual costs are based on hours additional accounting work required to identify services provided to parties connected to the company (CPs) in 5,000 to 9,000 disclosures per year. There are additional transitional costs in the first year, as this change would require auditors to put in place additional systems with companies to identify the recipients of these services and their value.

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

Other disadvantages revolve around the potential confusion which identifying and disclosing these additional services could create. First, auditors and companies (perversely) may learn of non-audit services to CPs they were previously unaware of and unaffected by. Second, users of information will not understand the relative significance of the threat to the auditor's independence (resulting from extent of influence of services on accounting and audit findings), only the relative fees paid.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0		1.05	**7.99**
High	0		2.88	**21.91**
Best Estimate	0		1.97	**14.95**

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

Unclear whether there would be any genuine quantifiable benefits above and beyond those for option 1. In a small number of cases there may be benefits from additional transparency for shareholder confidence. Even for them, effectiveness could be seriously compromised.

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

None beyond those for option 1. Any non-monetised benefits to shareholders and creditors could be compromised in any case by misapprehensions among shareholders as to the significance of any disclosure, given the range and number of CPs for large listed companies and groups, and the resulting likelihood of uncovering spurious data.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

Much of the discussion above about costs and benefits is based on assumptions about the likely effects of implementing this policy option in practice.

Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as
Costs: 8.72	**Benefits:** 1.68	**Net benefit: - 7.15**	Yes	IN

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?	United Kingdom				
From what date will the policy be implemented?	01/10/2011				
Which organisation(s) will enforce the policy?	Financial Reporting Review Panel (part of the Financial Reporting Council) / Companies House				
What is the annual change in enforcement cost (£m)?	0				
Does enforcement comply with Hampton principles?	Yes				
Does implementation go beyond minimum EU requirements?	Yes				
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)	**Traded:**	**Non-traded:**			
Does the proposal have an impact on competition?	Yes				
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?	**Costs:** 0	**Benefits:** 0			
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	**Micro** 0	**< 20** 0	**Small** 0	**Medium** 0	**Large** 100
Are any of these organisations exempt?	Yes	Yes	Yes	Yes	No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on…?	Impact	Page ref within IA
Statutory equality duties[1] Statutory Equality Duties Impact Test guidance	No	NA
Economic impacts		
Competition Competition Assessment Impact Test guidance	No	NA
Small firms Small Firms Impact Test guidance	No	NA
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	NA
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	NA
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	NA
Human rights Human Rights Impact Test guidance	No	NA
Justice system Justice Impact Test guidance	No	NA
Rural proofing Rural Proofing Impact Test guidance	No	NA
Sustainable development Sustainable Development Impact Test guidance	No	NA

[1] Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

References

Include the links to relevant legislation and publications, such as public impact assessments of earlier stages (e.g. Consultation, Final, Enactment) and those of the matching IN or OUTs measures.

No.	Legislation or publication
1	Draft Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2011 published by BIS for comment - www.bis.gov.uk/assets/biscore/business-law/docs/c/11-818-companies-disclosure-auditor-agreements-regulations-draft.pdf
2	Explanatory text on draft regulations - www.bis.gov.uk/assets/biscore/business-law/docs/e/11-819-explanatory-text-draft-companies-disclosure-auditor-agreements.pdf
3	The Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008 - www.legislation.gov.uk/uksi/2008/489/pdfs/uksi_20080489_en.pdf
4	APB Ethical Standards - www.frc.org.uk/apb/publications/ethical.cfm
5	APB Review Documentation - www.frc.org.uk/apb/publications/pub2324.html
6	Inspectors Report into Rover Group ltd and Phoenix Venture Holdings ltd (Volume 1) - www.bis.gov.uk/files/file52782.pdf
7	Inspectors Report into Rover Group ltd and Phoenix Venture Holdings ltd (Volume 2) - www.bis.gov.uk/files/file52783.pdf (see pages 675 to 686 in particular)
8	As background - Impact Assessment for the original Companies (Disclosure of Auditor Remuneration) Regulations 2005 www.legislation.gov.uk/uksi/2005/2417/pdfs/uksiem_20052417_en.pdf
9	

Annual profile of monetised costs and benefits* - (£m) constant prices

Option 1.	Y_0	Y_1	Y_2	Y_3	Y_4	Y_5	Y_6	Y_7	Y_8	
Transition	0	0	0	0	0	0	0	0	0	0
Annual	0	0	0	0	0	0	0	0	0	0
Total annual	0	0	0	0	0	0	0	0	0	0
Transition	0	0	0	0	0	0	0	0	0	0
Annual	0	1.97	1.97	1.97	1.97	1.97	1.97	1.97	1.97	1.97
Total annual	0	1.97	1.97	1.97	1.97	1.97	1.97	1.97	1.97	1.97

* For non-monetised benefits please see summary pages and main evidence base section

DISCLOSURE OF
JDITOR REMUNERA

Evidence Base (for summary sheets)

Problem under consideration

1. The UK regulatory framework for company audit has long recognised the importance of the impartiality of the auditor in advising the shareholders on whether the company's accounts represent a true and fair view of the financial position of the company. The auditor is appointed by the shareholders under company law and is expected to be independent of the company directors. Increasingly over the last 20 years, it has been recognised that this independence can be called into question when the auditor is also engaged to provide other "non-audit services" to the company. The existence of a wider business relationship between the company and it's auditor could be viewed as a potential threat to independence on its own, because that wider business provides the auditor with another source of income. However there are also more specific potential threats to independence, which may arise depending on the type of non-audit service provided. An example of this is the kind of "self-review" threat that might arise where an auditor has to review work which they have previously done in a non-audit capacity, such as where they have already provided internal audit services. A perceived lack of independence in the audit can affect confidence and investment due to perceived lack of transparency around whether the company's financial statements present a true and fair view of its financial position.

Background on the 2008 regulations and the APB ethical standards

2. The Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008 require disclosure in notes to the company's annual accounts of the amounts the company (with the wider members of the group if the company is part of one) has paid to it's auditor for various non-audit services. This works in parallel with the ethical standards produced by the Auditing Practices Board (APB). The standards are produced by the APB under arrangements with the Recognised Supervisory Bodies for Auditors (RSBs) to ensure the standards are set independently of the audit profession. They set out principles requiring auditors to undertake an analysis of threats to their independence (including from the provision of non-audit services) and to put in place any necessary safeguards in order to reduce the threats to an acceptable level. In some cases, it may be necessary for the auditor to refuse to provide certain non-audit services or alternatively to decline the audit appointment, to comply with the ethical standards.

3. Under Ethical Standard 5, which deals specifically with the provision of non-audit services, an analysis of threats, and identification of example safeguards, is set out under different headings of non-audit service that the auditor might provide. The standard also highlights those circumstances where it is unlikely that the threats can be reduced to an acceptable level, in effect identifying those services for which the threats to the auditors' independence are more significant.

Problems under consideration

4. It therefore makes sense if the classification of non-audit services under Ethical Standard 5 links to the classification of non-audit services for the purposes of disclosure in large companies' accounts. Following a review of the APB ethical standards[1], completed with revisions to the standards in December 2010, the classifications under the ethical standards and the 2008 regulations[2] are currently out of line. This imposes an additional administrative burden on companies and their auditors as, having undertaken an analysis of non-audit services for the purposes of complying with the ethical standards, and given disclosures to the company on this, the auditor is required by a quite separate framework in the 2008 regulations to provide information so that the company can disclose the fees for those services in its accounts. As the company is likely to need some assurance that the disclosure it received under the ethical standards is consistent with that it is advised to make under the 2008 regulations, the auditor will often have to produce a reconciliation as between the two.

5. Across the three options considered in this impact assessment, there are four problems which amendments to the 2008 regulations might potentially address. These are:

   - The administrative burden on auditors and companies of the two disclosure frameworks for non-audit services using two different classifications of non-audit services - this leads to the auditor having to provide the company with a reconciliation of the information in the two disclosures.

[1] See reference 5
[2] See reference 3

- The information asymmetry for users of the published accounts (particularly shareholders) who do not have the insight the company's audit committee and directors have into the process the auditor has gone through to identify potential threats to their independence - addressing this would allow shareholders to ask questions about the safeguards auditors have put in place and about the discussions on this that have taken place between auditors, audit committees and directors;
- The absence of a clear linkage of the disclosure under the 2008 regulations to the classification of non-audit services under the 4th and 7th Company Law Directives;
- The information asymmetry resulting from absence of disclosure in notes to the accounts of services provided by the company's auditor to parties connected to the company - these "connected parties" may be other companies owned or controlled by the directors of the company, some of which might conceivably have business relationships with the auditor which threaten the auditor's independence or confidence in it.

The information asymmetries described above could have the effect for some companies of undermining the perceived independence of the audit, and confidence that the accounts present a true and fair view of the company's finances. The confidence of users of accounts, particularly shareholders and investors is essential to continued investment.

Background on the APB review of ethical standards

6. In May 2009, the House of Commons Treasury Select Committee's report "The Banking Crisis: Reforming Corporate Governance and Pay in the City" raised concerns about the fees paid to auditors by companies that they audit for non-audit services provided in the run-up to the financial crisis. The APB responded to this by undertaking a review of the ethical standards. Auditors are subject to the ethical standards under rules applied by the recognised supervisory bodies (RSBs - certain accountancy institutes) by virtue of the auditor's contractual membership of the bodies. However the RSBs are required to impose these rules by the Companies Act 2006. The APB has responsibility to set the ethical standards independently of the audit profession and does so following thorough consultation, and in line with better regulation principles.

7. The APB review of the ethical standards began with a "Consultation on audit firms providing non-audit services to listed companies that they audit" in October 2009. With BIS's agreement, the consultation included consideration of the most appropriate classification of non-audit services for the purposes of both the ethical standards and disclosure under the 2008 regulations. The APB received 150 responses to the consultation. In July 2010 the APB followed up the first consultation with a "Feedback and Consultation Paper: The Provision of Non-Audit Services by Auditors" which included draft amendments to the ethical standards. The APB received 39 responses on the consultation and draft amendments to the ethical standards and issued a final feedback statement with the revised standards. The responses to both consultations were broadly supportive of amendments to the classification in the 2008 regulations so that it aligned with the classification in the revised ethical standards. The consultations also covered consideration of services provided by the company's auditor to parties connected to the company (discussed below). Proposals on this issue were narrowed as a result of the consultation, though some amendments were made to the ethical standards as a result.

8. The APB completed its review of the ethical standards on non-audit services in December 2010. The changes to the standards include a revision of the classification of non-audit services. It is used to identify possible threats to the auditor's independence and possible safeguards which could be put in place to address these. The revised ethical standards then require the auditor to disclose their analysis of threats to their independence to the audit committee. This requirement is in addition to that in the 2008 regulations for the auditor to supply to the company the information needed for it to make the disclosure under those regulations. The disclosure under the 2008 regulations is to a much wider audience however. The company's accounts, including the notes on non-audit services, must be provided to shareholders and filed at Companies House so that they are available to creditors and potential investors.

Background on the classification of non-audit services under the 4th and 7th Company Law Directives

9. The headings currently used in Schedule 2 for the classification of non-audit services are those originally used in the Companies (Disclosure of Auditor Remuneration) Regulations 2005 (SI 2005/2417). Those regulations predated the amendments to the 4th and 7th Company Law Directives requiring disclosure in notes to the company's accounts under EU law. Those provisions resulted from amendments made by the Audit Directive (2006/43/EC), which inserted them at Article 43.1(15) of the 4th Company Law Directive (78/660/EEC) and Article 34.16 of the 7th Company Law Directive (83/349/EEC). They required a large company, in notes to its accounts, or a large group in notes to its consolidated accounts, to

disclose the audit fee, as well as the any fees it had paid for other assurance services, taxation advisory services and other non-audit services.

10. When the Directive was implemented as part of the implementation of the Companies Act 2006, it was felt that the classification of non-audit services in the Directive (under 3 headings: other assurance services; tax advisory services and other non-audit services) matched sufficiently well with groupings of the headings in the original schedule, so that no change was needed to it. This was supported by respondents to the Government's consultations on implementation, and has been reflected more recently in the general development of APB policy on provision of non-audit services.

11. However, the amendments to the ethical standards present a good opportunity to provide a classification which can more clearly be linked to the headings in the Directives. Though there would probably be no cost or benefit for auditors or companies in creating a clearer linkage to the directive classification of non-audit services under the Directive, it would put the UK's compliance with its EU obligations beyond doubt. The regulations prepared under option 1 (the preferred option) reduce gold-plating of the implementation of the requirements in the 4th and 7th Company Law Directives and do not add any additional new requirements that would gold-plate the requirements in the Directives. This contrasts with option 4, which would add a new disclosure requirement which does not feature in the Directives
.

12. Attached at **Annex 2** is a comparison of the classifications of non-audit services used in the 2008 regulations; in the draft amendments to the 2008 regulations; and in the 4th and 7th Company Law Directives.

Services to parties connected to the company – the findings of the inspectors report into MG Rover Group ltd and Phoenix Venture Holdings ltd

13. BIS has considered whether further amendments may be needed to the 2008 regulations in response to the findings of the Inspectors appointed by the Secretary of State under the Companies Act 1985 to investigate the affairs of Phoenix Venture Holdings Ltd, MG Rover Group Ltd and 33 other companies. The report, published in September 2009, identified that, under predecessor regulations to the 2008 regulations, Phoenix Venture Holdings Ltd had disclosed non-audit fees which were considerably lower than those that the Inspectors found had been paid. When the report was published the then Secretary of State asked the Financial Reporting Council (FRC) to look into certain matters relating to the inspectors' findings. Having identified the associated issues, the FRC recommended that the Government review the 2008 regulations after the APB review of the ethical standards was completed.

14. The reason the inspectors found higher total payments than had been declared, in fees for non-audit services, was that the auditor was also earning fees for services to companies "connected" to Phoenix Venture Holdings Ltd, which were separate corporate vehicles owned and controlled by the directors, but not part of the Phoenix group. Fees for non-audit services provided to those corporate vehicles would not be required to be disclosed under the 2008 regulations.

15. It is therefore necessary to consider whether the 2008 regulations should be amended to require disclosure of fees for non-audit services to "connected parties" of this kind. The APB's Ethical Standards have already been amended to make provision for the auditor to disclose significant services of this kind to the audit committee, in response to the inspectors' findings. To go further than this, so as to require disclosure in the notes to the accounts would require additional (and probably separate) disclosure, based on a complicated definition of what is a "connected party". To cover companies like Phoenix Venture Holdings Ltd, this would need to apply to all large companies.

BIS project to review the classification of non-audit services in the 2008 regulations

16. Based on the APB's conclusions on the revision of the ethical standards, and on further discussion with APB officials on the effect of the 4th and 7th Company Law Directives, BIS published draft amendments to the 2008 regulations in March 2011 to give effect to the preferred option considered in this Impact Assessment. The deadline for comments on the draft amendments was 30 June 2011 and BIS received 9 responses. All the responses were broadly supportive of the proposed amendments, though some respondents did raise specific issues on the detailed drafting, which BIS has considered.

Rationale for intervention

Information asymmetry

17. The APB's ethical standards were amended to provide greater assurance of auditors' independence and to improve the dialogue between the auditor and the company about the steps the auditor had taken to ensure their independence. However the ethical standards do not facilitate any disclosure to shareholders. This is the role of the 2008 regulations. While the disclosure under those regulations is out of line with that to audit committee, there is therefore an information asymmetry for shareholders as they have no insight into the information provided to the company's audit committee or directors or into what steps the auditor has taken in accordance with the ethical standards. As is generally the case with company law, the only way to address the resulting asymmetry for shareholders is via regulatory intervention.

18. This rationale would also apply to measures intended to address the issues that arose in relation to MG Rover Group ltd and Phoenix Venture Holdings ltd. There continue to be potential information asymmetries between the company directors and shareholders because the directors may be aware of questions as to the auditor's independence arising from non-audit services they provide to parties connected to the company. The result of asymmetries of this kind is to cast doubt on the veracity of the audited accounts, damaging the confidence of investors and creditors.

Burden reduction

19. These proposals are intended to address the burdens which arise from requiring disclosure in line with the two separate frameworks under the 2008 regulations and the APB ethical standards. We have considered the extent to which it would be possible to address this problem through non-legislative means, such as guidance. An administrative burden imposed by legislation could not be addressed through guidance. Voluntary guidance on how to reconcile the information required for the two disclosures is already provided in the form of a reconciliation template in the ethical standards, though more guidance could be given. But as both requirements are in binding regulation (whether statutory or applying as a condition of an auditor's membership of their professional institute) guidance can achieve little more than the reconciliation template has achieved already.

Clarity of legislative implementation of EU law

20. Non-legislative intervention could also not address the absence of a clear linkage to the classification of non-audit services under the 4th and 7th Company Law Directives. Under EU law Member States are required to implement Directives clearly, and to do so in legislation. In respect of the requirements in the Directives, it is arguable that the clarity of the current implementation could be improved.

Policy objectives

The objectives of this project are to amend the classification of non-audit services, which must be used for disclosure in the notes to accounts of large companies, in order to:

- ensure clearer disclosure, improving insight for shareholders into the non-audit services the auditor has provided and the questions around their independence that arise, including what steps the auditor has taken to ensure their independence in accordance with the revised ethical standards;
- link more clearly to the classification of non-audit services under the 4th and 7th Company Law Directives.

Description of options considered

Option 1: *(Preferred option) Replace the classification in the regulations to create clear connections to that in the APB ethical standards, and to that in the 4th and 7th Company Law Directives (this option would require BIS to make regulations).*
This is the option implemented in the final amending regulations. Under this option, we would replace the existing Schedule 2 to the 2008 regulations with a new schedule providing a classification of non-audit services under 9 headings which link to the 13 headings used in the ethical standards. The nine headings in the regulations drafted fall into three distinct groups to reflect the three headings used in the 4th and 7th Company Law Directives.

Option 2: *Do nothing.*

The APB commenced its new ethical standards at the end of December 2010 ahead of consideration by the government of whether to amend the 2008 regulations. It produced a template for reconciliation of the disclosure under the ethical standards with that under the 2008 regulations. It would be possible to continue to rely on these however the problems identified above would not be addressed.

Option 3: *(Non-legislative option) APB to produce guidance on how to reconcile disclosures under the regulations and the ethical standards, including their existing reconciliation proforma, to also cover 4th and 7th Company Law Directive requirements.*
The APB has agreed that it would be possible for them to provide guidance to auditors on how they can make sure their disclosure under the 2008 Regulations reconciles directly with that under the ethical standards and is in line with that required by the 4th and 7th Company Law Directive.

Option 4: *Replace the classification in the regulations (in line with option 1) and require additional disclosure under the regulations of services provided to parties connected to the company (this option would require BIS to make regulations).*
Under this option the regulations would be amended in line with option 1, and additionally to require separate disclosure of non-audit services to parties connected to the company. This would require the drafting of a suitable definition of “connected party”, probably based on one of the existing definitions in the Companies Act 2006.

Costs and benefits of each option (including administrative burden);

Option 1: *(Preferred option) Replace the classification in the regulations to create a clear connection to that in the APB ethical standards, and to that in the 4th and 7th Company Law Directives.*

Annual Costs: £0 per year
For all the disclosures issued under the regulations, the data is supplied by the auditor, who almost certainly passes any cost onto companies through their fees. However there is no additional complexity involved in using the new classification of non-audit services in place of the current one. The new classification of non-audit services is already in use in the revised ethical standards. Comments on the draft amendments to the 2008 regulations, received from a range of stakeholders when the amendments were published for comment on the BIS website, suggest there is no additional complexity or ongoing new costs to auditors involved in using it. Any such complexity would in any case result primarily from the implementation of the ethical standards. The ongoing costs to auditors are therefore unchanged.

Transitional costs: £0
Auditors have already applied the revised ethical standards to analyse the non-audit services they have provided, including using the new classification, which is already part of the standards. Any transitional cost will have been expended with the introduction of the ethical standards. No further transitional costs are likely to arise.

Benefits: £1.05 million to £2.88 million per year (undiscounted)
There will be a benefit from removing the requirement for auditors to use two different classifications of non-audit services and to have to produce reconciliation as between them. The current cost associated with having two separate classifications, which must be used for each annual disclosure, has been estimated by the APB based on the time required to gather information on the second analysis and to perform the reconciliation. The APB estimates this to take 3 to 4 hours with the charge-out rate per hour of appropriate personnel estimated by the APB at £70 to £80 per hour. Charge-out rates have been used for all impact calculations in this assessment because this is the form in which the company’s costs would be passed onto the auditor. We estimate there are between 5,000 and approximately 9,000 large companies or groups of companies in the UK, each making one disclosure each year of the non-audit services they have received and fees they have paid. This is based on data from the FAME database[3] on numbers of large companies that either submit group accounts (meaning there must be at least one large company in the group) or that are not in groups. The benefit of removing the costs outlined above is therefore:

[3] http://www.bvdinfo.com/Products/Company-Information/National/FAME.aspx

Minimum within range: 3 hours at £70.00 per hour for 5000 companies = 3 x 70 x 5000 = **£1.05 million per year** (undiscounted)
Maximum within range: 4 hours at £80.00 per hour for 9000 companies = 4 x 80 x 9000 = **£2.88 million per year** (undiscounted)

The best estimate of the benefits of this option is therefore £1.97 million per year, the mid point of the range.

Non-monetised benefits
The main non-monetised benefit will result from the additional transparency that shareholders and other users of the published accounts will have as to the auditor's analysis of threats to their independence. That analysis is already being done using the revised classification in the ethical standards. Shareholders will therefore have an insight into its findings, and be able to anticipate the nature of the risks and possible safeguards that the auditor will have considered, in relation to the non-audit services they provide. Shareholders will then be able to ask questions about the safeguards the auditor has put in place, and assure themselves that the auditor has complied with the ethical standards in this respect, particularly where the company has an audit committee, which would be expected to discuss this with the auditor, in line with the revised guidance to audit committees. Shareholders will be able to ask the audit committee informed questions at the company's AGM about the discussion they and the auditor have had based on the same analysis that the auditor and audit committee have used. This would also be an area where shareholders of quoted companies would be able to raise audit concerns in advance of the AGM, prompting a possible statement from the auditor in response. This will overcome a current information asymmetry for shareholders by providing additional transparency as to the auditor's compliance with the ethical standards. This could be expected to result in increased confidence in the company's accounts and increased investment. Though these benefits are significant it would be impossible to estimate them without going to disproportionate costs of carrying out survey based analysis.

Also there are marginally fewer classes of non-audit services in the new schedule, reducing some complexity. Furthermore some classes of service are defined so as to remove some of the problems of classification that arose previously.

Assumptions / sensitivities / risks
The cost of using two different classifications of non-audit services, and of producing a reconciliation between them, arises from the difference between the 2008 regulations and the APB's revised ethical standards. This has arisen following the APB's revision of the standards. We do not consider these costs arise from legislation. Auditors must comply with the ethical standards as a condition of membership of their professional institute (though the accountancy institutes are required by law to impose a condition along these lines on their members).

Though the APB did not produce an impact assessment document as part of the process of revising the ethical standards, it does adhere to better regulation principles.

The analysis of the costs and benefits of this option above assumes that the suggested benefits will be realised in full and that no further or unanticipated costs will arise.

In calculating the net present value of these benefits (see summary sheets and the section above on "Annual profile of monetised costs and benefits"), we have assumed that costs and benefits will not arise until the completion of the annual accounts of companies affected. This will be at the end of the first accounting year beginning after commencement of the amendments to the regulations ie from October 2012 onwards.

There are likely to be some fluctuations in the cost of appropriate personnel, and the number of large companies and groups over the ten year period used to estimate the benefits of this proposal. However, estimates from the APB suggest costs and benefits are likely to be within the range used. Accordingly for our best estimate, we have selected the mid-point of the range. A precise value cannot be calculated due to the range of factors affecting the number of large companies and groups in the economy and the cost of appropriate personnel. This is a result of both long-term trends in the audit profession, the economic cycle and the case-specific nature of changes in company and group structure.

Option 2: *Do nothing.*

Costs: £0
Benefits: £0

Option 3: *(Non-legislative option) Expand APB guidance on how to reconcile the disclosures under the regulations and the ethical standards to also cover that required under the 4th and 7th Company Law Directives (alternative to regulation).*

Transitional costs: £6,000 in first year (2011 prices)
The APB has provided us with an estimate of the cost of producing guidance on reconciling the disclosure required under the ethical standards with that required for compliance with the regulations and the 4th and 7th Company Law Directives. They estimate there would be a "one off" cost to them of £6,000. This is based on the experience of costs incurred by the APB in 2008 to produce guidance on the effect of another provision of the Companies Act 2006 which was included to implement the 4th and 7th Company Law Directives. APB estimates that on that occasion a very similar guidance document required 70 hours work by APB officials and board members (who discussed a series of draft versions). At current prices, on average this work would cost the organisation £80 per hour. The guidance was then published on the APB website, which would now cost approximately £400. The calculation of the total cost is therefore:
(70 x £80) + £400 = £6,000 total "one off" cost in first year (2011 prices)

Ongoing costs: £0 per year
It is likely there would only be a small number of cases where new APB guidance would require a disclosure or reconciliation to be changed from those currently produced under the regulations and ethical standards. The APB's existing reconciliation pro forma would continue to form part of the guidance, and we do not think further consideration of the current implementation of the 4th and 7th Company Law Directives would result in any amendment to it.

Benefits: £0 per year
There would be no significant additional benefit for users of such guidance. The APB ethical standards already include a reconciliation pro forma. Although the current compliance of the 2008 regulations with the requirements in the 4th and 7th Company Law Directives is not as clear as it might be, we do not think this imposes a burden on auditors and companies preparing accounts. There would also be almost no benefit to the UK government in using guidance to ensure that disclosure under the regulations complies with the Directive. European law requires implementation of the Directive requirement to be clear in legislation. Non-legislative guidance to address any lack of clarity can not resolve this problem.

Assumptions / sensitivities / risks
This non-legislative option would not affect the requirement for the auditor to produce a reconciliation of disclosures required by the regulations and by the ethical standards. In some cases guidance may prompt the auditor to revise or add to the reconciliation they would have prepared using the pro forma in the ethical standards. But this would be a result of the obligations explained in the guidance, rather than the guidance itself. As with option 2 (do nothing) we do not think the requirement to produce a reconciliation arises from this option.

Option 4: *Replace the classification in the regulations (in line with option 1) and require additional disclosure under the regulations of services provided to parties connected to the company.*

Costs: £6.5 million to £14.94 million per year (undiscounted)
Transitional cost: £0.5 to £1.5 in first year
This is based on 12 hours additional accounting work required to identify services provided to parties connected to the company (or to all the companies in the group) (CPs) in 5,000 to 9,000 disclosures per year.

This estimate, provided by the APB, is based on the discussions it had with stakeholders during its review of the ethical standards. The APB considered the issues raised by Rover Group and Phoenix Venture Holdings during its review and initially it developed a proposal whereby the auditor would have had to identify parties connected to the company or group and then undertake an analysis of threats and safeguards related to the provision of non-audit services to them. Stakeholders expressed concern about the extent of the administrative burden involved in identifying all the parties connected to a company (i.e. companies that are, or are largely controlled by, company directors, and subsidiaries of those companies). This process is in addition to the normal process that would then follow of identifying the value of any audit or non-audit services the auditor has provided to those companies, and assembling their disclosure.

The APB has provided the following estimates of the time and costs involved:

First stage (identifying all the parties connected to a company or group of companies) - 6 to 7 hours work by appropriate personnel with a charge-out rate of £150 to £160 per hour. The cost calculation is therefore:

Minimum within range: 6 hours at £150.00 per hour for 5000 companies = 6 x 150 x 5000 = **£4.5 million per year** (undiscounted)
Maximum within range: 7 hours at £160.00 per hour for 9000 companies = 7 x 160 x 9000 = **£10.08 million per year** (undiscounted)

Second stage (estimate by the APB of what is involved in an additional disclosure under the 2008 regulations) – 5 to 6 hours work by appropriate personnel with a charge-out rate of £80 to £90 per hour

The costs calculation is therefore:

Minimum within range: 5 hours at £80.00 per hour for 5000 companies = 5 x 80 x 5000 = **£2 million per year** (undiscounted)
Maximum within range: 6 hours at £90.00 per hour for 9000 companies = 6 x 90 x 9000 = **£4.86 million per year** (undiscounted)

The **total cost** is therefore:
(£4.5 million + £2 million) to (£10.08 million + £4.86 million) **= £6.5 million to £14.94 million per year (undiscounted)**.

Additional transitional cost of: £0.5 million to £1.5 million in first year
APB estimates this will apply for the first year, as auditors will have to put in place additional systems with companies to identify the recipients of these services and their value. This transitional cost would be expected to fall to auditors, though it may well be reflected in audit fees over time.

The best estimate of the costs of this option is therefore £10.7 million per year (undiscounted) with an additional transitional cost of £1 million (2011 prices). The mid points of the range of costs have been taken as the best estimate.

Non-monetised costs
Another disadvantage of this option is the potential confusion which identifying and disclosing these additional services could create. Firstly, auditors and companies may learn of non-audit services to connected parties they were previously unaware of. This is a perverse outcome as, while the auditor was unaware of the services they had been providing to what was in fact a connected party, the auditor's independence would not have been at risk. However, once such a threat to independence is identified there could be a reduction in the level of confidence in the accounts of the company concerned on the part of users. Second users of information will not understand the relative significance of the threat to the auditor's independence resulting from the relative influence services to certain connected parties may have on accounting and audit findings. Reduced confidence may be inappropriate as shareholders and investors will only be aware of the relative fees paid. A significant fee may suggest a significant risk even if the non-audit service is provided to a relatively distantly connected party at relatively low risk to the auditor's independence.

Benefits: £1.05 million to 2.88 million per year (undiscounted)
There would not be any significant, genuine or quantifiable benefits in this proposal above and beyond those for option 3. In a small number of cases there may be benefits from additional transparency for shareholder confidence. Even for these cases, effectiveness could be seriously compromised. Any non-monetised benefits to shareholders and creditors could be compromised in any case by misapprehensions among shareholders as to the significance of any disclosure. The range and number of connected parties for large listed companies and groups, and the resulting likelihood of uncovering spurious data could cause a disclosure to include large figures, which did not. We cannot estimate whether or how much this would affect investment and the size of associated benefits.

The best estimate of the benefits of this option is £1.97 million per year (undiscounted), the mid point of the range of benefits.

Assumptions / sensitivities / risks

Much of the discussion about costs and benefits of this option above is based on assumptions about the likely effects of implementing this policy option in practice.

Summary table of costs and benefits

This table shows best estimates in terms of costs and benefits per year. We have taken the best estimate to be the lowest figure within the estimated costs and benefits range. This is primarily to ensure a conservative estimate of benefits and net benefits, and then for consistency of treatment across all the figures.

Option	Transitional costs	Ongoing costs	Benefits	Net Benefit
Option 1	£0	£0	£1.97 million per year	£1.97 million per year
Option 2	£0	£0	£0	£0
Option 3	£6,000	£0	£0	£0
Option 4	£1 million	£10.72 million per year	£1.97 million per year	-£8.76 million per year (net cost) + £1 million transitional cost

One In One Out

As the preferred option generates a net benefit to the private and voluntary sectors, under the Government's framework for balancing new regulatory burdens with the benefits of other changes to regulation, the preferred option represent a regulatory OUT of value £1.68 million using the EANCB calculated using 2009 base prices as recommended in the OIOO methodology.

Summary and preferred option with description of implementation plan

BIS has concluded that Option 3 above is its preferred option. Legislation is justified to remove the unnecessary burden of different classifications of non-audit services in the regulations and APB ethical standards and to improve transparency for users of published accounts.

We do not think further regulation on additional disclosure (option 4) is justified.

Amendments to the 2008 regulations are planned to be made as soon as possible in order to commence for accounting years beginning on or after 1 October 2011.

Consideration of the need to complete specific impact tests for preferred option (option 3)

Statutory equality duties – No impact in relation to equalities such as race, disability and gender, age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex and sexual orientation. It would also not be possible to adapt these proposals to promote equality in these respects.

Economic impacts

SMEs - No impact on small firms as these proposals only affect the disclosure to be made by large companies and groups in notes to their accounts. There are two indirect impacts:

- Where a large company or group is audited by a small audit firm – However the preferred option reduces the regulatory burden on companies and auditors, not just in terms of the net benefit but in that there are no added costs or transitional costs.
- Where a large group includes a small company – However, as the burden of disclosure falls primarily on the auditor and the holding company producing the consolidated group accounts (which would be unlikely to be small), we think there is no impact. Any impact will be to benefit the company in any case, without adding any transitional or other costs.

Competition - These proposals have no impact in terms of competition. The disclosed information will effectively be the same information organised in a different way. We do not think this has competition implications.

Environmental impacts – No impact on greenhouse gas emissions or on more widely on the environment.

Social impacts – No impact on health and well-being in communities, on human rights on the justice system or disproportionately on businesses or communities in rural areas.

Sustainable development – These proposals do not affect sustainable development.

Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added where the Specific Impact Tests yield information relevant to an overall understanding of policy options.

Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. If the policy is subject to a sunset clause, the review should be carried out sufficiently early that any renewal or amendment to legislation can be enacted before the expiry date. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

Basis of the review: [The basis of the review could be statutory (forming part of the legislation), i.e. a sunset clause or a duty to review , or there could be a political commitment to review (PIR)]; The APB has an ongoing programme to review all its technical and ethical standards. They estimate the ethical standards on non-audit services would be likely to be reviewed in the next 5 years. They have agreed with BIS that, as part of that review, they would consider the disclosure under the regulations and whether brining it into line with the classification of non-audit services in the ethical standard had increased transparency for shareholders and investors and reduced burdens on companies and auditors.
Review objective: [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?] The APB's review would most likely check that the original policy objective (that was fulfilled by the combined effect of the ethical standards and the disclosure regulations) was being fulfilled by the regulations ie that users of company accounts including shareholders and potential investors benefitted from increased understanding of how auditors had addressed threats to the independence and increased assurance of the auditor's independence.
Review approach and rationale: [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach] The APB's usual approach is to scan stakeholder views through a series of consultation exercises. However, as monitoring data is collated by the FRC in this area the Government and the FRC would expect it to be given due consideration. This data relates to the level of non-audit services audit firms have provided to their audit clients. Though there is no data available on the administrative burden involved in the assembling the disclosure under the regulations, or on increased investment in companies resulting from confidence in their auditors' independence, the APB would be able to identify anecdotal evidence on this from relevant stakeholders.
Baseline: [The current (baseline) position against which the change introduced by the legislation can be measured] The current baseline for any review of the 2008 regulations by the APB would be the disclosure requirements in Article 43.1(15) of the 4th Company Law Directive and Article 34.16 of the 7th Company Law Directive, which the UK must continue to implement in legislation. Any APB review would look beyond the amendments made under the preferred option to the whole of the underlying regulatory framework and its interraction with the ethical stanbdards on non-audit services.
Success criteria: [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives] Although there is no data against which to measure the main success criteria for these proposals we hope that the following will result from our preferred option: - a reduction in the administrative burden on companies and auditors of making disclosures under the different classifications of non-audit services in the 2008 regulations and the ethical standards; - increased investor confidence as a result of increased transparency in relation to the auditor's compliance wiith the APB's ethical standards; The most likely way to establish whether these criteria are met would be to survey stakeholder views, which the APB does through regular consultation. Any increase in non-audit services provided to companies by their auditors would be reflected in published data, which is collated by the FRC. Combined with the APB's ethical standards, the 2008 regulations (and particularly their 2006 predecessors) effectively brought about a reduction in the non-audit services provided

by auditors to their clients. This was felt by many to have reduced the potential for auditors' independence to be undermined. Though the review of the ethical standards and the changes to the regulations discussed in this IA are not intended to cause any significant further reduction, we would not wish to see those changes reversed. Assuming there is no significant worsening of concentration in the audit market, we therefore also hope that the current level of non-audit service provision by auditors to their clients will not have increased when these regulations and the ethical standards next come up for review.
Monitoring information arrangements: [Provide further details of the planned/existing arrangements in place that will allow a systematic collection systematic collection of monitoring information for future policy review] The APB has ongoing responsibility for monitoring the effectiveness of the ethical standards and connected regulatory frameworks. They are regularly contacted by auditors and their clients about problems that have arisen in practice with the standards and maintain records to identify areas of the framework that are in need of review. The overall extent of non-audit services provided by auditors to their clients is monitored by the Professional Oversight Board of the Financial Reporting Council (the POB), which colates figures provided in the notes to large companies' accounts. The POB publishes its colated figures on annual basis for each of the audit firms so that their performance can be compared.
Reasons for not planning a review: [If there is no plan to do a PIR please provide reasons here] NA

Annex 2 – Comparison of classification of non-audit services under the 2008 regulations with that in the draft 2011 amendments

This table is intended to show how the three classifications relate to one another. Those classes of non-audit service under the 2008 regulations that are not marked as relating to a specific class of service under the draft 2011 amendments should be considered to relate to class 9 (all other non-audit services not identified in paragraphs 6 to 8).

<table>
<tr><td>2008 regulations</td><td>2011 amendments</td><td>Article 43.1(15) of the 4th Company Law Directive and Article 34.16 of the 7th Company Law Directive</td></tr>
<tr><td>1. The auditing of accounts of associates of the company pursuant to legislation (including that of countries and territories outside the United Kingdom).</td><td>1. The auditing of accounts of any associate of the company.</td><td rowspan="3">1. Other assurance services</td></tr>
<tr><td rowspan="2">2. Other services supplied pursuant to such legislation.</td><td>2. Audit related assurance services.</td></tr>
<tr><td>3. All other assurance services not identified in paragraph 1 or 2.</td></tr>
<tr><td rowspan="2">3. Other services relating to taxation.</td><td>4. Taxation compliance services.</td><td rowspan="2">2. Taxation advisory services</td></tr>
<tr><td>5. All other taxation advisory services not identified in paragraph 4.</td></tr>
<tr><td>4. Services relating to information technology.</td><td></td><td rowspan="8">3. Other Non-audit services</td></tr>
<tr><td>5. Internal audit services.</td><td>6. Internal audit services.</td></tr>
<tr><td>6. Valuation and actuarial services.</td><td rowspan="3"></td></tr>
<tr><td>7. Services relating to litigation.</td></tr>
<tr><td>8. Services relating to recruitment and remuneration.</td></tr>
<tr><td rowspan="2">9. Services relating to corporate finance transactions entered into or proposed to be entered into on behalf of the company or any of its associates.</td><td>7. Services relating to a transaction entered into, or proposed to be entered into, by or on behalf of, the company or any of its associates for which a circular, prospectus or listing particulars is required to be produced.</td></tr>
<tr><td>8. Services relating to corporate finance transactions entered into, or proposed to be entered into, by or on behalf of the company.</td></tr>
<tr><td>10. All other services.</td><td>9. All other non-audit services not identified in paragraphs 6 to 8.</td></tr>
</table>