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ASSURANCE  
FACULTY

## re:Assurance

Audit-exempt companies

# COMPANY VIEWS ON THE ICAEW ASSURANCE SERVICE

RESEARCH PAPER



# re:Assurance

An initiative from [the ICAEW Audit and Assurance Faculty](#)

Businesses, investors, government, tax authorities, market regulators and other stakeholders need to be able to rely on credible information flows to make economic decisions and policy. It is therefore vital that there is confidence in the quality of information; people need to have information they can rely on. Confidence diminishes when there are uncertainties around the integrity of information or its fitness for purpose.

Through the *re:Assurance* initiative, the Institute of Chartered Accountants in England and Wales (ICAEW) aims to establish a constructive dialogue on the role that assurance services can play in supporting markets and the economy by giving credibility to information flows. It seeks to explore the practical application of the International Auditing and Assurance Standards Board's Framework for Assurance Engagements and to develop guidance on assurance services to meet emerging market needs.

Further information on the *re:Assurance* initiative, its current work programme and how to get involved is available at [www.icaew.com/assurance](http://www.icaew.com/assurance) or telephone +44 (0)20 7920 8493.

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# Company views on the ICAEW Assurance Service

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# 1. Introduction

Following the increase in the audit exemption threshold, companies that qualify as a small company<sup>1</sup> are no longer required to have a statutory audit of their financial statements, although some still choose to have a voluntary statutory audit.

The consequent reduction in the demand for statutory audits is likely to have an impact on the nature of professional services provided by smaller accountancy practices. Despite the removal of the statutory requirement for an audit, directors may wish to obtain independent assurance on their annual accounts from a qualified chartered accountant and therefore may choose a voluntary statutory audit to give greater credibility over the annual accounts they discuss with external parties or to help give themselves an additional degree of comfort over the accounts for which they are responsible. To widen the choice of professional services available to directors, the Institute of Chartered Accountants in England and Wales (ICAEW) has developed the ICAEW Assurance Service (the Assurance Service) that may be offered to companies on a market-led basis. The Assurance Service is positioned between a compilation engagement and a voluntary statutory audit. An explanatory brochure highlights the difference between the three services.

In order to gauge the level of interest in and reactions to the concept of a new assurance service, 15 in-depth interviews were conducted with decision-makers in a cross-section of businesses.

The research was co-ordinated, managed and reported by the Consultation & Research Centre of the ICAEW. All interviews and analysis were conducted by an independent market research agency, Lighthouse Global. Details on the research methodology and about Lighthouse Global can be found at pages 3, 15 and 16 of this report.

This report provides a summary of the main findings that emerged from the research into the Assurance Service and illustrates key considerations for chartered accountants who may wish to consider providing the Assurance Service. As this research is based on only 15 interviews, any quantitative information is indicative.

Any queries about the information relating to the Assurance Service should be directed to Jo Iwasaki at [jo.iwasaki@icaew.com](mailto:jo.iwasaki@icaew.com).

Any queries about the information contained within this report should be directed to Alpa Viridi at [alpa.virdi@icaew.com](mailto:alpa.virdi@icaew.com).

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<sup>1</sup> For details, see the relevant page on the DTI's website at <http://www.dti.gov.uk/bbf/financial-reporting>.

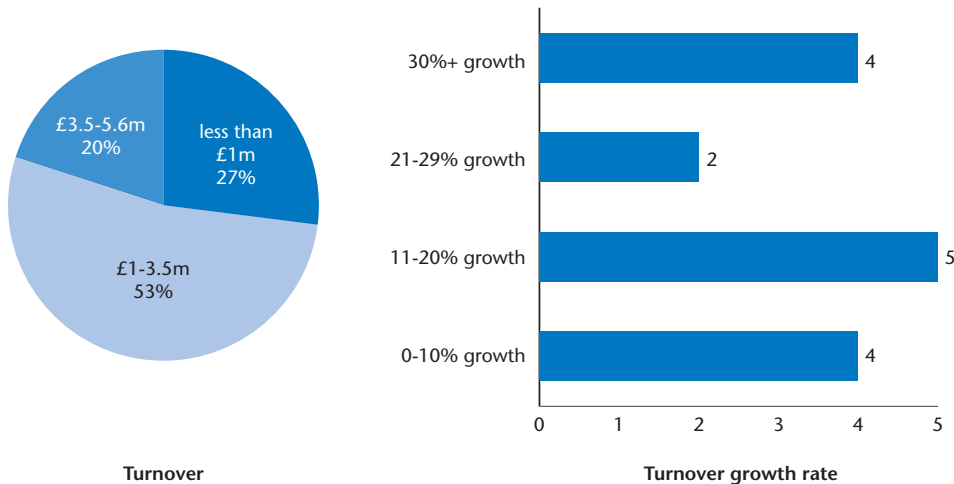
## 2. Research methodology and sampling

Between 7 March 2006 and 20 March 2006, 15 face-to-face interviews were conducted, approximately lasting an average of 45 minutes. All interviews were qualitative, in-depth discussions and were tape recorded (with the permission of the respondent).<sup>2</sup>

All interviews were conducted by Lighthouse Global's *Executive Insight* team who have extensive experience in accountancy market research.

The interviews were conducted among companies representing a range of industry sectors. The turnover of the companies and growth rates are shown in the chart below. Interviews were conducted in three locations to cover a regional spread: the South East, Northern England and the Midlands. Information was also gathered on levels of third party interest (e.g. from creditors). The sample included four companies that currently opt for a voluntary statutory audit.

The respondents were a combination of financial directors, financial controllers, managing directors and non-executive directors.



The interviews were conducted using a discussion guide that covered key questions in the light of business and research objectives. Lighthouse Global analysed the responses and reported them to the ICAEW Consultation & Research Centre to prepare this report.

<sup>2</sup> A charity donation of £60 was offered to each participant.

### 3. Business objectives

There is a need to identify whether audit exempt companies are interested in a new Assurance Service in relation to their annual accounts alongside the existing services: namely an accounts compilation service and a voluntary statutory audit.

If there is interest, there is a need to establish whether the Assurance Service developed by the ICAEW Audit and Assurance Faculty would meet such interest. Equally the nature of the interest, expectations and concerns on the Assurance Service would need to be identified.

Finally, there is a need to understand how the Assurance Service would be best communicated to companies and test whether companies would find the draft explanatory brochure practical and useful.

## 4. Research objectives

There were four research objectives:

- To understand the expectations of audit exempt companies from their accountants.
- To understand the level and nature of interest that audit exempt companies have in the Assurance Service.
- To understand the perceived benefits and concerns in relation to the Assurance Service.
- To identify how best to communicate the details of the Assurance Service.

## 5. Executive summary

### Needs of audit exempt companies

There were a wide variety of reported needs. Some companies only required minimal compliance with the law, whereas others wanted their accountant to reassure them on the validity of their accounting processes and compliance with tax regulation. Many directors also reported a need to demonstrate the financial viability of their company to banks, suppliers and customers. Conversely, the companies that were not opting for a voluntary statutory audit perceived that they had not experienced any problems as a result.

### Level of and nature of interest in the Assurance Service

The research indicated that a potential market for the Assurance Service is likely to exist. About half of the respondents expressed some degree of interest in the Assurance Service. However, interest was conditional on certain key benefits being realised and how the Assurance Service is explained to the companies.

### Key benefits of the Assurance Service

The respondents told us the potential benefits that underpinned their interest in the Assurance Service were:

- Access to cheaper and more extensive credit from banks or other credit providers. This is because banks and other sources of credit may find the information about the financial viability of the company more credible.
- Helps the business demonstrate to suppliers and customers that the company is financially viable.
- Provides credibility that the financial information of the business is compliant with financial regulations from agencies such as HMRC.
- Takes less time (and therefore cost) spent dealing and negotiating with regulators, lenders and customers.

In summary, respondents are interested in financial payback from the Assurance Service over and above accounts compilation.

### Key potential issues to be addressed

The key potential issues that respondents expressed included the following:

- The extent to which banks and regulators would regard the Assurance Service as a credible service to assist with their own decision-making process. This was the most significant issue identified.
- A perceived lack of rigour or confidence arising from the negatively worded statement in the assurance report compared with the positive wording in an audit report.
- A consideration that the value of the Assurance Service as a check on accounting processes might be reduced if carried out by the same accountants that compiled the accounts because his/her independence may be compromised.

## 6. Detailed findings

### Level of interest in the Assurance Service

Respondents were asked, based on the simple statement on the Assurance Service, whether they were interested in the Assurance Service. After giving their immediate response, the respondents were provided with a detailed explanation about the Assurance Service and were asked to consider whether their view remained the same.

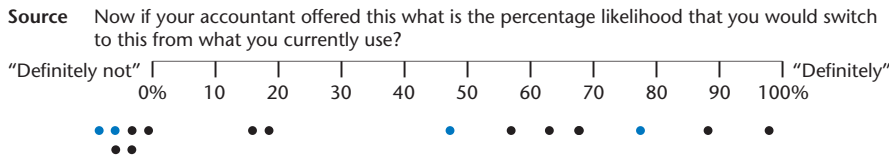
In the chart below, the responses made after detailed explanations are dotted on the scale that ranges from 0% ('Definitely not') to 100% ('Definitely'). Companies with a voluntary statutory audit are indicated in blue dots. 7 out of 15 respondents gave a 50% or greater likelihood of taking up the Assurance Service.<sup>3</sup>

In general, the respondents seemed fairly interested in the concept, with one or two saying they would definitely consider the Assurance Service and some saying they may consider it. About half the respondents would not consider it at all.

Following provision of a detailed explanation of the Assurance Service, a few respondents expressed an increased likelihood of take-up than that based on a simple statement. The number of respondents who gave more than 50% likelihood of taking up the Assurance Service remained the same.

### Level of interest in the Assurance Service

N.B. Those with voluntary statutory audit are shown in blue.



The positive responses included these comments:

*"The main benefit of the assurance scheme will be the cost saving compared to the full audit because there won't be as much time involved for the accountants."*

*"I think it would certainly appeal to those who need more detail but are not at the big end with complicated financial transactions. I don't think it would be attractive to the smaller companies who are quite happy with their normal accounts"*

*"Cost is how it will be perceived...if it can save somebody some money, rather than having to go from the compilation to the full audit, then it should have a place in the market."*

*"I think it's a good thing and I might well take it up."*

Explanations on respondents' concerns are available in section 4 *Concerns about the Assurance Service*.

<sup>3</sup> One respondent stated that he would 'definitely' consider provided that the Assurance Service was provided by an independent accountant but otherwise 'definitely not'. The Assurance Service may be provided by an independent accountant, and the response is classified as 'definitely'.

### The need for the Assurance Service

After telling us the likelihood of taking the Assurance Service up, respondents were asked to rate the importance of various potential benefits of the Assurance Service on a five-point scale, where 5 denotes 'very important' and 1 denotes 'very unimportant' (the remainder of the scale was unlabelled). The chart below shows the average point for each benefit.

The colour coding in the chart below categorises benefits into broad themes:

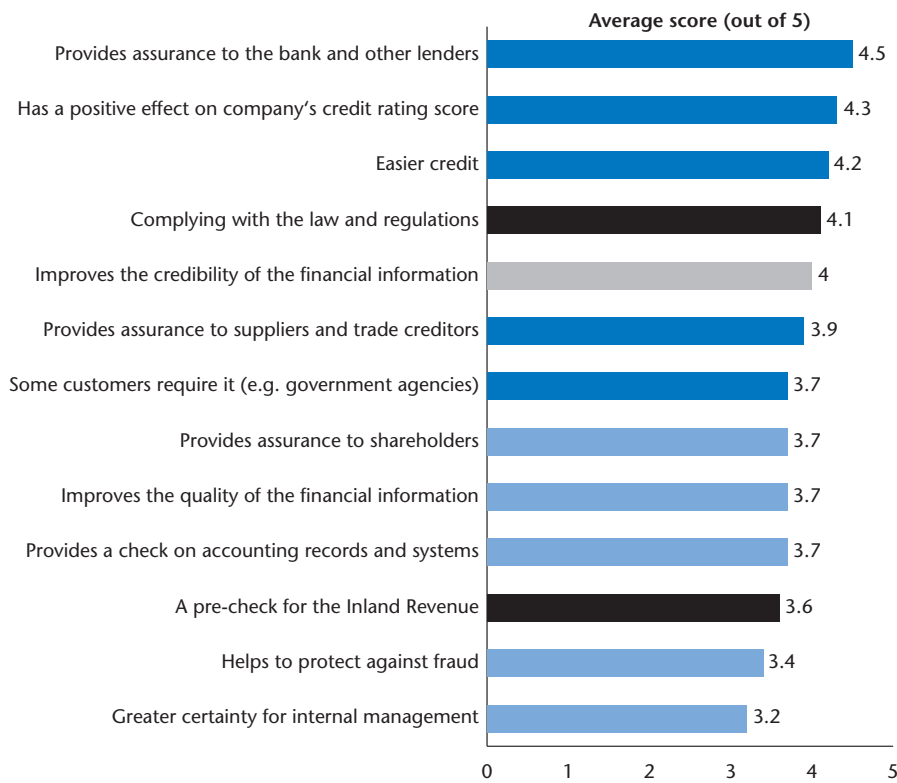
Blue – credit related issues

Black – compliance related issues

Grey – general credibility of financial information

Light Blue – Assurance to external shareholders and a check on internal financial processes

#### Benefits – Credit and compliance more important than internal management



Source: "How important are the following potential benefits?" (5= very important to 1= very unimportant)

Base: All respondents (15)

### Key perceived benefits

The key perceived benefits of the Assurance Service are summarised as:

- Access to cheaper and more extensive credit from banks or other creditors

A common response to the Assurance Service was to say it would be attractive if banks took it seriously:

*"The question for me is 'is it sufficient to provide the level of credibility that you would need to satisfy a potential lender or investor?' That question is best asked to potential lenders – the people who choose to rely on these reports rather than those who choose to buy them."*

- **Assurance required by some suppliers and customers including government agencies**

In addition to the banks and lenders, respondents considered that the Assurance Service would be useful where they need to demonstrate the financial viability of the business to its business partners.

- **Reassurance that the business is compliant with law and regulations**

Businesses wanted to ensure that they are compliant with increasingly complex financial reporting requirements. As regulatory requirements become more complex, respondents indicated that they were keen to ensure that they met relevant requirements. This may mean that the companies are hoping that any material errors in the accounts due to the changes in regulatory requirements could be identified and rectified before the accounts are filed and submitted. At the same time, businesses also wanted to reassure themselves they were doing the right thing by HMRC, and give them a reason not to undertake full investigations (which would otherwise take time and would therefore become an expensive process).

- **Less time (and therefore cost) spent dealing and negotiating with regulators, HMRC, creditors, lenders and customers**

A financial payback is needed to justify paying for the Assurance Service, e.g. potentially fewer visits from HMRC, easier access to loans, cheaper credit, the ability to take on customers that may otherwise have requested audited accounts from its suppliers.

### ***Moderately important benefits***

Based on the five point scale, a score of three can be considered moderately important to the respondents. These are:

- Assurance to shareholders.
- Internal checks on the quality of financial information and protection against fraud.
- A pre-check for the HMRC.

Respondents appeared to be confident of their processing and the figures they produced. The main emphasis of reassurance was for compliance with regulatory bodies.

However, a respondent voiced his concern over the accounts preparation: *“the thing that does concern me if you don’t have a full audit is that things get missed... If I had an assessment then perhaps I would have a full audit done every other year, just to satisfy me that I was doing things as they should be...it’s a bit of a confidence thing as I’m the only one here who deals with accounts, so I’ve got nobody to point out if things go wrong: it really is a safeguard for me.”*

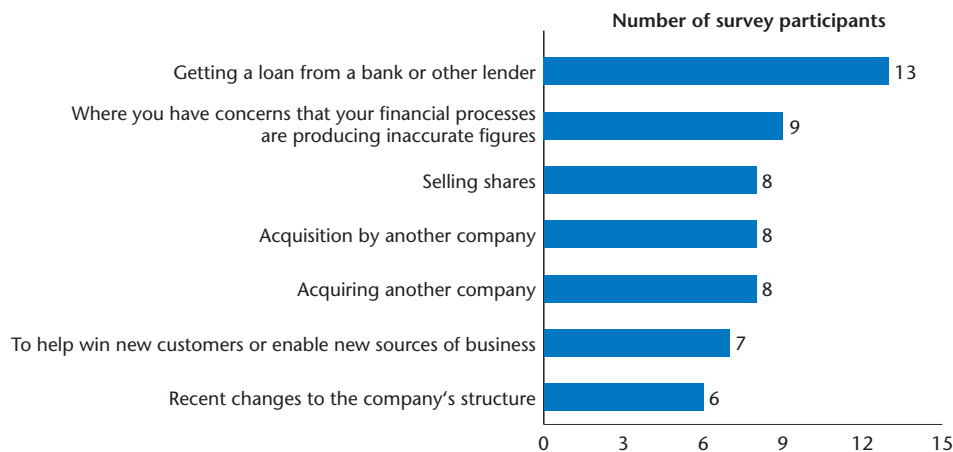
### **Triggers to taking up the Assurance Service**

Respondents were then asked to consider what scenarios might lead them to take up the Assurance Service. The majority of them mentioned the following key triggers:

- Looking for more credit from banks or other creditors (mentioned by 13 of the 15 respondents). One respondent replied that *“the benefit for 95% of people will be ‘can I get more money from the bank at a cheaper rate?’”* Building confidence of customers was also considered important: *“Given the scenario where customers are demanding sets of accounts then I can see a place in the market for it.”*
- Seeking reassurance of the accuracy of internal financial processes and accounts where there are concerns (mentioned by 9 of the respondents)

- Selling shares (mentioned by 8 of the respondents). Some directors think that a more accurate value needs to be attached to a company’s shares when they are being sold or issued to stakeholders.
- Mergers and acquisitions (mentioned by 8 of the respondents). Where companies expect to be acquired or have recently made an acquisition, the respondents said that more rigorous and robust financial records were either necessary or useful. The same applies for merger or de-merger activity.

**Getting loan is main trigger to use**



Source: “What triggers or scenarios do you think may prompt use of this service?”

Base: All respondents (15)

In contrast, less than half of the respondents considered the following scenarios likely to prompt them to use the Assurance Service.

- To help win new customers or enable new source of business.
- Recent changes to the company’s structure.

**Concerns about the Assurance Service**

Six respondents expressed no interest in the Assurance Service, and a further two expressed a low level of interest. We asked them what the reasons were for their lack of interest.

Hardly any respondents were aware of the independent requirements on accountants issued by the ICAEW and the level of independence of the accountant providing the Assurance Service was a concern to some respondents. In particular, it was felt that if offered by the company’s regular accountant who also provides the accounts compilation service, then it would provide no sort of check on internal financial processes or accuracy – the accountant would effectively be criticising themselves.

This point need to be clearly explained by the accountant to the client. The Assurance Service is provided by accountants subject to the ethical code issued by the ICAEW including specific requirements on independence.<sup>4</sup>

<sup>4</sup> See <http://www.icaew.com/ethics>.

Some felt that their accountants already provided an enhanced service, although it may not be a voluntary statutory audit:

*"I don't feel that we get any less of a service from our accountant currently than we would get from the assurance. I don't believe that anything that is posted at Companies House to give us benefits as a company would be any greater if we used this service."*

A number of respondents cited that the negative wording of the report as a cause of concern, because they thought the wording lacking rigour. Some businesses felt that already their voluntary statutory audit was less rigorous (in terms of the level of detail of examination) than their statutory audits had been, and approached the status of the Assurance Service. A respondent who was quoted earlier said that he may have the Assurance Service and a voluntary statutory audit in turn. The responses indicate the importance of communication between the accountants and companies when providing the Assurance Service.

### Pricing of the Assurance Service

Respondents were also asked how much they would expect to pay for the Assurance Service. Where respondents do not have a voluntary statutory audit, we asked how much more they would expect to pay for the Assurance Service and also how much for a voluntary statutory audit. Conversely, respondents who currently have a voluntary statutory audit were asked how much less they would expect to pay for the Assurance Service and how much for accounts compilation.

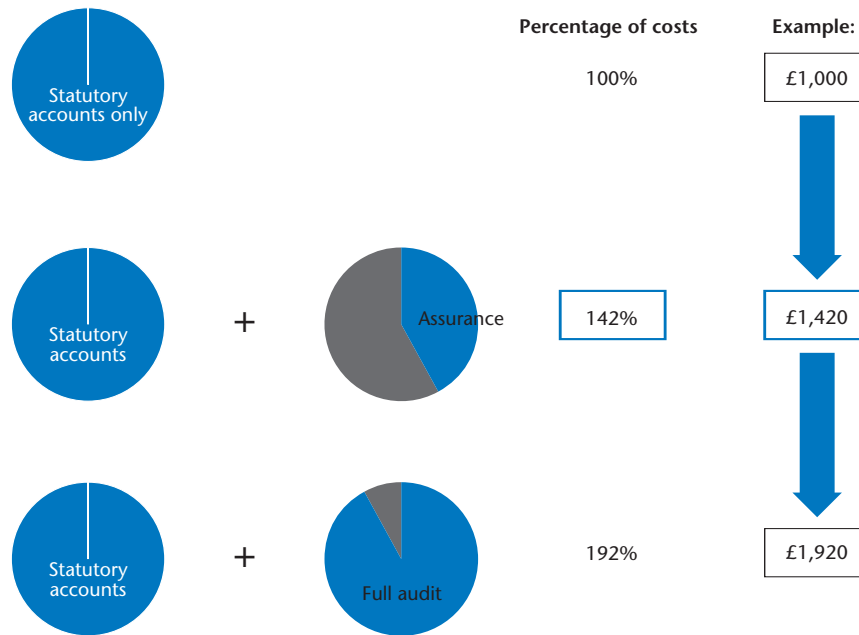
The key factors on pricing that emerged from the research are:

- Clients' estimates of the cost of the Assurance Service was varied, but averaged at 30-40% more than accounts compilation alone.
- The Assurance Service would almost certainly be more popular if a price were agreed and fixed with the client at the outset of the engagement. The open-ended cost of auditing was highlighted as a reason that companies opted out of a voluntary statutory audit despite its benefits.

The diagrams below illustrate the expected costs of the Assurance Service among those who currently do not have an audit (where the cost of accounts compilation is assumed to be £1,000).

On average, respondents expected to pay 42% above their current costs of accounts compilation service for an Assurance Service, whilst they expect to pay additional 92% more for a voluntary statutory audit. Based on an example cost of accounts compilation at £1,000, this equates to a cost of £1,420 for the Assurance Service and £1,920 for a voluntary statutory audit.

Cost expectations for the service by those that *do not* have an audit



Reinforcing that finding, those respondents that currently have a voluntary statutory audit expected to pay 72% of the costs of their audit for the Assurance Service and 57% for an accounts compilation service. Based on an example cost of voluntary statutory audit at £1,920, this equates to a cost of £1,382 for the Assurance Service and £1,094 for statutory accounts compilation. In other words, both types of respondents estimated the costs of the three services in a very similar manner.

## 7. Other considerations

In this section, we summarise the other information that was obtained in the course of the interviews. A large number of small companies now meet the audit exemption criteria. Some of the companies have decided to keep a voluntary statutory audit, as they face pressure to verify their accounts from banks, suppliers, customers or regulators. For other companies, the situation is more ambiguous. Some verification may be useful to them, but it may not be worthwhile to expend the time and money required for an audit.

### Understanding the companies' needs

The research showed that these companies come from a wide variety of sectors and are represented among all sizes of business up to £5.6 million. To some, the Assurance Service may be appropriate but the accountant will need to make a professional assessment of the circumstances and key requirements of the client. For example, according to the research, some companies only require minimal assurance over compliance with the law, whereas others want their accountant to reassure them on the validity of their accounting processes and compliance with HMRC. On the other hand, some respondents identified a need to demonstrate the financial viability of their company to banks, suppliers or customers.

### Explaining the Assurance Service to companies

For those companies who may be looking for additional reassurance, or looking to dispense with the audit and for whom the Assurance Service is deemed to be appropriate, a number of steps could be taken.

The research identified that the accountant was generally the first and often the only place that companies would look for information on accounting and financial reporting. It is therefore vital for chartered accountants to be able to provide clear information on the professional services they offer.

The research explored reactions to the draft explanatory brochure prepared by the ICAEW. In general the reaction was positive. The research made clear that the documentation needs to clearly show the comparison of existing services and the Assurance Service. The feedback was used to finalise the draft brochure<sup>5</sup>.

Providing explanatory brochures and other materials are important for explaining the Assurance Service, especially to small businesses, but detailed discussion between accountant and client would be crucial in helping businesses understand their needs.

*"I would definitely want to know exactly what they were going to be doing and to be satisfied that it is more than just re-churning out information that I have already given to them."*

### Pricing

The right pricing level and a fixed price was a key factor for many respondents. While there was some variation in estimates of the cost of the Assurance Service, the average was 40% greater than the accounts compilation service. The research also revealed that if the Assurance Service was offered with a fixed price at the outset of the engagement, it would have greater appeal:

*"If this service lacks that clarity in pricing, people will rapidly lose interest."*

Based on the comments received, we summarise some of the potential questions that companies may ask their chartered accountant.

<sup>5</sup> See <http://www.icaew.com/assuranceservice> for the explanatory brochure.

- Why pay for a service that is voluntary?
- Will the extra expense of an assurance pay back?
- What will be the benefits to my business?
- Doesn't the compilation engagement provide assurance anyway?
- Do the banks and credit agencies recognise the Assurance Service?
- What are the differences between this and a voluntary statutory audit?
- How can you ensure independence between the parties?

### What companies want from their accountants

There was clear consensus that the role of accountants had not changed a great deal and seemed unlikely to do so. There was little appetite for accountants to become more general business or strategic advisors: many directors felt that they knew their own businesses or sectors best.

Despite this, accountants were important to business people. This was especially true of those who were solely responsible for the accounting in the company, and wanted some external reassurance for compliance and internal management:

*"If you are in trouble, sometimes in your own head you can't get out of it, you can't see where you are going, and an accountant might say OK, what can we do to get out of this, it's another head to talk to, especially if you are a director on your own and there is nobody else that you can ask, which a lot of companies are, single companies or family companies."*

Accountants were often regarded as a more accessible source of advice than some other professional advisers, especially on issues such as employment or pensions.

Rather than general business advice it was 'proactive' advice on accounting issues that businesses look for. This means being aware early of risks to the company (spiralling costs or low revenues in a particular area for instance) and thus enabling the business to deal with them: *"Proactive accounting is very important, but not business advice."*

## Note to readers: MRS Code of Conduct

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- When reporting on the results of a marketing research project the Researcher must make a clear distinction between the findings as such, the Researcher's interpretation of these and any recommendations based on them.
- Where any of the findings of a research project are published by the Client, the latter has a responsibility to ensure that these are not misleading. The Researcher must be consulted and agree in advance the form and content of publication, and must take action to correct any misleading statements about the research and its findings.
- Researchers must not allow their names to be used in connection with any research project as an assurance that the latter has been carried out in conformity with this Code unless they are confident that the project has in all respects met the Code's requirements.
- Researchers must ensure that organisations are aware of the existence of this Code and of the need to comply with its requirements.
- **We therefore recommend that all ICAEW research that is published should carry the following statement:**

'This survey was completed with 15 representatives among UK businesses between from 7 March 2006 and 20 March 2006 from a survey entitled *Qualitative research into the Assurance Report*; Source: ICAEW Consultation & Research Centre'

## Acknowledgements

### **The Institute of Chartered Accountants in England and Wales**

is the largest professional accountancy body in Europe, with over 127,000 members. Three thousand new members qualify each year.

The prestigious qualification offered by the ICAEW is recognised around the world and allows members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

The ICAEW operates under a Royal Charter, working in the public interest. Its primary objectives are to educate and train chartered accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy.

[www.icaew.com](http://www.icaew.com)

**The Audit and Assurance Faculty** is a leading UK authority on external audit and other assurance activities. It is recognised nationally and internationally by members, professional bodies and others as a source of expertise on all audit issues. The Faculty's membership includes internal and external auditors from a wide range of organisations and within practice, which enables it to speak on audit matters.

The Faculty membership consists of nearly 9,000 members drawn from practising firms and organisations of all sizes from both the private and public sectors.

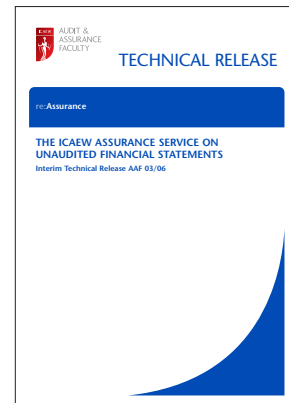
[www.icaew.com/aaf](http://www.icaew.com/aaf)

## Lighthouse

The research was conducted by **Lighthouse Global** on behalf of the ICAEW. Lighthouse Global is an independent business research consultancy. We provide strategic marketing advice to clients in the professional services and financial services sectors.

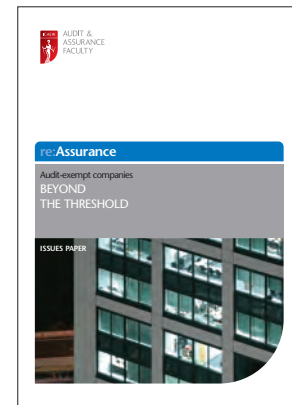
Further details about Lighthouse can be found at

[www.lighthouseglobal.eu.com](http://www.lighthouseglobal.eu.com)



***The ICAEW Assurance Service on Unaudited Financial Statements***

*The guidance for practitioners wishing to offer audit-exempt companies the new ICAEW Assurance Service positioned between the statutory audit and accounts compilation.*



***Beyond the threshold***

*This issues paper provides the background to the development of the new ICAEW Assurance Service and discusses issues arising. It seeks feedback from stakeholders with a series of questions on related subjects.*



***Chartered accountant services***

*This guide explains to company directors the key benefits of accounts compilation, the ICAEW Assurance Service and statutory audit.*