

2004 No. 3199

BUILDING SOCIETIES

**The Building Societies (Accounts and Related Provisions)
(Amendment) Regulations 2004**

<i>Made</i> - - - -	<i>6th December 2004</i>
<i>Laid before Parliament</i>	<i>6th December 2004</i>
<i>Coming into force</i> - -	<i>31st December 2004</i>

The Treasury, in exercise of the powers conferred upon them by sections 73(6), (7) and (8)(a) and 75(1) of the Building Societies Act 1986(b) hereby make the following Regulations:

PART 1

General

Citation, commencement and interpretation

1.—(1) These Regulations may be cited as the Building Societies (Accounts and Related Provisions) (Amendment) Regulations 2004 and come into force on 31st December 2004.

(2) These Regulations apply in relation to—

- (a) the annual accounts of any building society, and
- (b) any report which the directors of a building society are obliged to prepare by virtue of section 75 of the Building Societies Act 1986,

which relate to a financial year beginning on or after 1st January 2005.

(3) In these Regulations—

- (a) “the principal Regulations” means the Building Societies (Accounts and Related Provisions) Regulations 1998(c); and
- (b) references to numbered schedules are to schedules to the principal Regulations.

(a) See section 73(12) for definition of “prescribed”.

(b) 1986 c. 53.

(c) S.I. 1998/504; amended by S.I. 1999/248 and S.I. 2001/3649 and modified by S.I. 2003/1633.

PART 2

Changes to account formats, accounting rules and notes to the accounts

Differing business of subsidiary undertaking no longer a reason for exclusion from consolidated accounts

2. Paragraphs (7) and (7A)(a) of regulation 4 of the principal Regulations (group accounts: supplementary provisions) are omitted.

Accounts may show amounts in euro

3. In the principal Regulations after regulation 4, insert the following—

“Accounts in euro

4A.—(1) The amounts set out in the annual accounts of a society may also be shown in the same accounts translated into euro.

(2) Where amounts are shown in euro—

- (a) the amounts must have been translated at the exchange rate prevailing on the balance sheet date, and
- (b) that rate must be disclosed in the notes to the accounts.”.

Removal of provisions requiring disclosures in notes to accounts

4.—(1) Regulation 6 of the principal Regulations (holdings in undertakings) is omitted.

(2) The following paragraphs of Schedule 5 (notes to annual accounts) are omitted—

- (a) paragraphs 3 to 13;
- (b) paragraphs 14(3) to (5); and
- (c) paragraphs 15 and 35.

(3) Schedule 6 (information in respect of holdings in undertakings) is omitted.

Alteration of heading in balance sheet formats

5.—(1) In Schedule 2 (balance sheet formats), for “provisions for liabilities and charges”, wherever occurring, substitute “provisions for liabilities”.

Alteration to which liabilities and losses are to be taken into account

6. In Part 1 of Schedule 7 (accounting principles), in paragraph 4(1)(b) omit “and losses” and “or are likely to arise”.

Amounts in accounts to have regard to the substance of the reported transaction

7. In Part 5 (other accounting rules) of Schedule 7, insert the following after paragraph 20—

“20A. The directors of a society shall, in determining how amounts are presented within items in the income and expenditure account and balance sheet, have regard to the substance of the reported transaction or arrangement, in accordance with generally accepted accounting principles or practice.”.

(a) Paragraph 7A was inserted by S.I. 2001/3649, article 565.

PART 3

Fair value method of valuation

Valuation at fair value

- 8.—(1) In Part 3 (fixed assets) of Schedule 7—
- (a) in paragraph 8(1) (general rules for inclusion of fixed assets), for “paragraph 28”, substitute “paragraph 13, 28, 31A, 31C or 31D”;
 - (b) in paragraph 13(1) (financial fixed assets), at the end, insert “and to paragraphs 31A, 31C and 31D”.
- (2) In Part 4 (current assets) of Schedule 7, in paragraph 14, for “paragraphs 15 and 16” substitute “paragraphs 15, 16, 31A, 31C and 31D”.
- (3) After paragraph 31 of Schedule 7, insert—

“Part 6A

Valuation at Fair Value

Inclusion of financial instruments at fair value

31A.—(1) Subject to sub-paragraphs (2) to (4), financial instruments, including derivative financial instruments, may be included at fair value.

(2) Sub-paragraph (1) only applies to financial instruments which constitute liabilities if—

- (a) they are held as part of a trading portfolio; or
- (b) they are derivative financial instruments.

(3) Sub-paragraph (1) does not apply to—

- (a) non-derivative financial instruments held to maturity;
- (b) loans and receivables originated by the society or connected undertakings of the society and not held for trading purposes;
- (c) interests in connected undertakings or joint ventures;
- (d) equity instruments issued by the society or connected undertakings of the society;
- (e) contracts for contingent consideration in a business combination; and
- (f) other financial instruments with such special characteristics that the instruments, according to generally accepted accounting principles or practice, should be accounted for differently from other financial instruments.

(4) If the fair value of a financial instrument cannot be determined reliably in accordance with paragraph 31B, sub-paragraph (1) does not apply to that financial instrument.

(5) In this paragraph, “joint venture” means an undertaking, other than a connected undertaking, which a society manages jointly with one or more undertakings.

Methods for determining fair value

31B.—(1) The fair value of a financial instrument is its value determined in accordance with this paragraph.

(2) If a reliable market can readily be identified for the financial instrument, its fair value is to be determined by reference to its market value.

(3) If a reliable market cannot readily be identified for the financial instrument but can be identified for its components or for a similar instrument, its fair value is to be determined by reference to the market value of its components or of the similar instrument.

(4) If neither sub-paragraph (2) nor (3) apply, the fair value of the financial instrument is to be a value resulting from generally accepted valuation models and techniques.

(5) Any valuation models and techniques used for the purposes of sub-paragraph (4) must ensure a reasonable approximation of the market value.

Hedged items

31C. A society may include any assets or liabilities, or identified portions of such assets or liabilities, which qualify as hedged items under a fair value hedge accounting system at the amount required under that system.

Other assets which may be included at fair value

31D.—(1) This paragraph applies to—

- (a) investment property, and
- (b) living animals and plants,

which under international accounting standards may be included in accounts at fair value.

(2) Such investment property and such living animals and plants may be included at fair value, provided that all such investment property, or as the case may be, all such living animals and plants are so included where their fair value can reliably be determined.

(3) In this paragraph “fair value” means fair value determined in accordance with relevant international accounting standards.

Accounting for changes in value of financial instruments

31E.—(1) This paragraph applies where a financial instrument is valued in accordance with paragraph 31A or 31C.

(2) Notwithstanding paragraph 4 in Part 1 of this Schedule, and subject to sub-paragraphs (3) and (4) below, a change in the value of the financial instrument shall be included in the income and expenditure account.

(3) Where—

- (a) the financial instrument accounted for is a hedging instrument under a hedge accounting system that allows some or all of the change in value not to be shown in the income and expenditure account, or
- (b) the change in value relates to an exchange difference arising on a monetary item that forms part of a society’s net investment in a foreign entity,

the amount of the change in value shall be credited to or (as the case may be) debited from a separate reserve (“the fair value reserve”).

(4) Where the instrument accounted for—

- (a) is an available for sale financial asset, and
- (b) is not a derivative financial instrument,

the amount of the change in value may be credited to or (as the case may be) debited from the fair value reserve.

The fair value reserve

31F.—(1) The fair value reserve shall be adjusted to the extent that the amounts shown in it are no longer necessary for the purposes of paragraph 31E(3) or (4).

(2) The treatment for taxation purposes of amounts credited or debited to the fair value reserve shall be disclosed in a note to the accounts.”.

Information about fair value in notes to the accounts

9. After paragraph 35 of Schedule 5 (notes to annual accounts) insert—

“Information about fair value of financial instruments

36.—(1) This paragraph applies where the amounts to be included in a society’s accounts in respect of financial instruments have been determined in accordance with paragraph 31A or 31C of Schedule 7.

(2) There shall be stated—

- (a) the significant assumptions underlying the valuation models and techniques used where the fair value of the instruments has been determined in accordance with paragraph 31B(4) of that Schedule;
- (b) for each category of financial instrument, the fair value of the instruments in that category and the changes in their value—
 - (i) included in the income and expenditure account, and
 - (ii) credited to or (as the case may be) debited from the fair value reserve, in respect of instruments in that category; and
- (c) for each class of derivative financial instruments, the extent and nature of the instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows.

(3) Where any amount is transferred to or from the fair value reserve during the financial year, there shall be stated in tabular form—

- (a) the amount of the reserve as at the date of the beginning of the financial year and as at the balance sheet date respectively;
- (b) the amount transferred to or from the reserve during that year; and
- (c) the source and application respectively of the amounts so transferred.

Information where investment property and living animals and plants are included at fair value

37.—(1) This paragraph applies where the amounts to be included in a society’s annual accounts in respect of investment property or living animals and plants have been determined in accordance with paragraph 31D of Schedule 7.

(2) The balance sheet items affected and the basis of valuation adopted in determining the amounts of the assets in question in the case of each such item shall be disclosed in a note to the accounts.

(3) In the case of investment property, for each balance sheet item affected there shall be shown, either separately in the balance sheet or in a note to the accounts—

- (a) the comparable amounts determined according to the historical cost accounting rules; or
- (b) the differences between those amounts and the corresponding amounts actually shown in the balance sheet in respect of that item.

(4) In sub-paragraph (3) above, references in relation to any item to the comparable amounts determined in accordance with that sub-paragraph are references to—

- (a) the aggregate amount which would be required to be shown in respect of that item if the amounts to be included in respect of all the assets covered by that item were determined according to the historical cost accounting rules; and

- (b) the aggregate amount of the cumulative provisions for depreciation or diminution in value which would be permitted or required in determining those amounts according to those rules.”.

PART 4

Changes to the directors’ report and interpretation

Disclosures in relation to financial instruments

10. In Schedule 8 (directors’ report), after paragraph 10 (new activities) insert—

“Financial risk management objectives and policies

11. The directors’ report shall contain, in relation to the use of financial instruments by the society and by any subsidiary undertaking, and where material for the assessment of the society’s or (as the case may be) group’s assets, liabilities, financial position and profit or loss—

- (a) the financial risk management objectives and policies of the society or (where applicable) the group, including the policy for hedging each major type of forecasted transaction for which hedge accounting is used, and
- (b) the exposure of the society or (where applicable) of the group to price risk, credit risk, liquidity risk and cash flow risk.”.

Interpretation

11. In Schedule 11 (interpretation of schedules)—

- (a) in paragraph 9(3)—
 - (i) for “provisions for liabilities and charges” substitute “provisions for liabilities”, and
 - (ii) for “or loss” substitute “the nature of which is clearly defined and”;
- (b) after paragraph 12 (amounts repayable), insert—

“Financial instruments

12A. References to “derivative financial instruments” are deemed to include commodity-based contracts that give either contracting party the right to settle in cash or some other financial instrument, except where such contracts—

- (a) were entered into and continue in order to meet the society’s expected purchase, sale or usage requirements;
- (b) were designated for such purpose at their inception; and
- (c) are expected to be settled by delivery of the commodity.”;
- (c) in paragraph 13 (other definitions)—
 - (i) after the definition of “EEA State”, insert—

““fair value reserve” has the meaning given by paragraph 31E of Schedule 7;”;
 - (ii) omit the definition of “financial fixed assets”;
- (d) after paragraph 13, insert—

“14.—(1) The expressions listed in sub-paragraph (2) have the same meaning as they have in Council Directive 78/660/EC on the annual accounts of certain types of companies,

as amended^(a); and for the purposes of those expressions, it shall be assumed that a society is subject to the provisions of that Directive.

(2) “Available for sale financial asset”, “business combination”, “cash flow risk”, “commodity-based contracts”, “credit risk”, “equity instrument”, “exchange difference”, “fair value hedge accounting system”, “financial fixed asset”, “financial instrument”, “foreign entity”, “hedge accounting”, “hedge accounting system”, “hedged items”, “hedging instrument”, “held to maturity”, “held for trading purposes”, “liquidity risk”, “monetary item”, “price risk”, “receivables”, “reliable market”, and “trading portfolio”.

Minor and consequential amendments

12. The Schedule to these Regulations makes minor and consequential amendments.

*Derek Twigg
John Heppell*

6th December 2004

Two of the Lords Commissioners of Her Majesty’s Treasury

(a) O.J. L222 of 14.8.1978 page 11, as amended in particular by Directives 2001/65/EEC and 2003/51/EEC of the European Parliament and of the Council (O.J. L238 of 27.12.2001, page 28, and O.J. L178 of 17.7.2003, page 16).

SCHEDULE

Regulation 12

1. The principal Regulations are amended as follows.
2. In regulation 2 (interpretation)—
 - (a) in the definition of “group accounts society”, for “section 72 of the Act (duty of directors to prepare annual accounts)” substitute “section 72E of the Act (duty to prepare group accounts)”; and
 - (b) in the definition of “subsidiary undertaking”, for “section 72” substitute “section 72E”.
- 3.—(1) In regulation 4 (group accounts: supplementary provisions), for “subsections (2) and (3) of section 73 of the Act”, wherever occurring, substitute “subsection (2) of section 72F of the Act”.
4. In regulation 5 (notes to annual accounts)—
 - (a) in paragraph (1) after “required to be included” insert “by the Act and”;
 - (b) in paragraph (3) omit “relevant”; and
 - (c) omit paragraph (4).
5. In paragraph 2(3) of Schedule 4 (form and content of the annual accounts of a group accounts society), for “subsections (2) and (3) of section 73 of the Act” substitute “subsection (2) of section 72F of the Act”.
- 6.—(1) In paragraph 22 of Schedule 5 (reserves and provisions in notes to annual accounts), for “provisions for liabilities and charges”, wherever occurring, substitute “provisions for liabilities”.

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations make provision to give effect to two directives:

- Parts of Directive 2003/51/EC of the European Parliament and of the Council amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC as regards modernising the annual and consolidated accounts of certain types of companies, banks and other financial institutions to bring the preparation of those accounts more into line with international accounting standards (OJ L 178, 17/07/2003, p.16 – 22) (“the Modernisation of Accounts Directive”); and
- Directive 2001/65/EC of the European Parliament and of the Council 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 (OJ L 283 27/10/2001 p.28 – 32) (“the Fair Value Directive”).

The parts of the Modernisation of Accounts Directive implemented by these Regulations are those that require amendments to be made to the Building Societies (Accounts and Related Provisions) Regulations 1998 (S.I. 1998/504 – “the 1998 Regulations”). Part 2 of these Regulations, regulation 11(a) and the Schedule to the Regulations make those amendments required in order to implement that Directive. Part 3 of the Regulations and paragraphs (b), (c) and (d) of regulation 11 make those amendments required in order to implement the Fair Value Directive.

The Regulations also change cross-references to sections of the Building Societies Act 1986 required due to the Building Societies Act 1986 (International Accounting Standards and Other Accounting Amendments Order) 2004.

Regulation 2 deletes two paragraphs of regulation 4 of the 1998 Regulations which previously required building societies to exclude from their group accounts those of its subsidiaries whose activities were so different that it would be incompatible with the accounts giving a true and fair view of the group’s position to include them.

Regulation 3 permits societies to additionally show amounts in their accounts in euro. Regulation 4 deletes certain provisions of the 1998 Regulations which relate to disclosures in the notes to the society’s accounts. These disclosures are now to be required by provisions in the Building Societies Act 1986 which are being inserted by the Building Societies Act 1986 (International Accounting Standards and Other Accounting Amendments) Order 2004.

Regulations 5 and 6 effect the details of how liabilities and provisions for liabilities are to be presented in the accounts. Regulation 7 provides that amounts included in the accounts must be determined with regard to the substance of a reported transaction or arrangement.

Regulation 8 permits building societies to include certain financial instruments (including derivative financial instruments) and other classes of assets, in their accounts at fair value. The amendments specify the type of financial instruments and other assets which may be valued at fair value, 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.

Regulation 9 requires information about fair valuation to be given in the notes to a society’s accounts. Regulation 10 requires disclosures to be made in the directors’ report in relation to the use of financial instruments by a building society.

Regulations 11, 12 and the Schedule deal with definitions and minor and consequential amendments.

A separate transposition note for each Directive showing how the main provisions of each Directive (as it applies to building societies) will be transposed into UK law is available from HM Treasury. Copies may be obtained from the General Insurance, Mutuels and Inclusion Team, HM Treasury, 1 Horse Guards Road, London SW1A 2HQ and the notes will be available on the Treasury website (www.hm-treasury.gov.uk).

A regulatory impact assessment has been prepared in relation to these Regulations. A copy of it is available on the Treasury website or from the above address. Copies of both the transposition notes and the regulatory impact assessment have been placed in the library of both Houses of Parliament.

STATUTORY INSTRUMENTS

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