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## EXPLANATORY NOTE

*(This note is not part of the Regulations)*

These Regulations amend Part 7 of the Companies Act 1985 (“the 1985 Act”) on accounts and audit in order to–

- ensure the effective application of, and implement Member State options in, EC Regulation No. 1606/2002 of the European Parliament and of the Council of 19th July 2002 on the application of international accounting standards (Official Journal No. L243/1 of 11th September 2002) (“the IAS Regulation”);
- implement Directive [2001/65/EC](#) of the European Parliament and of the Council of 27th September 2001 amending Directives [78/660/EEC](#), [83/349/EEC](#) and [86/635/EEC](#) as regards the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions (Official Journal No. L283/28 of 27th October 2001) (“the Fair Value Directive”);
- implement Directive [2003/51/EEC](#) of the European Parliament and of the Council of 18th June 2003 amending Directives [78/660/EEC](#), [83/349/EEC](#), [86/635/EEC](#) and [91/674/EEC](#) on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings (Official Journal No. L178/16 of 17th July 2003) (“the Accounts Modernisation Directive”) (with the exception of articles 1.14, 1.17(in part) and 2.10).

They also make certain other minor and consequential amendments to the 1985 Act and to other enactments.

Part 1 of the Regulations (regulation 1) is introductory, and includes provision applying the Regulations to companies' financial years beginning on or after 1st January 2005.

Part 2 of the Regulations (regulations 2 and 3 and Schedule 1) amends Part 7 of the 1985 Act in order to give full effect to the requirement in article 4 of the IAS Regulation that companies whose securities are admitted to trading on a regulated market prepare their consolidated accounts in accordance with international accounting standards adopted pursuant to the Regulation. Article 4 defines regulated markets as having the meaning specified in article 1(13) of Council Directive [93/22/EEC](#) of 10th May 1993 on investment services in the securities field (Official Journal No. L141/27 of 11th June 1993).

Part 2 of the Regulations also implements the Member State option in article 5 of the IAS Regulation by permitting (subject to certain conditions) –

- companies governed by article 4 (other than charitable companies) also to prepare their individual accounts, and
- all other companies (again with the exception of charitable companies) to prepare their individual and consolidated accounts

using adopted international accounting standards (see the definition of “international accounting standards” inserted into section 262 of the 1985 Act by paragraph 20(2)(d) of Schedule 1).

Part 3 of the Regulations (regulations 4 to 15 and Schedules 2 to 7) contains the following further modifications of Part 7 of the 1985 Act –

- regulation 4 inserts a new section 228A conferring an exemption from the obligation to prepare group accounts on a parent company that is included in group accounts drawn up by a parent undertaking that is not established under the law of a State that is a member of the

European Economic Area. This implements the Member State option in article 11 of the 7th Council Directive [83/349/EEC](#) of 13th June 1983 on consolidated accounts (Official Journal No. L193/1 of 18th July 1983);

- regulation 5 amends section 229 of the 1985 Act in implementation of article 2.6 of the Accounts Modernisation Directive. It repeals section 229(4) which provided for a parent company to exclude a subsidiary undertaking from the parent's consolidated accounts if that undertaking's activities were so different from those of other undertakings to be included in the consolidation that its inclusion would be incompatible with the obligation to give a true and fair view;
- regulations 6 to 8 amend sections 235, 236 and 240 of the 1985 Act on the auditors' report to implement articles 1.15 to 1.18 and 2.11 of the Accounts Modernisation Directive;
- regulation 9 amends section 244 of the 1985 Act to remove the ability for directors to extend by 3 months the period allowed for laying and delivering accounts and reports where the company has overseas interests;
- regulation 10 amends section 245 of the 1985 Act to permit voluntary revision by directors of a company of a summary financial statement prepared under section 251 of the 1985 Act;
- regulation 11 amends section 251 of the 1985 Act to extend the power of the Secretary of State to make regulations for companies to send out summary financial statements in place of the full accounts and reports so that such regulations are capable of applying to all companies, and not just to listed companies;
- regulation 12 amends section 258 of the 1985 Act to remove the requirement in section 258(4) for a participating interest to exist in order for an undertaking to be a subsidiary undertaking, and otherwise to extend the circumstances in which a parent-subsidiary undertaking relationship exists. This implements article 2.1 of the Accounts Modernisation Directive. The amendment is extended to the Building Societies Act 1986 and the Financial Services and Markets Act 2000;
- regulation 13 modifies Schedule 7 to the 1985 Act (disclosures to be made in directors' report) to implement the Fair Value Directive requirement for disclosures in relation to the use of financial instruments by a company and its subsidiary undertakings. Small companies are exempt from this requirement (see the amendment to section 246(4) of the 1985 Act in regulation 13(2)).

Regulation 14 of the Regulations introduces Schedules 2 to 6 to the Regulations which amend Schedules 4 (form and content of company accounts), 8 (form and content of accounts prepared by small companies), 8A (form and content of abbreviated accounts of small companies), 9 (form and content of accounts of banking companies and groups) and 9A (form and content of accounts of insurance companies and groups) to the 1985 Act.

Paragraphs 2 and 7(2) of Schedule 2 amend the rules in Schedule 4 to the 1985 Act on the disclosure of dividends in company accounts. Equivalent amendments are made to Schedules 8, 9 and 9A to the 1985 Act by paragraphs 2 and 7(2) of Schedule 3, paragraphs 2 and 8(2) of Schedule 5 and paragraphs 2 and 8 of Schedule 6 respectively.

Paragraph 3 of Schedule 2 implements article 1.2 of the Accounts Modernisation Directive by requiring that amounts be presented within items in the profit and loss account and balance sheet having regard to the substance of the reported transaction. Equivalent amendments are made to Schedules 8, 9 and 9A to the 1985 Act by paragraphs 3 of Schedules 3, 5 and 6.

Paragraphs 4, 5, 8, 9 and 12 of Schedule 2 implement articles 1.4, 1.5, 1.7, 1.9 and 1.11 of the Accounts Modernisation Directive by making minor changes to the terminology of the 1985 Act relating to "provisions". Equivalent amendments are made to Schedules 8, 8A, 9 and 9A to the 1985 Act by paragraphs 4, 5, 8 and 11 of Schedule 3, paragraph 2 of Schedule 4, paragraphs 4, 5, 9 and 12 of Schedule 5 and paragraphs 4, 5, 10 and 13 of Schedule 6 respectively.

Paragraph 6 of Schedule 2 inserts a new Section D in Part 2 of Schedule 4 to the 1985 Act in order to implement the Fair Value Directive and article 1.12 of the Accounts Modernisation Directive. New Section D permits a company to include certain financial instruments (including derivatives), and investment property, living animals and plants in its accounts at fair value. It specifies –

- the type of financial instrument and other assets that may be fair valued,
- the methods for determining fair value,
- how assets and liabilities that qualify as hedged items under a fair value hedge accounting system are to be accounted for, and
- how changes in the value of financial instruments are to be accounted for.

Paragraph 7(3) of Schedule 2 requires information about fair valuation of financial instruments, investment property and living animals and plants to be given in the notes to a company's accounts, including where a company has chosen not to fair value its financial instruments. Paragraphs 10 and 11 insert definitions of relevant terms.

Equivalent modifications on fair valuation are made to–

- Schedules 8 and 8A (small company accounts – see paragraphs 6, 7(3), 9 and 10 of Schedule 3 to the Regulations and paragraph 3 of Schedule 4 to the Regulations),
- Schedule 9 (banking company accounts – see paragraphs 6, 7, 8(3), 10 and 11 of Schedule 5 to the Regulations), and
- Schedule 9A (insurance company accounts – see paragraphs 6, 7, 9, 11 and 12 of Schedule 6 to the Regulations).

Finally, regulation 15 of, and Schedule 7 to, the Regulations make minor and consequential amendments to the 1985 Act and to other enactments.

Full regulatory impact assessments of the effect that this instrument will have on the costs of business are available from the Department of Trade and Industry, Corporate Law and Governance Directorate, Elizabeth House, 39 York Road, London SE1 7LJ (they are also available electronically at [www.dti.gov.uk/cld](http://www.dti.gov.uk/cld)). Copies have also been placed in the libraries of both Houses of Parliament.