

EXPLANATORY MEMORANDUM TO
THE BUILDING SOCIETIES ACT 1986 (ACCOUNTS, AUDIT AND EEA STATE
AMENDMENTS) ORDER 2008

2008 No. 1519

THE BUILDING SOCIETIES (ACCOUNTS AND RELATED PROVISIONS) (AMENDMENT)
REGULATIONS 2008

2008 No.1143

1. This explanatory memorandum has been prepared by Her Majesty's Treasury ("HMT") and is laid before Parliament by Command of Her Majesty.

2. Description

2.1 The Building Societies Act 1986 (Accounts, Audit and EEA State Amendments) Order ("the Order") amends provisions of the Building Societies Act 1986 relating to the accounts and audit requirements for building societies. It implements in part Directive 2006/43/EC¹ ("the Audit Directive") and 2006/46/EC² ("the Accounts Directive"). The changes relate to disclosure of off-balance sheet arrangements, disclosure of auditor remuneration, signature of the auditor's report, dismissal of an auditor on improper grounds, and notification where an auditor ceases to hold office.

2.2 The Building Societies (Accounts and Related Provisions) (Amendment) Regulations ("the Regulations") amend the Building Societies (Accounts and Related Provisions) Regulations 1998 (S.I. 1998/504). They implement in part the Accounts Directive. The changes relate to disclosure of related party transactions and fair value accounting.

2.3 The Order also updates a reference to "EEA State" in the Building Societies Act 1986.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 Articles 3, 4, 5, 6(2) and 7 of the Order are made under section 104(5) of the Building Societies Act 1986 (power to amend, etc to assimilate to company law). Articles 6(1) and 8 are made under section 2(2) of the European Communities Act 1972, as they do not assimilate company law.

3.2 Regulation 3 of the Regulations corrects a defect in the amendment to regulation 10(1) of the Building Societies (Accounts and Related Provisions) Regulations 1998, made by S.I. 2007/859. As the Regulations contain other amendments, they are not being issued free of charge to purchasers of the defective instrument.

4. Legislative Background

¹ Directive 2006/43/EC of the European Parliament and of the Council on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/449/EEC and repealing Council Directive 84/253/EEC (OJ L 157, 9.6.2006, p.87).

² Directive 2006/46/EC of the European Parliament and the Council of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings (OJ L 224, 16.8.2006, p.1).

- 4.1 These instruments are being made as part of the UK's implementation of the Audit and Accounts Directives referred to above. The Department for Business, Enterprise and Regulatory Reform ("BERR") has implemented these Directives for companies and other entities in the Companies Act 2006 and in secondary legislation. Other measures are also being taken to implement the Directives.
- 4.2 BERR's implementation, and the other implementing measures, already implements the Directives in part for building societies. However, implementation also requires amendment of building society legislation, for which HMT is responsible.
- 4.3 Full transposition notes for both Directives are reproduced in the Annex.
- 4.2 Building Societies in the UK are subject to building societies legislation, principally the Building Societies Act 1986 ("the 1986 Act"). That Act was substantively revised by the Building Societies Act 1997 and by and under the Financial Services and Markets Act 2000 (FSMA 2000). Building societies' accounts are governed by the Building Societies (Accounts and Related Provisions) Regulations 1998 where they are prepared under the 1986 Act rather than under international accounting standards (see sections 72A to 72G of the 1986 Act, substituted by S.I. 2004/3380).
- 4.3 HMT's approach has been to make the implementation of these Directives for building societies as similar as possible to BERR's implementation for companies. The provisions of the Order on disclosures of off-balance-sheet arrangements, disclosure of auditor remuneration, signature of auditor's report, and notification of auditor ceasing to hold office, closely follow the equivalent provisions for companies. The provisions of the Regulations on disclosure of related party transactions and extension of fair value accounting also follow the equivalent provisions for companies.
- 4.4 The provision on removal of auditor on improper grounds (article 6(1)) does not follow the equivalent company law provision. For companies this requirement (Article 28.1 of the Audit Directive) is implemented by an amendment to section 994 of the Companies Act 2006 (petition by company member), and there is no equivalent to that section for building societies. Article 6(1) therefore creates a new right for certain persons to apply to the High Court where an auditor has been dismissed on improper grounds.
- 4.5 The existing definition of "EEA State" in section 97 of the 1986 Act excludes Bulgaria and Romania, which became Community member States on 1st January 2007. The Order amends section 97 to bring the definition up to date.

5. Territorial Extent and Application

- 5.1 The Order and the Regulations apply to all of the United Kingdom.

6. European Convention on Human Rights

- 6.1. The Exchequer Secretary to the Treasury (Angela Eagle) has made the following statement regarding Human Rights.

"In my view the provisions of the Building Societies Act 1986 (Accounts, Audit and EEA State Amendments) Order 2008 are compatible with the convention rights".

- 6.2 As the Regulations are subject to negative resolution procedure and do not amend primary legislation, no statement is required.

7. Policy background

- 7.1 Building Societies are organisations owned by their members, which pay interest on deposits and lend money on the security of property to enable members to buy their own homes. There were 59 building societies in the UK as at 31 March 2008 with total assets over £350 billion and savings balances of £215 billion.
- 7.2 The Audit and Accounts Directives seek to improve the credibility of financial statements provided by businesses in the EU, establish some basic sets of principles for the conduct of statutory audits and to engender good corporate governance practice.
- 7.3 These instruments fulfil these objectives by implementing the Directives' requirements on:
- (Audit Directive)
- disclosure of auditor remuneration (article 4 and Schedule 1 of the Order);
 - naming the auditor and signature of the auditor's report (article 5);
 - dismissal of auditor on improper grounds (article 6(1));
 - notification where an auditor ceases to hold office (article 6(2));
- (Accounts Directive)
- disclosure of off-balance sheet arrangements (article 3);
 - disclosure of related party transactions (regulation 4 of the Regulations);
 - extending the use of fair value accounting (regulation 5).
- 7.4 The instruments amend existing legislation, to implement those parts of the Directives for building societies within the existing legal framework. They seek to put into statute the minimum provision required to meet the obligations of the Directives. Other parts of the Directives are implemented for building societies by other measures (see transposition notes).
- 7.5 The main interest in the instruments is expected to be from building societies and accountancy and audit firms.
- 7.6 The instruments commence on 29th June 2008, which is the Directive's deadline for implementation. They apply in relation to financial years starting on or after that date. The amendment to the definition of EEA State applies from the date the Order comes into force.

8. Impact

- 8.1 The Department for Business Enterprise & Regulatory Reform (BERR) held a public consultation in July 2007 on the impact of the two Directives on entities for which they have policy responsibility (companies and partnerships). BERR are also implementing the Directives in relation to Industrial & Provident Society Insurers, which are within the scope of the Directives.
- 8.2 HMT held a public consultation from 4 January 2008 to 29 February 2008 for the mutual sector, specifically building societies and friendly societies for which it has policy and legislative responsibility. Over 300 copies of the consultation documents were issued to stakeholders in the UK and a copy posted on the HMT public website. Recipients included all the 59 UK building societies and the 200 friendly societies regulated by the FSA. Copies were also sent to Other Government Departments, accountancy and audit firms and housing associations.
- 8.3 Three consultation responses were received, two of which were from the trade associations on behalf of their members. All the responses were unanimous in welcoming the Government's implementation proposals and of the view that these were consistent with general trends in improved governance, transparency and accounting treatment for businesses.
- 8.4 As part of the consultation HMT informed and discussed with other Government departments and agencies including the Department for Business Enterprise & Regulatory Reform, Department for

Communities & Local Government, Ministry of Justice and the FSA. HMT also consulted with and informed the Scottish Executive, Welsh and Northern Ireland Authorities.

8.5 A summary of the consultation responses will be available on the HM Treasury public website at www.hm-treasury.gov.uk

8.6 An Impact Assessment is attached to this explanatory memorandum and will be available on the HMT public website alongside a copy of the consultation document and summary of responses.

9. Contact

9.1 For further information or queries regarding the Order and the Regulations please contact:

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ANNEX

TRANSPOSITION NOTE

IMPLEMENTATION OF DIRECTIVE 2006/46/EC

OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 14th June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings

The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008

No. 2008/

The Large and Medium-sized Companies and Groups (Accounts and Directors' Report) Regulations 2008

No. 2008/

The Companies Act 2006 (Amendment) (Accounts and Reports) Regulations

No. 2008/

The Building Societies Act 1986 (Accounts, Audit and EEA State Amendments) Order

No. 2008/

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

No. 2008/

The Friendly Societies Act 1992 (Accounts, Audit and EEA State Amendments) Order

No. 2008/

The Friendly Societies (Accounts and Related Provisions) (Amendment) Regulations

No. 2008/

Transposition Notes

DIRECTIVE 2006/46/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 14th June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies (“the 4th Directive”), 83/349/EEC on consolidated accounts (“the 7th Directive”), 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions (“the Bank Accounts Directive”) and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings (“the Insurance Accounts Directive”)

This table has been prepared by the Department for Business, Enterprise and Regulatory Reform and Her Majesty’s Treasury. It sets out the objective of each article of the Directive, and how it is to be implemented in the United Kingdom. The Secretary of State, HM Treasury and the Financial Services Authority are responsible for implementation.

European Union accounting requirements are based primarily on the 4th, 7th, Bank Accounts and Insurance Accounts Directives. From 6th April 2008 UK implementation of those Directives will be in Parts 15 and 16 of the Companies Act 2006 (“the 2006 Act”), and regulations to be made under Part 15. The transposition of Directive 2006/46, which amends the accounting Directives and which must be transposed no later than 5th September 2008, therefore takes the form of amendments to the 2006 Act, and provisions of the regulations to be made under Part 15. The Bank Accounts and Insurance Accounts Directives are implemented for building societies and friendly societies by Part VIII of the Building Societies Act 1986, Part VI of the Friendly Societies Act 1992, and accounting regulations made under those Acts. Transposition of Directive 2006/46 for building societies and friendly societies takes the form of amendments to those Acts and regulations.

The legislation implementing the Directive does not go beyond what is necessary to implement the Directive, including making consequential changes to domestic legislation to ensure its coherence in the area to which they apply.

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
1.1	Amends the Member State Option in article 11 of the 4 th Directive (applied to groups by article 6 of the 7 th Directive) to increase the thresholds used to define small companies and groups for the purpose of certain accounting, reporting and audit exemptions. To qualify as small, a company or group is required to meet 2 of the 3 criteria in respect of balance sheet total, net turnover or employee numbers.	The criteria defining small companies in the UK are set out in sections 382 (3) and 477(2) of the 2006 Act. The criteria defining small groups are set out in sections 383 (4) and 479(2) of the 2006 Act. Not applicable to building societies or friendly societies.	Secretary of State
	The maximum financial thresholds are raised from EUR 3,650,000 to 4,400,000 in the case of balance sheet totals and EUR 7,300,000 to 8,800,000 in the case of net turnover – the average number of employees remains the same (50).	The financial thresholds for small companies and groups are amended in line with the Directive by regulations 3 and 5 in Part 2 of the Companies Act 2006 (Amendment) (Accounts and Reports) Regulations 2008. Not applicable to building societies or friendly societies.	

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
1.2	Amends the 4 th Directive to provide for the financial thresholds used to define small companies in the 4 th Directive to be increased by any Directive, and not just by a Directive implementing the formal 5 yearly review process previously provided for in article 53(2) of the 4 th Directive.	No action necessary.	
1.3	<p>Amends the Member State Option in article 27 of the 4th Directive (applied to groups by article 6 of the 7th Directive) to increase the financial thresholds used to define medium-sized companies and groups.</p> <p>To qualify as medium-sized, a company or group is required to meet 2 of the 3 criteria in respect of balance sheet total, net turnover or employee numbers.</p> <p>The maximum financial thresholds are raised from a balance sheet total of EUR 14,600,000 to 17,500,000 and net turnover EUR 29,200,000 to 35,000,000 - the average number of employees remains the same (250).</p>	<p>The criteria defining medium-sized companies are set out in section 465 (3) of the 2006 Act.</p> <p>The criteria defining medium-sized groups are set out in section 466 (4) of the 2006 Act.</p> <p>The financial thresholds are amended by regulation 4 in Part 2 of the Companies Act 2006 (Amendment) (Accounts and Reports) Regulations 2008.</p> <p>Not applicable to building societies or friendly societies.</p>	Secretary of State
1.4	Amends the 4 th Directive to provide for the financial thresholds used to define medium-sized companies in the 4 th Directive to be increased by any Directive, and not just by a Directive implementing the formal 5 yearly review process previously provided for in article 53(2) of the 4 th Directive.	No action necessary.	

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
1.5	Amends article 42a of the 4 th Directive as inserted by Directive 2001/65/EC (O.J.L283/328 of 27 th October 2001) (often referred to as the Fair Value Directive). This contains a Member State Option to permit or require valuation of financial instruments and associated disclosure requirements which are provided for in international accounting Standards adopted in accordance with Regulation (EC) No. 1606/2002 of the European Parliament and Council up until 5 September 2006.	<p>Small Companies and Groups (Accounts and Directors' Report) Regulations 2008, Schedule 1 paragraph 36 (4) gives small companies the option of fair valuing financial instruments in accordance with Article 1.5 of the Directive.</p> <p>Equivalent option given to large and medium-sized companies by the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008- Schedule 1 paragraph 36 (4) (non-banking or insurance companies), Schedule 2 paragraph 44 (4) (banking companies), and Schedule 3 paragraph 30 (4) (insurance companies).</p>	Secretary of State
		<p>Building societies: the Building Societies (Accounts and Related Provisions) Regulations 1998, Schedule 7, paragraph 31A, as amended by regulation 5 of the Building Societies (Accounts and Related Provisions) (Amendment) Regulations 2008.</p> <p>Friendly Societies: the Friendly Societies (Accounts and Related Provisions) Regulations 1994, Schedule 6, paragraph 24A, as amended by the Friendly Societies (Accounts and Related Provisions) (Amendment) Regulations 2008.</p>	<p>HM Treasury</p> <p>HM Treasury</p>

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
1.6	<p>Amends article 43 of the 4th Directive to require additional disclosure in the notes to accounts.</p> <p>New article 43(7a) imposes a requirement to include information about financial arrangements that do not appear on the balance sheet and the financial impact of those arrangements, where the risks or benefits arising are material, and in so far as the information is necessary to assess the financial position of the company.</p>	<p>Part 3 of the Companies Act 2006 (Amendment) (Accounts and Reports) Regulations 2008 which inserts section 410A into the Companies Act 2006.</p> <p>Building Societies: section 72L of the Building Societies Act 1986, inserted by Article 3 of the Building Societies Act 1986 (Accounts, Audit and EEA State Amendments) Order 2008.</p> <p>Friendly Societies: section 69L of the Friendly Societies Act 1992, inserted by Article 3 of the Friendly Societies Act 1992 (Accounts, Audit and EEA State Amendments) Order 2008.</p>	<p>Secretary of State</p> <p>HM Treasury</p> <p>HM Treasury</p>
	<p>Member State option to exempt small companies from the disclosure requirement.</p> <p>Member State option to limit the disclosure required of medium-sized companies to information about the nature and business purposes of the arrangements.</p>	<p>Options in respect of small and medium-sized companies exercised in new section 410A(1) and (4) respectively.</p> <p>Building societies and friendly societies: not applicable.</p>	

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
	<p>New article 43(7b) imposes a requirement to disclose transactions entered into with related parties as defined in international accounting standards adopted in accordance with EC Regulation 1606/2002. Information may be aggregated unless separate information is necessary for understanding the impact of transactions on the company.</p> <p>Member State option to exempt small companies from the disclosure requirement.</p>	<p>Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 - Schedule 1 paragraph 72 (non-banking or insurance companies), Schedule 2 paragraph 92 (banking companies), and Schedule 3 paragraph 90 (insurance companies).</p> <p>Building Societies (Accounts and Related Provisions) Regulations 1998, Schedule 5, paragraph 38, inserted by regulation 4 of the amending Regulations.</p> <p>Friendly Societies (Accounts and Related Provisions) Regulations 1994, Schedule 4, paragraph 35, inserted by regulation 5 of the amending Regulations.</p> <p>Option exercised. No requirement for small companies to make the disclosure. Not applicable to building societies or friendly societies.</p>	<p>Secretary of State</p> <p>HM Treasury</p> <p>HM Treasury</p>

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
	Member State option to exempt medium-sized companies which are not public companies from the disclosure requirement.	Option exercised in regulation 4(2)(b) of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. Not applicable to building societies or friendly societies.	
1.7	<p>Inserts a new article 46a into the 4th Directive. This imposes a requirement for companies whose securities are traded on a regulated market to produce a corporate governance statement either as a separate part of their annual (directors') report, or as a separate statement. The statement must cover-</p> <ul style="list-style-type: none"> a. The corporate governance code applying to the company. b. Departures from the code and an explanation of the reasons for doing so. c. A description of main features of the company's internal control and risk management systems in relation to the financial reporting process. d. Certain matters related to the company's shares and control structures already required by Directive 2004/25/EC (the Takeovers Directive) e. The operation of the shareholder meeting and key powers and description of shareholders rights and how they are exercised unless information is already fully provided for in national laws or regulations f. The composition and operation of the board of directors and its committees. 	Rules to be made by the Financial Services Authority under Part 6 of the Financial and Market Services Act 2000 as amended by section 1269 of the 2006 Act (corporate governance rules).	Financial Services Authority

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
	<p>e 46a.2 contains a Member State Option to permit information to be set out in a separate report published with the annual report by means of a reference in the annual report to where such document is publicly available on the company's website.</p> <p>event of a separate report the corporate governance statement may contain a reference to the annual report where information is required at point d above.</p> <p>is a requirement for a statutory auditor to express an opinion concerning the consistency with information in the annual report and accounts for the same financial year in the case of points c and d. For remaining information the statutory auditor shall check that the corporate governance statement has been produced.</p>	<p>Option to be implemented in the FSA rules referred to above.</p> <p>Section 496 of the 2006 Act (auditor's report on directors' report) to be amended by regulations under section 2(2) of the European Communities Act 1972 once the FSA rules have been made.</p>	<p>Financial Services Authority</p> <p>Secretary of State</p>
	<p>Includes a Member State Option to permit companies issuing securities other than shares, admitted to trading on a regulated market, to be exempt from provisions a, b, e and f.</p>	<p>Option to be implemented in the FSA rules referred to above.</p>	<p>Financial Services Authority</p>
<p>1.8</p>	<p>A new Section 10A is inserted into the 4th Directive. New Article 50b imposes a requirement for Member States to ensure that the directors have collective responsibility for drawing up and publishing accounts and reports, and the corporate governance statement when provided separately.</p>	<p>Part 15 (Accounts and Reports) of the 2006 covers specific responsibilities in respect of accounts and reports:</p> <p>Chapter 4 – collective duty to prepare accounts (sections 394, 399); approval and signing</p>	<p>Secretary of State</p>

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
		<p>of accounts (section 414) and criminal penalties for failure to comply (section 414(4) and (5)).</p> <p>Chapter 5 – collective duty to prepare directors' report (section 415); approval and signing of directors' report (section 419) and criminal penalties for failure to comply (section 415(4) and (5), section 419(3) and (4)).</p>	
		<p>Chapter 10 – duty to file accounts and reports with registrar of companies, with criminal and civil penalties for non-compliance (sections 451 to 453).</p> <p>Building Societies Act 1986: collective duty to prepare accounts (sections 72A, 72E), collective duty to prepare report (section 75), signing of balance sheet with accounts and report annexed (section 80), penalties for failure to comply (sections 75(4) and 80(6)).</p> <p>Friendly Societies Act 1992: collective duty to prepare accounts (sections 69A, 69E), collective duty to prepare report (section 71), signing of balance sheet with accounts and report annexed (section 76), penalties for failure to comply (sections 71(3) and 76(6)).</p>	<p>HM Treasury</p> <p>HM Treasury</p>

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
	New article 50c imposes a requirement on Member States to ensure that their laws, regulation and administrative provisions on liability apply to the administration, management and supervisory bodies of a company for a breach of the duty referred to above at least towards the company.	Chapter 11 – provisions for civil enforcement of accounting and reporting requirements, which may result in a court order against the directors (section 456). The provisions listed above in Part 15 of the 2006 Act which relate to the directors' report to be amended by regulations under section 2(2) of the European Communities Act 1972 once the FSA rules have been made to include reference to any separate corporate governance statement.	Secretary of State
1.9	Requires that Member States exclude companies trading on a regulated market from the exemptions permitted for small and medium-sized companies.	Sections 384, 467 and 478 of the 2006 Act.	Secretary of State
1.10	Requires that Member States lay down rules on penalties applicable to infringements of national provisions adopted pursuant to the Directive.	See the notes against article 1.8 above.	Secretary of State

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
2	Applies provisions set out in Article 1 of the Directive to the 7 th Directive on consolidated accounts.	<p>Section 410A(5) to be inserted by regulation 8 of the Companies Act 2006 (Amendment) (Accounts and Reports) Regulations 2008.</p> <p>Provisions on individual accounts in the regulations to be made under Part 15 of the 2006 Act are applied to consolidated accounts by- regulation 8 of, and Schedule 6 to, the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008; and</p> <p>Regulation 9 of, and Schedule 6 to, the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.</p> <p>New article 36(2)(f) of the 7th Directive to be implemented by FSA rules (see entry for Article 1.7 above).</p>	Secretary of State
		<p>Building societies: new provisions apply equally to consolidated accounts. See Building Societies Act 1986, new section 72L(4), and Building Societies (Accounts and Related Provisions) Regulations 1998, regulation 5(2) and 7.</p> <p>Friendly societies: new provisions apply equally to consolidated accounts. See Friendly Societies Act 1992, new section 69L(4), and Friendly Societies (Accounts and Related Provisions) Regulations 1998, regulation 8(2) and 10.</p>	<p>HM Treasury</p> <p>HM Treasury</p>

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
3	Applies the provisions in Article 1 of the Directive to the Bank Accounts Directive covering the annual and consolidated accounts of banks and other financial institutions.	See the notes against Articles 1 and 2 above. For those banking undertakings not governed by the 2006 Act or by the Building Societies Act 1986, implementation will be by means of the Bank Accounts Directive (Miscellaneous Banks) Regulations 2008 to be made in early Spring 2008 to come into force on 6th April 2008.	Secretary of State, HM Treasury and Financial Services Authority
4	Applies the provisions in Article 1 of the Directive to the Insurance Accounts Directive covering the annual reports and accounts of insurance undertakings.	See the notes against Articles 1 and 2 above. For those insurance undertakings not governed by the 2006 Act or by the Friendly Societies Act 1992, implementation will be by means of the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008 to be made in early Spring 2008 to come into force on 6th April 2008.	Secretary of State, HM Treasury and Financial Services Authority
5	Requires that the relevant provisions of the Directive be transposed no later than 5 September 2008. Details of transposition shall be communicated to the Commission.	Parts 15 and 16 of the 2006 Act, and the regulations referred to above in this Table, will come into force on 6th April 2008, and will apply to financial years beginning on or after that date. The FSA rules will have the same date of application. Measures applying to building societies and friendly societies will come into force on 29 th June 2008. Details of transposition measures will be communicated to the EU Commission by administrative process.	Secretary of State, HM Treasury and Financial Services Authority
6	Provides that the Directive comes into force on 5 September 2006.	No action necessary.	
7	Addresses the Directive to the Member States.	No action necessary.	

ANNEX

TRANSPOSITION NOTE

DIRECTIVE 2006/43/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL OF 17 MAY 2006 ON STATUTORY AUDITS OF ANNUAL ACCOUNTS AND CONSOLIDATED ACCOUNTS, AMENDING COUNCIL DIRECTIVES 78/660/EEC AND 83/349/EEC AND REPEALING COUNCIL DIRECTIVE 84/253/EEC

This note describes the implementation in the UK of Directive 2006/43 EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC (OJ L157, 9.6.2006, p.87). The Directive must be implemented by 29 June 2008.

The Directive regulates auditors and the audit process, repealing and replacing the Eighth Council Directive 84/253/EEC of 10 April 1984 based on Article 54 (3) (g) of the Treaty on the approval of persons responsible for carrying out the statutory audits of accounting documents. The Directive extends to auditors in the European Economic Area by virtue of Decision of the EEA Joint Committee No. 160/2006 of 8 December 2006 amending Annex XXII (Company law) to the EEA Agreement (OJ L 89, 29.3.2007, p.38).

The Directive applies in relation to all audits of accounts required by Community law (article 2.1): that is, audits of company accounts and the accounts of certain partnerships, insurers and credit institutions (e.g. building societies, friendly societies).

The Directive sets down requirements as to:

- auditors' qualifications (articles 3-13);
- registration of auditors (articles 15-20);
- auditors' professional ethics (articles 21-24);
 - auditing standards (article 26);
- aspects of the audit process (articles 25, 27, 28);
- monitoring and investigation of auditors (articles 29-30);
- oversight of auditors by competent authorities (articles 32-36, 47); and
- regulation of third country auditors (articles 45-46).

There are also some obligations in the Directive on audited entities, relating to:

- appointment of auditors (article 37);
- dismissal of auditors (article 38); and
- establishment of an audit committee (article 41).

UK law already regulates auditors and the audit process in the Companies Act 1985 and the Companies Act 1989 in Great Britain, and equivalent legislation in Northern Ireland.

Those provisions are replaced by Parts 16 and 42 of the Companies Act 2006, which apply to the whole of the UK and (it is intended) will be brought into force on 6th April 2008 (see the Companies Act 2006 (Commencement No. 5, Consequential Amendments, Transitional Provisions and Savings) Order 2007).

The UK implementation of the Directive consists of provisions in the following instruments, which are the responsibility of the Secretary of State for Business, Enterprise and Regulatory Reform, except where indicated:

- Parts 16 and 42 of the Companies Act 2006;
- Statutory Auditors and Third Country Auditors Regulations 2007 (including amendments to the Companies Act 2006);
- the Statutory Auditors (Delegation of Functions etc) Order 2008 (which delegates functions of the Secretary of state under Part 42 of the Companies Act 2006 to the Professional Oversight Board);

- the Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008;
- Partnerships (Accounts) Regulations 2008;
- Bank Accounts Directive (Miscellaneous Banks) Regulations 2008;
- Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008;
- Building Societies Act 1986 (*HM Treasury responsible*);
- Building Societies Act 1986 (Accounts, Audit and EEA State Amendments) Order 2008 (*HM Treasury responsible*);
- Friendly Societies Act 1992 (*HM Treasury responsible*);
- Friendly Societies Act 1992 (Accounts, Audit and EEA State Amendments) Order 2008 (*HM Treasury responsible*);
- regulations to be made replacing the Insurance Accounts Directive (Lloyd’s Syndicate and Aggregate Accounts) Regulations 2004 (*HM Treasury responsible*);
- regulations to be made regarding the register of auditors, the subjects for auditors’ examinations, and transparency reports (*Professional Oversight Board responsible*);
- rules to be made relating to audits of certain entities whose securities are traded on a regulated market (*Financial Services Authority responsible*).

The implementing provisions in the above instruments do not go beyond the Directive’s requirements in any significant respect.

The table below describes the main substantive provisions implementing the Directive.

Unless otherwise indicated, references in the table to a section or schedule are to provisions of the Companies Act 2006 and references to a regulation are to a provision of the Statutory Auditors and Third Country Auditors Regulations 2007.

Directive 2006/43/EC on statutory audits: Transposition Measures		
Article	Objective	Implementation
1	Describes the Directive’s subject matter.	No implementation required.
2	Sets out definitions of terms used in Directive.	Directive definitions reflected in substantive implementing provisions.
APPROVAL OF AUDITORS		
3.1	Statutory audits may only be carried out by approved statutory auditors.	Section 1212(1).
3.2	Competent authorities to be designated for approving statutory auditors.	Section 1217 and Schedule 10.
3.3	Statutory auditors who are individuals to be approved only if articles 4 and 6-10 are met.	See implementation of articles 4 and 6-10 below.
3.4	Statutory auditors which are firms to be approved only if individuals conducting audits comply with articles 4 and 6-12, and if firm is controlled and managed by qualified individuals.	Paragraphs 6 and 7 of Schedule 10. See also implementation of articles 4 and 6-12 below.
4	Statutory auditors must be of good repute.	Paragraph 8 of Schedule 10.

5.1	Approval to be withdrawn if good repute compromised.	Paragraphs 8 and 14 of Schedule 10.
5.2	Approval to be withdrawn if firm not controlled and managed by qualified individuals.	Paragraphs 6, 7 and 14 of Schedule 10.
5.3	Withdrawal of approval to be notified to relevant authorities of other Member States.	Sections 1223A and 1253C (as inserted by regulations 7 and 14).
AUDITORS' QUALIFICATIONS		
6	Qualifications to include theoretical instruction, practical training and examination of professional competence.	Sections 1219 and 1220, and paragraphs 6 to 11 of Schedule 11.
7	Examination of professional competence must guarantee theoretical knowledge of subjects relevant to statutory audit, and the ability to apply that knowledge in practice.	Paragraph 8 of Schedule 11 and <i>regulations to be made by the Professional Oversight Board prescribing examination subjects.</i>
8.1 and 8.2	List of subjects to be included in test of theoretical knowledge.	Paragraph 8 of Schedule 11 and <i>regulations to be made by the Professional Oversight Board prescribing examination subjects.</i>
8.3	Commission may adopt further measures.	No implementation required at this stage.
9.1	Person holding a degree in a subject may be exempted from further test of theoretical knowledge under Article 7 or 8 in that subject.	Paragraph 8(2) of Schedule 11.
9.2	Person holding a degree in a subject may be exempted from further test of ability to apply knowledge under Article 7 if also has a diploma attesting to practical training.	Paragraph 8(3) of Schedule 11.
10.1	Practical training of minimum 3 years, at least 2 years of which with a statutory auditor.	Paragraph 9 of Schedule 11.
10.2	Training providers must provide adequate guarantees of their ability to provide training.	Paragraph 9(3) of Schedule 11.
11	Member State may allow a person who does not meet the Article 6 requirements instead to qualify through: (a) 15 years' professional experience and passing the exam under Article 7; or (b) 7 years' professional experience, passing the exam under Article 7, and completing the practical training under Article 10.	(a) Not implemented. (b) Paragraph 7 of Schedule 11.
12.1	Theoretical instruction of more than 1 year may count towards up to 4 years of the professional experience required by Article 11.	Paragraph 10(1) of Schedule 11.
12.2	Combination of professional experience and practical training must not be shorter than combination of theoretical instruction with practical training.	Paragraph 10(2) of Schedule 11.
13	Statutory auditors required to take part in continuing education.	Paragraphs 11 and 14 of Schedule 10.

14	Member State authorities must approve auditors from other Member States who pass an aptitude test.	Paragraph 6 of Schedule 10 (as amended by regulation 17).
REGISTRATION OF AUDITORS		
15.1	Auditors to be entered into public register in accordance with Articles 16 and 17. Requirements of Articles 15 and 16 may be disapplied if threat to a person's security.	See implementation of Articles 16 and 17 below. <i>Regulations to be made by the Professional Oversight Board on register of auditors.</i>
15.2	Each auditor to be identified by registration number; register to be in electronic form and electronically accessible.	<i>Regulations to be made by the Professional Oversight Board on register of auditors.</i>
15.3	Register to contain name and address of auditors' supervisory authorities.	<i>Regulations to be made by the Professional Oversight Board on register of auditors.</i>
15.4	Register to be fully operational by 29 June 2009.	<i>Regulations to be made by the Professional Oversight Board on register of auditors.</i>
16.1	Register to contain individual statutory auditor's name and address, details of any firm he is employed by, and details of any registration in other Member States.	<i>Regulations to be made by the Professional Oversight Board on register of auditors.</i>
16.2	Third country auditors to be marked in register as such.	Regulation 32(2)(c).
17.1	Register to contain audit firm's name and address, legal form, names and addresses of owners and managers, and details of any registration in other Member States.	<i>Regulations to be made by the Professional Oversight Board on register of auditors.</i>
17.2	Third country audit firms to be marked in register as such.	Regulation 32(3)(d).
18	Statutory auditors under a duty to update register.	<i>Regulations to be made by the Professional Oversight Board on register of auditors.</i>
19	Information provided for register under Articles 16, 17 and 18 must be signed by statutory auditor.	<i>Regulations to be made by the Professional Oversight Board on register of auditors.</i>
20.1	Register to be in a language permitted by Member State.	<i>Regulations to be made by the Professional Oversight Board on register of auditors.</i>
20.2	Member State may allow information on register in a second Community language.	Not implemented.
PROFESSIONAL ETHICS		
21.1	Statutory auditors subject to professional ethics principles, including integrity, objectivity, professional competence and due care.	Paragraphs 9 and 21 of Schedule 10 (as amended by regulation 19).
21.2	Commission may adopt further measures.	No implementation required at this stage.

22.1	Statutory auditor to be independent of audited person.	Sections 1214 and 1215, and paragraphs 9 and 21 of Schedule 10 (as amended by regulation 19).
22.2	Audit not to be carried out if significant threats to statutory auditor's independence; safeguards to be applied to mitigate threats. Audit of public interest entity not to be carried out in case of self-review or self-interest,	Paragraphs 9 and 21 of Schedule 10 (as amended by regulation 19). Paragraphs 9 and 21 of Schedule 10 (as amended by regulation 19).
22.3	Statutory auditors to record significant threats to independence and safeguards applied.	Paragraphs 9 and 21 of Schedule 10 (as amended by regulation 19).
22.4	Commission may adopt further measures.	No implementation required at this stage.
23.1	Audit documents to be subject to rules on confidentiality.	Paragraph 9(3)(b) of Schedule 10 (as amended by regulation 19).
23.2	Such confidentiality rules not to impede enforcement of Directive.	Paragraph 9(3)(b) of Schedule 10 (as amended by regulation 19).
23.3	Outgoing statutory auditor to provide incoming statutory auditor with all relevant information.	Paragraph 9(3)(c) of Schedule 10 (as amended by regulation 19).
23.4	Obligations of Article 23.1 and 2 extend to former statutory auditors.	Paragraph 9(4) of Schedule 10 (as amended by regulation 19).
24	Owners and managers of audit firms not to compromise independence and objectivity of individual auditors in conduct of audits.	Paragraph 9(3)(a) of Schedule 10 (as amended by regulation 19).
25	Audit fees not to be influenced by provision of additional services or based on a contingency.	Paragraphs 9(1)(e) and 21 of Schedule 10 (as amended by regulation 19).
AUDIT STANDARDS AND REPORTING		
26.1	Statutory audits to be conducted in accordance with international auditing standards adopted by Commission; but national standards may be applied if no such standards adopted.	No implementation required at this stage.
26.2	Commission may adopt international auditing standards under certain conditions.	No implementation required.
26.3	Member States may derogate from adopted international auditing standards under certain conditions.	No implementation required at this stage.
26.4	Member States may impose additional requirements until 29 June 2010.	No implementation required at this stage.
27(a)	For statutory audits of group accounts group auditor bears full responsibility.	- sections 495 and 471; - section 78(4)(c) of Building Societies Act 1986; - section 73(5)(c) of Friendly Societies Act 1992.
27(b)	Group auditor reviews work performed by other auditors, and documents review.	Paragraphs 10A(1) and 22 of Schedule 10 (as inserted by regulation 20).
27(c)	If work is carried out by an auditor in a country with which there is no Article 47	Paragraph 10A(3) to (6) of Schedule 10 (as

	arrangement, group auditor is to retain copies of that auditor's documentation and make them available to authorities.	inserted by regulation 20).
28.1	Audit report of audit firm to be signed by individual auditor carrying out the work, unless threat to personal security.	<ul style="list-style-type: none"> - sections 503 to 506; - regulation 10 of the Partnerships (Accounts) Regulations 2008; - regulation 9 of the Bank Accounts Directive (Miscellaneous Banks) Regulations 2008; - regulation 8 of the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008; - sections 78A to 78D of Building Societies Act 1986 (as inserted by article 5 of Building Societies Act 1986 (Accounts, Audit and EEA State Amendments) Order 2008); - sections 74 to 74C of Friendly Societies Act 1992 (as inserted by article 5 of Friendly Societies Act 1992 (Accounts, Audit and EEA State Amendments) Order 2008); - regulations to be made replacing the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004.
28.2	If no international standard adopted for audit reports under Article 26.1, Commission may adopt a common EU standard.	No implementation required at this stage.
QUALITY ASSURANCE REVIEWS		
29.1	Statutory auditors must be subject to quality assurance reviews meeting following conditions:	
	(a) independent of the auditors;	Paragraph 12(1A) of Schedule 10 (as amended by regulation 22).
	(b) funding secure and free from influence;	Paragraph 12(1) of Schedule 10 (as amended by regulation 22).
	(c) adequate resources;	Paragraph 12(1) of Schedule 10 (as amended by regulation 22).
	(d) carried out by persons with appropriate education and experience;	Paragraph 13(4) of Schedule 10 (as amended by regulation 23).
	(e) selection of reviewers is objective;	Paragraph 13(4) of Schedule 10 (as amended by regulation 23).
	(f) review to test audit files, check compliance with audit standards, independence requirements, resources allocated, audit fees, and internal quality control;	Paragraph 13(5) and (6) of Schedule 10 (as amended by regulation 23).
	(g) review to be subject of a report;	Paragraph 13(8) of Schedule 10 (as amended by regulation 23).
	(h) take place at least every 6 years;	Paragraph 13(3) of Schedule 10 (as amended by regulation 23).

	(i) overall results of reviews to be published annually;	Section 1251A (as inserted by regulation 11).
	(j) review recommendations to be followed up, or disciplinary action taken.	Paragraphs 12 and 14 of Schedule 10 (as amended by regulation 22).
29.2	Commission may adopt measures for the uniform application of (a), (b) and (e) to (j) above.	No implementation required at this stage.
INVESTIGATIONS AND OVERSIGHT		
30.1	Member States to have effective systems of investigations and penalties.	Paragraphs 12 and 14 of Schedule 10 (as amended by regulation 22).
30.2	Penalties to be effective, proportionate and dissuasive.	Paragraphs 12 and 14 of Schedule 10 (as amended by regulation 22).
30.3	Penalties to be disclosed to the public and include the possibility of withdrawal of approval.	Paragraph 12(3) of Schedule 10 (as amended by regulation 22).
31	Commission to present a report on auditors' liability.	No implementation required.
32.1	Member States to have effective oversight of statutory auditors in accordance with paragraphs 2 to 7.	Sections 1209 to 1264 and Schedules 10 to 14.
32.2	All statutory auditors to be subject to public oversight.	Sections 1212(1) and 1217, paragraphs 1 to 4 of Schedule 10, and article 4 of the Statutory Auditors (Delegation of Functions etc) Order 2008.
32.3	System of public oversight to be governed by independent non-practitioners.	Article 4 of the Statutory Auditors (Delegation of Functions etc) Order 2008.
32.4	System of public oversight to oversee approval and registration of statutory auditors, adoption of audit standards, continuing education, quality assurance, investigations and discipline.	Sections 1209 to 1264 and Schedules 10 to 14, and article 4 of the Statutory Auditors (Delegation of Functions etc) Order 2008.
32.5	System of public oversight to include conducting investigations in relation to statutory auditors and taking appropriate action.	Sections 1224 and 1225, and article 4 of the Statutory Auditors (Delegation of Functions etc) Order 2008.
32.6	System of public oversight to be transparent and publish annual work programmes and activity reports.	Paragraph 10 of Schedule 13 and article 7 of the Statutory Auditors (Delegation of Functions etc) Order 2008.
32.7	System of public oversight to be adequately funded, and funding free from undue influence.	Article 4 of the Statutory Auditors (Delegation of Functions etc) Order 2008.
33	Member States to ensure cooperation of national public oversight systems, and to nominate one entity as responsible for that cooperation.	Sections 1253A to 1253C (as inserted by regulation 16), and article 4 of the Statutory Auditors (Delegation of Functions etc) Order 2008.
34.1	Member States to respect the principle of home-country regulation.	Sections 1210 and 1212.

34.2	For audits of group accounts, Member States may not impose additional requirements on audits of subsidiaries established in other Member States.	Sections 1210 and 1212, and paragraphs 6 to 11 of Schedule 10 (as amended by regulations 17 to 21).
34.3	For companies whose securities are traded on the market of a second Member State, the second Member State may not impose additional requirements on their audits.	Sections 1210 and 1212, and paragraphs 6 to 11 of Schedule 10 (as amended by regulations 17 to 21).
35.1	Member States to designate competent authorities for Directive's tasks.	Section 1217 and Schedule 10, Section 1220 and Schedule 11, and the Statutory Auditors (Delegation of Functions etc) Order 2008.
35.2	Competent authorities to avoid conflicts of interest.	Section 1217 and Schedule 10, Section 1220 and Schedule 11, and the Statutory Auditors (Delegation of Functions etc) Order 2008.
36.1	Competent authorities of Member States to cooperate with one another, render assistance and exchange information.	Sections 1253A to 1253C (as inserted by regulation 14).
36.2	Obligations of professional secrecy to apply to employees of competent authorities.	Sections 1224A and 1224B and Schedule 11A (as inserted by regulation 8 and Schedule to the Regulations).
36.3	Article 36.2 shall not prevent competent authorities exchanging information.	Section 1224A(4) and (5) and Schedule 11A (as inserted by regulation 10 and Schedule to the Regulations).
36.4	Competent authorities to provide information requested by competent authorities of other Member States. They may refuse in certain circumstances.	Section 1253B (as inserted by regulation 14).
36.5	Competent authorities to notify competent authorities of other Member States if aware of unlawful conduct in their territories.	Section 1253C (as inserted by regulation 14).
36.6	Competent authorities to conduct investigations requested by competent authorities of other Member States. They may refuse in certain circumstances.	Section 1253B (as inserted by regulation 14).
36.7	Commission may adopt further measures to facilitate cooperation between competent authorities.	No implementation required at this stage.

APPOINTMENT AND DISMISSAL OF AUDITORS

37.1	Statutory auditor to be appointed by members of audited entity.	<ul style="list-style-type: none"> - sections 485 and 489; - regulation 8 of the Partnerships (Accounts) Regulations 2008; - regulation 7 of the Bank Accounts Directive (Miscellaneous Banks) Regulations 2008; - regulation 6 of the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008; - section 77 of, and Schedule 11 to, the Building Societies Act 1986;
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		<ul style="list-style-type: none"> - section 72 of, and Schedule 14 to, the Friendly Societies Act 1992; - <i>regulations to be made replacing the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004.</i>
37.2	Alternative systems of appointment allowed if designed to ensure independence of auditor from managers of audited entity.	Sections 486 and 490;
38.1	Statutory auditors not to be dismissed on improper grounds.	<ul style="list-style-type: none"> - section 994 (as amended by regulation 42); - regulation 11 of the Partnerships (Accounts) Regulations 2008; - regulation 10 of the Bank Accounts Directive (Miscellaneous Banks) Regulations 2008; - regulation 9 of the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008; - paragraph 6A of Schedule 11 to the Building Societies Act 1986 (as inserted by article 6 of Building Societies Act 1986 (Accounts, Audit and EEA State Amendments) Order 2008); - paragraph 10A of Schedule 14 to the Friendly Societies Act 1992 (as inserted by article 6 of Friendly Societies Act 1992 (Accounts, Audit and EEA State Amendments) Order 2008); - <i>regulations to be made replacing the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004.</i>
38.2	Statutory auditor and audited entity to inform competent authority of dismissal or resignation, including an explanation of the reasons.	<ul style="list-style-type: none"> - sections 522 and 523; - regulations 12 and 13 of the Partnerships (Accounts) Regulations 2008; - regulations 11 and 12 of the Bank Accounts Directive (Miscellaneous Banks) Regulations 2008; - regulations 10 and 11 of the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008; - paragraphs 8A to 8C of Schedule 11 to the Building Societies Act 1986 (as inserted by article 6 of Building Societies Act 1986 (Accounts, Audit and EEA State Amendments) Order 2008); - paragraphs 15A to 15C of Schedule 14 to the Friendly Societies Act 1992 (as inserted by article 6 of Friendly Societies Act 1992 (Accounts, Audit and EEA State Amendments) Order 2008); - <i>regulations to be made replacing the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004.</i>
STATUTORY AUDITS OF PUBLIC INTEREST ENTITIES		
39	Member States may exempt non-traded public interest entities from the requirements of Articles 40 to 43.	Implemented in provisions relating to Articles 40 to 43 – see below.

40.1	Statutory auditors of public interest entities to publish transparency reports containing certain information on their websites.	<i>Regulations to be made by the Professional Oversight Board on transparency reports.</i>
40.2	Transparency report to be signed by the statutory auditor.	<i>Regulations to be made by the Professional Oversight Board on transparency reports.</i>
41.1	Public interest entities to have audit committees, whose membership includes one independent person competent in accounting or auditing.	No implementation required – see Article 41.5 below.
41.2	Functions of an audit committee to include monitoring financial reporting process, the audit, and the independence of the statutory auditor.	No implementation required – see Article 41.5 below.
41.3	Proposal of public interest entity’s managers for appointment of statutory auditor to be based on audit committee’s recommendation.	No implementation required – see Article 41.5 below.
41.4	Statutory auditor to report to audit committee on key matters arising from audit.	Paragraph 10B(2)(e) and (f) of Schedule 10 (as inserted by regulation 21).
41.5	Member States may exempt public interest entities from the above requirements if they have a body performing equivalent functions.	<i>Rules to be made by the Financial Services Authority.</i>
41.6	Member States may exempt from the above requirements: (a) a subsidiary of a public interest entity; (b) a collective investment undertaking; (c) an issuer of asset-backed securities; (d) a credit institution which is not traded or issued debt securities of more than 100 million euros.	<i>Rules to be made by the Financial Services Authority.</i>
42.1	Statutory auditors of public interest entities to: (a) confirm annually in writing to audit committee their independence; (b) disclose annually to audit committee any additional non-audit services provided to entity; (c) discuss with audit committee the threats to their independence and the safeguards applied.	(a) Paragraph 10B(2)(a) of Schedule 10 (as inserted by regulation 21). (b) Paragraph 10B(2)(b) of Schedule 10 (as inserted by regulation 21). (c) Paragraph 10B(2)(c) and (d) of Schedule 10 (as inserted by regulation 21).
42.2	In audit firms, key audit partners responsible for audit to rotate after 7 years.	Paragraph 10C(1)(a) and (b) of Schedule 10 (as inserted by regulation 21).
42.3	Key audit partners not to take up key management posts in audited entity for two years following audit.	Paragraph 10C(3) and (4) of Schedule 10 (as inserted by regulation 21).
43	Quality assurance review under Article 29 must be every 3 years for statutory auditors of	Paragraph 23(1A) of Schedule 10 (as inserted by regulation 28).

	public interest entities.	
AUDITORS FROM THIRD COUNTRIES		
44.1	Member States may approve third country auditors as statutory auditors, subject to reciprocity, if they meet requirements equivalent to Articles 4 and 6 to 13.	Section 1221(3) and (4).
44.2	The requirements of Article 14 also apply to approval of a third country auditor.	Section 1221(1A) and (7A) (as amended by regulation 6).
45.1	Competent authorities of Member State must register in accordance with Articles 15 to 17 third country auditor who provide an audit report of a company whose securities are traded on a regulated market in that Member State.	Regulations 34 to 37.
45.2	Articles 18 and 19 also apply to such registration.	Regulations 35(5) and 39.
45.3	Member States to subject registered third country auditors to their systems of oversight, quality assurance, and investigation and penalties.	Sections 1242 to 1245 and Schedule 12 (as amended by regulations 32 and 33).
45.4	Audit reports to have no legal effect if the third country auditor is not registered.	<i>Rules to be made by the Financial Services Authority.</i>
45.5	Third country auditors to be registered only if: (a) meet requirements equivalent to Article 3(3); (b) majority of firm's managers meet requirements of Articles 4 to 10; (c) individual auditors meet requirements of Articles 4 to 10; (d) audits conducted in accordance with standards and requirements equivalent to Articles 22, 24, 25 and 26; (e) publish a transparency report equivalent to Article 40 requirements.	(a) Regulations 35(3)(c) and (4) and 36(c); (b) Regulations 35(3)(c) and 36(b)(i); (c) Regulations 35(3)(c) and 36(b)(ii); (d) Regulations 35(3)(c) and 36(d) and (e); (e) Regulations 35(3)(c) and 36(f).
45.6	Equivalence referred to in Article 45.5(d) to be assessed by Commission. Member States may assess if no Commission decision.	Regulation 36(d) and (e).
46.1	Member States may disapply Article 45.1 – 3 on basis of reciprocity if a third country auditor is subject in home country to quality assurance, investigations and oversight equivalent to Articles 29, 30 and 32.	Sections 1239(7) and 1242(4) (as amended by regulation 30(5)).
46.2	Equivalence referred to in Article 46.1 to be assessed by Commission. Member States may assess if no Commission decision.	Sections 1239(7) and 1242(4) (as amended by regulation 30(5)).
46.3	Member States to communicate to Commission their assessments of equivalence and any cooperative arrangements with third	No implementation required in legislation.

	country authorities.	
TRANSFER OF PAPERS TO THIRD COUNTRY AUTHORITIES		
47.1	Member States may allow transfer of audit papers to a third country authority if: (a) papers relate to a company traded in that country or a group based in that country; (b) transfer is via Member State authority; (c) third country authority meets requirements declared as adequate under Article 47.3; (d) there are working arrangements based on reciprocity between the authorities; (e) transfer is in accordance with Data Protection Directive.	Section 1253D (as inserted by regulation 15). (No further implementation required at this stage until a Commission decision under Article 47.3.)
47.2	Working arrangements referred to in Article 47.1(d) must ensure that: (a) requests for audit papers are justified; (b) employees of authority are subject to professional secrecy obligations; (c) authorities only use papers for oversight and other functions equivalent to Articles 29, 30 and 32; (d) a request for papers may be if adverse effect on security or public order, or judicial proceedings initiated in respect of same matter.	No implementation required at this stage until a Commission decision under Article 47.3.
47.3	Adequacy referred to in Article 47.1(c) to be decided by Commission.	No implementation required at this stage.
47.4	As a derogation from Article 47.1, Member States may allow direct transfer of papers from auditors to third country authorities if: (a) authorities have initiated investigations; (b) transfer does not conflict with auditor's obligations to Member State authority; (c) reciprocal working arrangements between authorities for direct access; (d) Member State authority informed of request in advance; (e) working arrangements comply with Article 47.2.	(a) Paragraph 16A(2) of Schedule 10 (as inserted by regulation 24). (b) No implementation required, as no such conflicting obligations exist. (c) Paragraph 16A(1)(a) of Schedule 10 (as inserted by regulation 24) and section 1253E (as inserted by regulation 15). (d) Paragraph 16A(4) of Schedule 10 (as inserted by regulation 24). (e) Paragraph 16A(1)(a) of Schedule 10 (as inserted by regulation 24) and section 1253E (as inserted by regulation 15).
47.5	Commission may specify the cases to which Article 47.4 applies.	No implementation required at this stage.
47.6	Member States to communicate to Commission working arrangements referred to above.	No implementation required in legislation.
COMMITTEE PROCEDURE		
48	Committee procedure (comitology) for further measures to be made by Commission under	No implementation required.

	Directive.	
DISCLOSURE OF AUDITOR REMUNERATION		
49.1(a)	Article 43.1 of Directive 78/660/EEC amended so that notes on company accounts include auditor's fees for audit and other services.	<ul style="list-style-type: none"> - Regulation 5 of the Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008; - regulation 4(2) of the Partnerships (Accounts) Regulations 2008; - regulation 4(2) of the Bank Accounts Directive (Miscellaneous Banks) Regulations 2008; - regulation 3(5) of the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008; - Schedule 10C to the Building Societies Act 1986 (as inserted by Schedule 1 to the Building Societies Act 1986 (Accounts, Audit and EEA State Amendments) Order 2008); - Schedule 13F to the Friendly Societies Act 1992 (as inserted by Schedule 1 to the Friendly Societies Act 1992 (Accounts, Audit and EEA State Amendments) Order 2008); - <i>regulations to be made replacing the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004.</i>
49.1(b)	Article 44.1 of Directive 78/660/EEC amended so that Member States may allow small companies not to produce notes on such fees.	<ul style="list-style-type: none"> - regulation 4 of the Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008; - regulation 4(2) of the Partnerships (Accounts) Regulations 2008; - regulation 4(2) of the Bank Accounts Directive (Miscellaneous Banks) Regulations 2008;
49.1(c)	Article 45.2 of Directive 78/660/EEC amended so that Member States may allow medium-size companies not to disclose such fees if disclosed to audit regulator on request.	<ul style="list-style-type: none"> - regulation 4(4) of the Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008; - regulation 4(2) of the Partnerships (Accounts) Regulations 2008; - regulation 4(2) of the Bank Accounts Directive (Miscellaneous Banks) Regulations 2008;
49.2	Article 34 of Directive 83/349/EEC amended so that notes on group accounts include auditor's fees for audit and other services.	<ul style="list-style-type: none"> - regulation 6 of the Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2007; - regulation 4(2) of the Partnerships (Accounts) Regulations 2008; - regulation 4(2) of the Bank Accounts

		<p>Directive (Miscellaneous Banks) Regulations 2008;</p> <p>- regulation 3(5) of the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008;</p> <p>- Schedule 10C to the Building Societies Act 1986 (as inserted by Schedule 1 to the Building Societies Act 1986 (Accounts, Audit and EEA State Amendments) Order 2008);</p> <p>- Schedule 13F to the Friendly Societies Act 1992 (as inserted by Schedule 1 to the Friendly Societies Act 1992 (Accounts, Audit and EEA State Amendments) Order 2008);</p> <p>- regulations to be made replacing the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004.</p>
FINAL PROVISIONS		
50	Directive 84/253/EEC (previous directive on audit) is repealed.	No implementation required.
51	Statutory auditor approved under Directive 84/253/EEC before this Directive is transposed to be considered as approved in accordance with this Directive.	Section 1219(b) and (c).
52	Member States may impose more stringent requirement, unless otherwise provided for in Directive.	No specific implementation required.
53	Member States must transpose Directive by 29 June 2008, and communicate main provisions of national law to Commission.	No specific implementation required.
54	Directive enters into force 20 days after publication.	No implementation required.
55	Directive addressed to the Member States.	No specific implementation required.

Department for Business, Enterprise and Regulatory Reform
17 December 2007

Summary: Intervention & Options

Department /Agency: HM Treasury	Title: Impact Assessment of the implementation of Directive 2006/43/EU - Statutory Audit Directive	
Stage:	Version: 1	Date: 31 March 2008
Related Publications:		

Available to view or download at:

<http://www.hm-treasury.gov.uk/consultations>

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

To give effect in UK law and to implement Directive 2006/43/EC (the Statutory Audit Directive) - to establish minimum levels of investor protection across the EU by strengthening audit regulation. This will enhance the level of confidence in EU capital markets and whilst these measures may not guarantee the prevention of financial scandals they will mitigate the risks of corporate malpractice occurring.

What are the policy objectives and the intended effects?

The Directive clarifies the duties of statutory auditors and provides for their independence and ethical standards; introduces a requirement for external quality assurance; provides for public oversight of the audit profession, including third party country auditors and increased cooperation between oversight bodies in the EU. It also provides for international cooperation between regulators in the EU and with regulators in third countries.

What policy options have been considered? Please justify any preferred option.

- (a) No intervention.
 - (b) Blanket implementation of the Directive proposals for all entities without taking up Member State exemptions (or distinction to legal form).
 - (c) Implement the Directive by building on the existing UK framework and taking advantage of the flexibilities provided in the Directive, where these are considered to be the preferred policy choice.
- Option C represents the Governments preferred option. It represents the best means of

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

Actual costs and benefits and the achievement of desired effects will be evident after the first reports which are subject to the new requirements are published in 2009. Will be reviewed in 3 years

Ministerial Sign-off Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:

.....Date:

Summary: Analysis & Evidence

Policy Option:	Description:
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' Audit costs incurred for extra disclosure requirements, recording and verifying non audit work performed by accountant for large building societies and friendly societies; Also Government costs relating to policy, legal, printing and distribution of consultation document and implementation.			
	One-off (Transition) Yrs				
	£ 0.01-0.05 million		1		
	Average Annual Cost (excluding one-off)				
	£	Total Cost (PV)	£ 0.01 - 0.05 million		
Other key non-monetised costs by 'main affected groups' Corporate inertia and confusion resulting from a blanket implementation of the Directive's proposals and associated costs of interpreting the provisions.					

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' Benefits arising from building society and friendly society members increasing deposits as a direct result of increased confidence following the extra disclosure in their accounts. Not possible to quantify.		
	One-off Yrs			
	£			
	Average Annual Benefit (excluding one-off)			
	£	Total Benefit (PV)	£	
Other key non-monetised benefits by 'main affected groups' Enhanced reputation to Government by ensuring that the framework for audit profession and legal framework for societies are up to date. However difficult to monetise the benefits of the Directive.				

Key Assumptions/Sensitivities/Risks Discount Rate of 3.5% based on Green Book. Costs incurred in first year of implementation. There is a legal obligation to implement the Directive into UK law.

Price Base Year	Time Period Years	Net Benefit Range (NPV) £ Not possible to quantify	NET BENEFIT (NPV Best estimate) £ Not possible to quantify
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What is the geographic coverage of the policy/option?	UK wide			
On what date will the policy be implemented?	6 April 2008			
Which organisation(s) will enforce the policy?	FRC and FSA			
What is the total annual cost of enforcement for these organisations?	£ to be confirmed			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	No			
What is the value of the proposed offsetting measure per year?	£ to be confirmed			
What is the value of changes in greenhouse gas emissions?	£ N/A			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	YES	YES	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of	£ 0.03 million	Decrease of	£ 0
Net Impact			+£ 0.03 million

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

1. PROPOSAL

Giving effect in UK law and implementing EC Directive 2006/43 on the Statutory Audit Directive.

2. OBJECTIVE

2.1 The overall objective of this Directive is to clarify the duties of statutory auditors in Member States and to provide for their independence and ethical standards. It also introduces a requirement for external quality assurance; provides for public oversight of the audit profession, including third country auditors and improved cooperation between oversight bodies in the EU.

2.2 The Department for Business, Enterprise and Regulatory Reform (BERR) has already conducted a public consultation on the impact of this Directive on audit firms. The objective of this Impact Assessment is to evaluate the benefits and costs of implementing these measures on the mutual sector. **The Directive will have limited impact on the mutuals sector.**

2.3 Unlike in some Member States, the existing UK framework for statutory audits of entities already provides for a significant proportion of the areas covered by the Directive. Examples include the Directive's proposals on:

- Education and qualifications (Articles 3-14);
- Registration provisions (Articles 15-20);
- Ethics (articles 21-25);
- Standards and reporting (Articles 26-27);
- Public oversight, investigations and discipline (Articles 29-36); as well as
- Cooperation with third country authorities (article 47).

2.4 However there are some areas where specific provision will need to be made in the legislative framework for mutual societies for which the Treasury has policy responsibility (specifically in relation to building societies and friendly societies).

The key elements of this Directive with relevance for the mutuals sector are:

(a) Statutory audits of consolidated accounts

Article 27 of the Directive sets out provisions for the statutory audits of consolidated accounts for groups of undertakings and requires that the auditor bears full responsibility for the audit report in relation to consolidated accounts. This requirement is already provided for in relation to building societies (by section 78(4)(c) of the Building Societies Act 1986 and for friendly societies by section 73 of the Friendly Societies Act 1992. Therefore HM Treasury (HMT) requires no further implementation action for the mutual sector.

(b) Audit reporting

Article 28.1 requires that the statutory auditor to sign the audit report and allow Member States to provide that the name of this person need not be disclosed to the public for security reasons. HM Treasury is aiming to amend the relevant provisions of the Building Societies and Friendly Societies Acts to bring them into line with Companies Act on this point. There are no anticipated costs to societies.

(c) Appointment of auditors

Article 37.1 requires the statutory auditor or audit firm to be appointed by the general meeting of shareholders of the audited entity. Member States may provide for alternative appointment methods provided that the independence of the auditors is not compromised. This provision is already met in relation to building societies by section 77 of and Schedule 11 to the Building Societies Act 1986 and by section 72 of and Schedule 14 to the Friendly Societies Act 1992 so therefore no implementation is required.

(d) Audit reporting

Article 28.1 requires that the statutory auditor to sign the audit report and allows Member States to provide that the name of this person need not be disclosed to the public for security reasons. HMT is proposing to amend the relevant provisions of the Building Societies and Friendly Societies Acts to bring them into line with Companies Act on this point. To facilitate this measure a building society or friendly society must pass a members' resolution and notify the authority of the resolution. There will be costs if a society chooses to correspond with its members specifically in order to implement this requirement. It is expected however that societies will pass such a resolution as part of their Annual General Meeting (AGM) and therefore at no additional cost to societies.

(e) Dismissal and resignation of auditors

Article 38.1 of the Directive requires Member States to ensure that statutory auditors or audit firms are only dismissed where there are proper grounds. Divergence of opinions on accounting treatments or audit procedures shall not be proper grounds for dismissal. This provision is not fully met by the building society and friendly society legislation. The Government therefore proposes to implement this requirement in relation to building societies and friendly societies by introducing a new right to apply to the High court in cases where a society's auditor is alleged to have been removed from office on unfair grounds.

(f) Auditor remuneration for non-audit work

Article 49.1(a) of the Directive requires audited entities to specify separately in the notes to the annual accounts the fees paid to the statutory auditor for non audit work. The existing requirements for building societies and friendly societies on disclosure of auditor remuneration for non-audit work do not meet the requirements of the Directive. The Government proposes to implement this by amending the relevant provisions of the Building Societies Act 1986 and Friendly Societies Act 1992 to bring them in line with company law.

3. BACKGROUND TO DIRECTIVE 2006/43/EC

Directive 2006/43/EC was adopted on 17 May 2006 and published in the Official Journal of the European Communities on 9 June 2006. The purpose of this Directive is "to improve the credibility of financial information and to strengthen protection in the European Union against financial scandals". The full text can be found at www.europa.eu.int

4. OPTIONS APPRAISAL

(a) No intervention. Do nothing to implement the Directive, continuing with the current UK regime, which already reflects many but not all of the provisions in the Directive.

(b) Blanket implementation of the provisions in the Directive without taking up Member State exemptions or taking into account the different legal forms.

(c) Implement the Directive proposals by building on the existing UK framework and taking advantage of the flexibilities provided in the Directive, where these are considered to be the preferred policy choice.

Option C is the Government's preferred option. It represents the most cost effective and efficient means of implementing this Directive taking into account the flexibilities provided.

TABLE OF OPTIONS

See key assumptions, facts and calculations in the Annex

OPTION	COSTS PER ANNUM	BENEFITS PER ANNUM
(a) No intervention	Difficult to quantify but could lead to investor confidence for both building societies and friendly societies.	No benefit to either the building society or friendly society sectors.
(b) Blanket implementation of the provisions in the Directive without taking up Member State exemptions or taking into account the different legal forms.	<p>TOTAL £39,980- £96,000</p> <p><u>Building Societies</u></p> <ul style="list-style-type: none"> • £7,080 to £11,800 <p><u>Friendly Societies</u></p> <ul style="list-style-type: none"> • £2,000 to £22,800 <p><u>Government</u></p> <ul style="list-style-type: none"> • £5,000-£10,000 <p><u>Additional administrative costs for societies in applying legislation</u></p> <ul style="list-style-type: none"> • £25,900 - £51,500 	Not possible to monetise
(c) Implement the Directive proposals by building on the existing UK framework and taking advantage of the flexibilities provided in the Directive, where these are considered to be the preferred policy choice.	<p>TOTAL £14080 - £44,600</p> <p><u>Building Societies</u></p> <ul style="list-style-type: none"> • £7,080 to £11,800 <p><u>Friendly Societies</u></p> <ul style="list-style-type: none"> • £2,000 to £22,800 <p><u>Government</u></p> <ul style="list-style-type: none"> • £5,000-£10,000 	Not possible to monetise

Option C: Admin burdens/Costs incurred by affected societies excluding Government costs

(11,800 + 22,800)/1,000,000= £0.03 million

5. RISK, UNCERTAINTY AND UNINTENDED CONSEQUENCES

5.1 The Directive seeks to reduce the risk of future corporate scandals such as WorldCom, Enron, Parmalat by setting out provisions to ensure better regulation of and transparency in the statutory audit function.

5.2 It is difficult to accurately quantify the risk of poor investor confidence across Europe and in the wider global economy resulting from lax audit standards. However it is reasonable to suggest that companies that are embroiled in corporate scandals resulting from negligent audit supervision/checks lose significant market value and are often forced to restructure with subsequent job losses.

5.3 It has been estimated that the loss in stock market wealth in the US as a result of the Enron and WorldCom scandals has been at least 9% or 0.36% of the Gross Domestic Product (GDP)-\$38.2 billion in the first year. (See Graham, Carol/Litan, Robert/Sukhtanker, sandip (2002) “ The bigger they are, the harder they fall: an estimate of the costs of the crisis in corporate governance”.

5.4 A consequence of this is the contagion effect on unrelated businesses that suffer as a result of the wider loss in market confidence.

6. IMPLEMENTATION

6.1 The Directive will be implemented by Orders made under the Building Societies Act 1986, the Friendly Societies Act 1992 and section 2(2) of the European Communities Act 1972.

6.2 HMT is implementing these Directives by, inter alia, amending and providing for the enforcement of certain elements of the regulatory framework that applies to building societies and friendly societies.

7. WHO WILL BE AFFECTED

7.1 The Directives requirements will affect all accountancy firms that carry out statutory audits, and all companies and financial institutions, such as bank and insurance undertakings, which are subject to the requirement to have a statutory audit.

7.2 The Financial Reporting Council is funded by the Government, companies (via listing fees) and the accountancy profession. For Recognised Supervisory Bodies costs will be met on a cost recovery basis via increases in membership fees and therefore falls on auditors and audit firms.

8. EQUITY AND FAIRNESS

8.1 The Government considers that the measures introduced by the Directive will not bring disproportionate benefits or have a disproportionate effect on particular groups.

9. CONSULTATION WITH SMALL BUSINESS

9.1 BERR has held consultative meetings with representative bodies of the audit and accounting profession with a view to assessing the impact of the proposed legislation on the sector.

- **SMALL FIRMS IMPACT TEST (SFIT)**

9.2 The audit Directive applies to those entities that are already subject to statutory audits under the requirements of existing Community law. Under the 4th and 7th Company Law Directives small companies are exempt from the requirements to have a statutory audit providing they meet certain turnover and balance sheet threshold limits. Some small companies, which are not required by law to have their accounts audited, nonetheless elect to do so because they see economic benefits in doing so.

9.3 This SFIT specifically looks at the impact on mutual societies and concludes that it will not have a significant or disproportionate impact on small mutual societies.

- **COMPETITION ASSESSMENT**

9.4 The Directives requirements will affect all accountancy firms that carry out statutory audits, and all companies and financial institutions, such as bank and insurance undertakings, which are subject to the requirement to have a statutory audit.

9.5 It is not expected that the Directive will affect any of these businesses more than others; affect market structure; change the number or sizes of those businesses or lead to higher start-up costs.

10. CONSULTATION

10.1 HMT has discussed the consultation requirements with BERR and the FSA. BERR has in addition discussed the proposed implementing provisions with the Small Business Service and HMRC. The Office of Fair Trading and Companies House have similarly been advised.

10.2 BERR on behalf of Government has discussed the provisions of the Directive with the Financial Reporting Council including the Professional Oversight Board, the Auditing Practices Board, the Financial Reporting Review Panel and the Accounting Standards Board.

10.3 BERR held a public consultation on the provisions of this Directive in July 2007. HMT is now conducting a parallel consultation aimed at informing the mutuals sector, for which it has policy responsibility.

11. ENFORCEMENT AND SANCTIONS

11.1 The Directives provisions will be enforced and monitored by the FSA and the financial reporting Council. The court system will be responsible for sanctions and penalties arising from infringement.

12. SUMMARY AND RECOMMENDATIONS

12.1 The majority of the provisions of the Directive will have to be implemented by 29 June 2008. In line with Government policy on common commencement dates, it is envisaged that the implementing regulations will come into force on 6 April 2008 and will apply to reporting periods on or after that date. Actual costs and benefits and the achievement of the desired effects will be evident after the first reports which are subject to the new requirements are published in 2009.

12.2 Based on our preliminary assessment however the expected benefits of this Directive far outweigh the costs and is recommended. We also recommend a post implementation review in 3 years time to establish whether the implemented regulations are having the intended effect and to ascertain whether there are any unintended effects, which will need to be addressed.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

Annexes

A

OPTION	TOTAL COSTS	TOTAL BENEFITS
A	N/A	N/A
B	£39,980 - £96,100	Not possible to monetise
C	£14,080 - £44,600	Not possible to monetise

B

Some key assumptions and facts

Staff and Production Costs

- Month's salary costs for policy staff and legal teams in researching, drafting, publishing consultation document and implementing legislation.

Building societies

- **59 Building societies** in the UK as at 1 November 2007.
- Main costs associated with the extra disclosure requirement for audited entities to specify separately in the notes to the annual accounts the fees paid to the statutory auditor for non-audit work.
- Based on 4 hours work for accountant. Hourly rates of £30 per hour for Small Enterprises and £50 per hour for Medium – Large.

Friendly Societies

- Analysis based on 200 friendly societies and total membership of 6.9 million as at 1 January 2007.
- Based on 4 hours work for accountant. Hourly rates of £30 per hour for Small Enterprises and £50 per hour for Medium – Large.
- In terms of funds under management the friendly society sector is highly concentrated with the top 10 societies accounting for just 90% of the total net assets as well as membership.
- The Directive's requirements will potentially benefit the mutual societies (building societies and friendly societies). It would increase transparency in their accounts making it easier for investors to make informed decisions. It would also mean that their accounts are subject to the same rigour and scrutiny as their EU counterparts.

- It is difficult at this stage to provide a precise quantification of the benefits and costs associated with this Directive as it is uncertain how or when these (especially the benefits) would take effect. It is also unlikely that the benefits would be felt by all societies instantaneously. It is more likely to have a staggered impact with the initial impact possibly felt by the largest societies.

OPTION A (Cost/Benefit comparison)

- There are no benefits to failing to implement this Directive. On the contrary building societies and friendly societies would suffer from a lack of investor confidence. The audit profession would also suffer a credibility gap, as their legislative framework would not be abreast with EU standards. It would also put the UK at risk of infraction proceedings from the EU.

OPTION B (Cost/Benefit comparison)

Building societies

- The main effect of this Directive is that audited entities would need to specify separately in the notes to the annual accounts the fees paid to the statutory auditor for non audit work. It is likely that the auditor will need to perform extra checks to ensure that (a) all non-audit work have been disclosed and (b) that the work has been correctly valued at arm's length valuations. This may require an independent auditor other than the one who had performed the services in question.
- Costs based on ½ day's work for an accountant.
- **Small Building Society: £30 x 4 hours x 59 = £7,080**
- **Medium to large Building Society: £50 x 4 hours x 59 = £11,800**

Friendly societies

- The costs are based on ½ day's work for an accountant.
- Top 10 incurring additional costs of £200 each and remaining 190 incurring additional costs of £120 each
- **Large Friendly Society: £50 x 4 hours x 10 = £2000**
- **Small to Medium Friendly Society: £30 x 4 hours x 190 = £22,800**

Additional costs for societies

Extra time resources in interpreting legislation to apply to the affected mutual societies with each society incurring between £100 and £200. Costs in relation to staff and cash resources expended on **reformatting the Directive requirements to fit the needs of societies. (£25,900 - £51,500)**

Government costs

Comprising of staff costs (including legal) in researching, drafting, publishing consultation document and implementing legislation. **£5,000 to £10,000.**

OPTION C (Cost/benefit comparison)

Building Societies

- The main effect of this Directive is that audited entities would need to specify separately in the notes to the annual accounts the fees paid to the statutory auditor for non audit work. It is likely that the auditor will need to perform extra checks to ensure that (a) all non-audit work have been disclosed and (b) that the work has been correctly valued at arm's length valuations. This may require an independent auditor other than the one who had performed the services in question.
- Costs based on ½ day's work for an accountant.
- **Small Building Society: £30 x 4 hours x 59 = £7,080**
- **Medium to large Building Society: £50 x 4 hours x 59 = £11,800**

Friendly Societies

- The costs are based on ½ day's work for an accountant.
- Top 10 incurring additional costs of £200 each and remaining 190 incurring additional costs of £120 each
- **Large Friendly Society: £50 x 4 hours x 10 = £2000**
- **Small to Medium Friendly Society: £30 x 4 hours x 190 = £22,800**

Summary: Intervention & Options

Department /Agency: HM Treasury	Title: Impact Assessment of Directive 2006/46/EC on Company Reporting- Amending the Accounting Directives	
Stage:	Version: 1	Date: 12/06/2008
Related Publications:		

Available to view or download at:

<http://www.hm-treasury.gov.uk/consultations>

Contact for enquiries: Sammy Amissah

Telephone: 020 7270 5291

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

To give effect in UK law and to implement Directive 2006/46/EC on Company Reporting-amending the 4th and 7th Accounting Directives-to reduce the risk of future corporate scandals and the adverse impact on investor confidence.

What are the policy objectives and the intended effects?

To further enhance confidence in the financial statements and annual accounts published by mutual societies (building societies and friendly societies) allowing members and stakeholders to make comparable assessments of different societies across borders by having access to complete and reliable information in relation to their financial arrangements and corporate governance.

What policy options have been considered? Please justify any preferred option.

- (a). No intervention.
- (b). Blanket implementation of the provisions in the Directive for all entities without taking up Member State exemptions (or distinction to legal form).
- (c). Implement the provisions in the Directive for mutual societies which fall within the scope of the Directive taking up all Member State exemptions and taking into account the different legal form.

Preferred options C - there are distinct differences between mutual societies and companies, which need to be reflected in the implementation proposals. Taking up

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? Date to be confirmed. But at least 3 years after implementation.

Ministerial Sign-off Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:

..... Date:

Summary: Analysis & Evidence

Policy Option:	Description:
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups'		
	One-off (Transition) Yrs			
	£0.02-0.12mn	1	Additional disclosure costs for large building societies and friendly societies in respect of annual corporate governance statement, related party and off-balance sheet transactions. Also Government costs relating to policy, legal printing and distribution of consultation document	
	Average Annual Cost (excluding one-off)			
£		Total Cost (PV)	£0.02-0.12mn	
Other key non-monetised costs by 'main affected groups' Corporate inertia and confusion arising from a blanket implementation of the Directive's proposals and associated costs of interpreting the provisions.				

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups'		
	One-off Yrs			
	£		Benefits arising from building society and friendly society members increasing deposits as a direct result of increased confidence following the extra disclosure in their accounts.	
	Average Annual Benefit			
£		Total Benefit (PV)	£	
Other key non-monetised benefits by 'main affected groups' Increased investor confidence will attract additional investment.				

Key Assumptions/Sensitivities/Risks Key assumptions: Discount Rate of 3.5% based on Green Book. Costs incurred in the first year of implementation approximately 1 day's work (8 hours) for accountant at £30-£50 per hour. Benefits are amortised over 3 years. Discount period is assumed to be 3 years, (when policy will be reviewed).

Price Base Year 2007	Time Period Years	Net Benefit Range (NPV) £ Not possible to quantify.	NET BENEFIT (NPV Best estimate) £ Not possible to quantify.
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What is the geographic coverage of the policy/option?		UK wide		
On what date will the policy be implemented?		06 April 2008		
Which organisation(s) will enforce the policy?		FSA		
What is the total annual cost of enforcement for these		£ to be confirmed		
Does enforcement comply with Hampton principles?		Yes		
Will implementation go beyond minimum EU requirements?		No		
What is the value of the proposed offsetting measure per year?		£ to be confirmed		
What is the value of changes in greenhouse gas emissions?		£ N/A		
Will the proposal have a significant impact on competition?		No		
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)				(Increase - Decrease)
Increase	£ 0.08	Decrease	£	Net
				+£ 0.08 million

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

1. PROPOSAL

1.1 The Directive 2006/46/EC (“the Directive”) of the European Parliament and Council was published on 16th August 2006. The proposal aims to give effect in UK law and to implement this Directive. The full text of the Directive can be found at www.europa.eu.int

1.2 The Directive amends Council Directives:

- 78/660/EC on the annual accounts of certain types of companies (“the Fourth Directive”),
- 83/349/EEC on consolidated accounts (“the Seventh Directive”),
- 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions (“the bank Accounts Directive”)
- 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings (“the Insurance Accounts Directive”).

2. OBJECTIVE

2.1 The Directive seeks to “further enhance confidence in the financial statements and annual reports published by European companies to provide shareholders and other stakeholders (e.g. employees and suppliers) with reliable, complete, and easily accessible information”.

2.2 In order to achieve its overall objective the Directive contains six revisions to the 4th and 7th Directives and the Bank Accounts and Insurance Accounts Directives, five of which require, or contain a Member State option to permit, changes to the relevant UK company law.

(a) Raising the financial thresholds used to define small and medium sized companies for accounting and reporting purposes.

This option is not relevant to building societies or friendly societies.

(b) Extended use of Fair Value Accounting

This Member State option will be applicable to all building societies and friendly societies that choose to adopt fair value accounting for financial instruments and associated disclosures.

(c) Enhancing transparency about off-balance sheet arrangements.

This will apply to friendly society insurers falling within the scope of the insurance Directives and to building societies.

(d) Enhancing transparency about related party transactions

This will apply to building societies and friendly societies that prepare their accounts under the Building Societies or Friendly Societies Acts rather than in accordance with international accounting standards.

(e) Introducing an annual corporate governance statement

The only building societies and friendly societies affected by this provision will be those whose securities are traded on a regulated market.

3. BACKGROUND TO DIRECTIVE 2006/46/EC

3.1 As part of the European Commission's broader programme of company law reform it published an Action Plan in May 2003 containing some legislative measures aimed at enhancing the credibility of financial statements and annual reports published by European Companies.

3.2 The Directive focuses on linked objectives of increasing confidence in corporate governance frameworks and improving investor confidence through increased transparency and better information on companies.

3.3 The measures in the Directive contribute to several of the aims of that the Government believes are important to industry, namely:

- increased financial stability and market confidence
- extending investment opportunities across the EU
- improving access to capital by companies across borders.

3.4 Research by academics including "The Benefits of Transparency" by Christian Leuz, Capital Ideas Journal, July 2006 and "International Differences in the Cost of Equity Capital", by Hail, Luzi and Leuz, December 2005 - concludes that there is a link between transparency and cost of capital of certain institutions. They found that firms from countries with more extensive disclosure requirements, stronger securities regulation and stricter enforcement mechanisms (as enabled by a high quality legal infrastructure) had significantly lower cost of capital.

3.5 This is because where there are increased disclosure requirements, investors are better placed to assess the risks and benefits of their investments and so enable them to make more efficient investment decisions.

3.6 The requirements of this Directive are broadly consistent with existing UK law and practice. Informal stakeholder soundings in response to the proposals indicate that Government should support its broad principles. The Department for Business Enterprise and Regulatory Reform (BERR) has met with representatives and stakeholders of entities affected by the Directive to discuss the implementation proposals.

4. OPTIONS APPRAISAL

(a) No Intervention

Not doing anything may put mutual societies in the UK in a disadvantageous position in relation to their EU counterparts and would breach UK's obligations under the EC Treaty. This option would therefore have limited economic effect but would cause difficulties in the future.

(b) Blanket implementation of the provisions in the Directive for all entities, without taking up Member State exemptions (or distinction to legal form).

Implementing the Directive requirements without taking up the exemptions or distinction to the legal form to create a "one size fits all" situation would not be beneficial or practical. There are distinct differences between the various legal forms with their specific audit reporting and corporate governance requirements

(c) Implement the provisions in the Directive for mutual societies, which fall within the scope of the Directive taking up all exemptions and tailored to meet the specificities of the mutual form.

This option would enable an optimal application of the Directive to reflect the differences in legal form and ensure that the Directive requirements are applied in an effective and proportionate manner to suit each type of legal form and mutual society.

4.1 The Government's preferred option is C - there are distinct differences between mutual societies and proprietary companies, which needs to be reflected in the implementation proposals.

TABLE OF OPTIONS

See key assumptions, facts and calculations in the Annex.

OPTION	COST PER ANNUM	BENEFIT PER ANNUM
(a) No Intervention	Difficult to quantify but could lead to loss of investor confidence for both building societies and friendly societies.	No benefit to either the building society or friendly society sectors.
(b) Implement the provisions in the Directive for all entities, which fall within the scope of the Directive (without taking up exemptions or distinction to legal form)	<p>TOTAL £49,060 - £121,700</p> <p><u>Building Societies</u></p> <ul style="list-style-type: none"> • £14,160 - £23,600 <p><u>Friendly Societies</u></p> <ul style="list-style-type: none"> • £4000 - £45,600 <p><u>Government</u></p> <ul style="list-style-type: none"> • £5,000 - £10,000 <p><u>Additional implementation costs</u></p> <ul style="list-style-type: none"> • £25,900 - £51,500 	<ul style="list-style-type: none"> • Not possible to monetise
(c) Implement the provisions in the Directive only for mutual societies, which fall within the scope of the Directive taking up all exemptions.	<p>TOTAL £23,160 - £89,200</p> <p><u>Building Societies</u></p> <ul style="list-style-type: none"> • £14,160 - £23,600 <p><u>Friendly Societies</u></p> <ul style="list-style-type: none"> • £4000 - £45,600 <p><u>Government</u></p> <p>£5,000 - £10,000</p>	<ul style="list-style-type: none"> • Not possible to monetise.

	<p>Plus £10,000 for annual corporate governance statement for the 20 or so largest building societies, which have listed securities and traded, subordinated debt.</p>	
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Option C: Admin burdens/costs incurred by affected societies excluding Government costs

(23,600 + 45,600 + 10,000)/1,000,000 = 0.08 million

5. RISK, UNCERTAINTY AND UNINTENDED CONSEQUENCES

5.1 The provisions in this Directive arose because the Commission had concerns that investor confidence had been badly compromised following the recent corporate scandals such as WorldCom, Enron and Parmalat. The Commission’s view was that making financial arrangements more transparent and requiring companies to give information relevant to good corporate governance would reduce the risk of future corporate scandals in Europe.

5.2 Analysis of the loss in investor confidence based on the fall in stock market wealth following the failure of Enron and WorldCom in July 2002 was estimated at 0.36% of Gross Domestic Product or \$38.2 billion in the first year. (See Graham, Carol/Litan, Robert/Sukhtanker, Sandip 2002) - The bigger they are, the harder they fall: an estimate of the costs of the crisis in corporate governance”.

5.3 It is therefore imperative that any reasonable steps that are taken by the Commission to mitigate this risk are treated constructively. An unintended consequence of this Directive is that the smallest mutual societies will be required to provide the same level of detailed information as the larger ones. This will however ensure comparability between societies irrespective of size or physical location within the European Union.

6. IMPLEMENTATION

The Directive will be implemented by Orders made under the Building Societies Act 1986, the Friendly Societies Act 1992 and section 2(2) of the European Communities Act 1972.

7. WHO WILL BE AFFECTED?

7.1 This Directive will affect companies, partnerships, building societies and those friendly societies and industrial & provident societies covered by the Insurance Accounts Directive, and other institutions covered by the Bank Accounts directive. The HMT consultation is specifically aimed at building societies and friendly societies. The other entities are already covered by the BERR consultation and implementation procedures. The changes will apply in relation to financial years commencing on or after 6 April 2008.

8. EQUITY AND FAIRNESS

8.1 The Government considers that the measures introduced by the Directive will not have a disproportionate impact on the groups identified.

9. CONSULTATION WITH SMALL BUSINESS

- **SMALL FIRMS IMPACT TEST**

9.1 BERR has held consultative meetings with some representative groups in the mutual sector with a view to assessing the impact of the proposed legislation on small firms. The Government view is that only the very largest businesses would be impacted on by the Directive requirements. For example only the largest societies would have/find the need to engage in substantial off-balance sheet transactions. Accordingly it is Government's view that there will not be a disproportionate impact on small business.

- **COMPETITION ASSESSMENT**

9.2 We have carried out a competition filter test and concluded that the Directive has a potential impact on UK building societies and friendly societies. It was considered that the Directive would not give rise to disproportionate costs of entry or administrative costs for either small or larger societies. The Directive is not expected to restrict innovation in sectors characterised by rapid technological change and would not impair the freedom to provide services.

10. CONSULTATION

10.1 HMT has discussed the consultation requirements with BERR and the FSA. BERR has in addition discussed the proposed implementing provisions with the Small Business Service and HMRC. The Office of Fair Trading, Companies House have also been informed.

10.2 BERR on behalf of Government has discussed the provisions of the Directive with the Financial Reporting Council including the Professional Oversight Board, the Auditing Practices Board, the Financial Reporting Review Panel and the Accounting Standards Board.

10.3 BERR held a public consultation on the provisions of this Directive as applicable to certain types of companies from 5 March 2007 to 7 June 2007. HMT is now conducting a parallel consultation in respect of mutual societies for which it has policy responsibility (building societies and friendly societies).

11. ENFORCEMENT AND SANCTIONS

11.1 The bodies responsible for monitoring and enforcing sanctions are the Financial Services Authority and the Courts. We believe that the organisations involved together have the necessary powers to monitor and enforce the Directive requirements.

12. SUMMARY AND RECOMMENDATIONS

12.1 The Government is required to implement this EC Directive by the deadline of 5 September 2008. It aims to do this in an effective and proportionate manner without imposing extra burdens on societies affected. The implementation proposals suggested in the consultation document, the Members State options exercised by the Government as well as the implementation option adopted would ensure that these objectives are achieved in a cost effective and efficient manner.

12.2 The expected benefits of this Directive far outweigh the costs and is recommended.

12.3 We also recommend a post implementation review in 3 years time to establish whether the implemented regulations are having the intended effect and to ascertain whether there are any unintended effects, which will need to be addressed.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

Annexes

A

OPTION	TOTAL COSTS PER ANNUM (BUILDING SOCIETIES & FRIENDLY SOCIETIES)	TOTAL BENEFITS PER ANNUM (BUILDING SOCIETIES & FRIENDLY SOCIETIES)
A	N/A	N/A
B	£49,060 - £121,700	Not possible to monetise
C	£23,160 - £ 89,200	Not possible to monetise

* Same quantifiable benefits, however more costly.

B

Some key assumptions and facts

Building Societies:

- **59 Building Societies** in the UK as at 1 November 2007
- Accountant's fees per 8-hour day (£240 - £400). Based on hourly rates of £30 per hour for Small Enterprises and £50 per hour for Medium – Large.

Friendly Societies:

- Analysis based on **200 friendly societies** and total membership of 6.9 million as at 1 Jan 2007.
- Accountant's fees per 8-hour day (£240 - £400). Based on hourly rates of £30 per hour for Small Enterprises and £50 per hour for Medium – Large.
- Although more than 2000 societies registered as various classes of societies under the Friendly Societies Acts little more than 200 of them are regulated by the Financial Services Authority under the Financial Services and Markets Act 2000.
- In terms of funds under management the friendly society sector is highly concentrated with the top 10 societies accounting for just over 90% of the total net assets as well as membership.
- The Directive's proposals will potentially benefit all the mutual societies (building societies, friendly societies) affected. It would increase transparency in the accounts making it easier for investors to make informed decisions.
- It is difficult at this stage to provide a precise quantification of the benefits and costs associated with this Directive, as it is uncertain as to when these benefits would take effect. It is unlikely that the benefits would be felt by all societies instantaneously. It is more likely to have a staggered impact.

OPTION A (Cost/Benefit comparison)

- There are no benefits to failing to implement this Directive. On the contrary mutual societies in the UK would suffer from investor confidence and inability to make like with like comparisons with societies in other Member States.

OPTION B (Cost/Benefit comparison)

Building societies

- There are currently 59 building societies in the UK. Implementing the Directive requirements could entail additional reporting on the use of Fair Value Accounting, off-balance sheet arrangements, related party transactions and annual corporate governance statement.

Costs based on accountants fee for day's work.

Small building society: £240 x 59 = **£14,160**

Medium to large building society: £400 x 59 = **£23,600**

Friendly Societies

- There are 200 Friendly Societies. The costs are based on accountant's fee for day's work.

Top 10 each incurring additional costs of £400 and remaining 190 incurring £240 each.

Large Friendly Society: 10 x £400 = **£4,000**

Medium to large Friendly Society: 190 x 240 = **£45,600**

- In contrast the benefits of transparency and increased investor confidence would be immense. There were 6.9 million members as at 31 December 2006. Even based on a conservative estimate if the total membership increased their deposits by a **marginal £1** this would be **equal to £6.9 million**

Government

- Government costs for policy research, legal drafting, publishing and distribution of consultation document estimated to be around **£5,000 to £10,000**

Additional Costs by all 259 societies (building and friendly societies)

Resulting from extra time resources in interpreting legislation to apply to Mutuals with each society incurring £100 - £200. **(£25,900 - £51,500)**

OPTION C (Cost/ Benefit comparison)

Building Societies:

- There are currently 59 building societies in the UK. Implementing the Directive requirements could entail additional reporting on the use of Fair Value Accounting, off-balance sheet arrangements, related party transactions and annual corporate governance statement.

Costs based on accountants fee for day's work.

Small building society: £240 x 59 = **£14,160**

Medium to large building society: £400 x 59 = **£23,600**

- **PLUS** an additional £500 each for the 20 Building Societies, which have listed securities and traded subordinated debt and will therefore need to have an annual corporate governance statement (**£10,000**).

Friendly societies:

- Costs based on top 10 each incurring additional costs of £400 and remaining 190 incurring £240 each.

Large Friendly Society: $10 \times £400 = £4,000$

Medium to Large Friendly Society: $190 \times 240 = £45,600$

Government

- Government costs for policy research, legal drafting, publishing and distribution of consultation document estimated to be around **£5,000 to £10,000**