

**GUIDANCE FOR BRITISH COMPANIES
ON PROPOSED CHANGES TO THE REPORTING
AND ACCOUNTING PROVISIONS
OF THE COMPANIES ACT 1985**

NOTE:

***THIS GUIDANCE IS A DRAFT. REGULATIONS TO
IMPLEMENT THE CHANGES IT DESCRIBES HAVE NOT YET
COMPLETED THEIR PROGRESS THROUGH PARLIAMENT.
THE GUIDANCE WILL BE FINALISED WHEN THE
REGULATIONS HAVE BEEN MADE, WHICH WILL BE
BEFORE THE END OF 2004.***

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1. SUMMARY OF CHANGES

Proposed changes to the accounting and auditing requirements in the Companies Act 1985 will affect all companies in some way. However, not all the changes are relevant for every company. This brief summary of the changes is intended to help companies see which changes may be relevant to them, and to point them to where those changes are discussed in these Guidance Notes.

For all companies, there are changes to the requirements in these areas:

- how and where proposed dividends are disclosed in the accounts (paragraph 6.2);
- how items must be presented in the balance sheet and profit and loss account (paragraphs 6.3 - 6.6);
- disclosure of information on derivatives (paragraph 6.15).

For all companies, there are new accounting options, which companies can choose to use if they wish:

- preparation of accounts using International Accounting Standards rather than UK GAAP (section 4);
- fair valuation of financial instruments, investment property and living plants and animals (paragraphs 6.7 - 6.14).

For parent companies, there are changes to the requirements and options on consolidation (section 5).

For all companies except small companies, there is a new requirement to disclose information about financial instruments in the directors' report (section 7).

For all companies that have their accounts audited, there are new requirements concerning the audit report (section 8).

For companies that issue summary financial statements, these can now be revised voluntarily in the same way as annual accounts and directors' reports (paragraph 9.2).

For companies that have overseas interests, the current automatic three month extension for laying and delivering accounts is repealed (paragraph 9.1).

2. ABBREVIATIONS AND DEFINITIONS

ASB	Accounting Standards Board
EC	European Commission
EEA	European Economic Area (EU members plus Norway, Iceland and Liechtenstein)
EU	European Union
IAS	International Accounting Standards (standards inherited by the IASB from its predecessor body, including those subsequently modified by the IASB)
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards (completely new standards issued by the IASB)
LLPs	Limited Liability Partnerships
OJ	Official Journal (official publication of the European Union)
Publicly traded companies	Those whose securities are admitted to trading on a regulated market in any Member State in the European Union
UK GAAP 1985 Act	UK Generally Accepted Accounting Practice Companies Act 1985

3. INTRODUCTION

3.1 Three pieces of legislation passed by the EU in recent years have made a number of changes to EU accounting requirements for companies. These are:

- Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of International Accounting Standards¹ (the “IAS Regulation”);
- Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Council Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings² (the “Modernisation Directive”); and
- Directive 2001/65/EC of the European Parliament and of the Council of 27 September 2001 amending Directives 78/660/EEC, 83/349/EEC and 86/635/EEC as regards the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions³ (the “Fair Value Directive”).

These can be downloaded from the Official Journal section of the EC’s website www.europa.eu.int/eur-lex/en/search/search_oj.html.

3.2 Some of the changes are minor, and are designed to clarify or bring EU accounting requirements into line with modern best practice. But others, in particular those contained in the IAS Regulation, are more fundamental and far-reaching.

3.3 It is proposed that, following debates in both Houses of Parliament, the Secretary of State will make the Companies Act 1985 (International Accounting Standards and Other Accounting Amendments) Regulations 2004 to implement these changes for British companies through amendments to the 1985 Act. These Regulations will apply to financial years beginning on or after 1 January 2005.

3.4 This guidance outlines the main changes contained in these Regulations, and the effect of the changes. In particular, it explains how the IAS Regulation and the option to choose IAS will work. It also indicates those parts of the 1985 Act that still apply to companies using IAS. It is not intended to be a comprehensive statement of the law or the recent changes. Companies should not consider it a substitute for familiarising themselves with the legislation itself. In particular, any organisation that wishes to clarify its own position under the law should take its own legal advice.

3.5 Legislation will also be passed to bring similar changes into effect for companies and building societies in Northern Ireland.

3.6 Regulations will also be made to ensure that these amendments work properly for LLPs, and for certain banking and insurance undertakings.

¹ OJ L243/1 of 11 September 2002.

² OJ L178/16 of 17 July 2003.

³ OJ L283/28 of 27 October 2001.

3.7 Separate guidance will be issued for proposed new requirements for an Operating and Financial Review and new requirements from the Modernisation Directive for the directors' report when the relevant regulations are made.

3.8 Guidance from the EC on the interaction between the IAS Regulation and the Accounting Directives can be found at

http://www.europa.eu.int/comm/internal_market/accounting/docs/ias/200311-comments/ias-200311-comments_en.pdf.

4. INTERNATIONAL ACCOUNTING STANDARDS

A Background

4.1 The IAS Regulation introduces important changes that will directly affect the way in which certain companies across the EU prepare their financial statements.

4.2 Under Article 4 of the IAS Regulation, companies governed by the law of a Member State, whose securities are admitted to trading on a regulated market in any Member State in the European Union (“publicly traded companies”), are required to prepare their consolidated accounts on the basis of accounting standards issued by the IASB that are adopted by the EC. This applies to financial years commencing on or after 1 January 2005.

4.3 The list of regulated markets at 17 February 2004 is set out at Annex B. It has been announced that the Alternative Investment Market (AIM) will cease to be a regulated market from 12 October 2004. However, the London Stock Exchange is also considering introducing a separate requirement for AIM-quoted companies to follow IFRS.

4.4 At 11 October 2004, all IAS have been adopted with the exception of [IAS 32 and 39] [IAS 32 (although IAS 39 has only been partially adopted)]. In addition, IFRS 1 has also been adopted. However, some of these standards have since been amended, and the EC will need to consider the revised versions for adoption in due course. For the current list of adopted standards, see the EC website (www.europa.eu.int/comm/internal_market/accounting/ias_en.htm#adopted-commission).

4.5 Under Article 5 of the IAS Regulation, Member States have the option to extend use of adopted IAS on a permissive or mandatory basis. In Britain, the application of the Regulation is to be extended so that:

- publicly traded companies are permitted to use IAS in their individual accounts; and
- non-publicly traded companies are permitted to use IAS in both their individual and consolidated accounts.

However, charities are not to be permitted to use IAS (nor would they fall within Article 4 of the IAS Regulation, as non-profit-making bodies are excluded – see paragraph 4.8(i)).

4.6 For the purposes of the extension to the application of the IAS Regulation under Article 5, to be effected by the Companies Act 1985 (International Accounting Standards and Other Accounting Amendments) Regulations 2004, “company” means companies required to prepare accounts by the 1985 Act. Separately, the application of the IAS Regulation is to be extended to building societies formed under the Building Societies Act 1986 and to LLPs and certain banking and insurance undertakings to which Part VII of the 1985 Act is specifically applied.

B Companies obliged to use IAS

4.7 Publicly traded companies governed by the law of a Member State are required by the IAS Regulation to prepare their consolidated accounts using adopted IAS. Certain other

companies may be required to prepare accounts using IAS for different reasons, for example by a regulator; this section does not cover such situations.

4.8 To work out whether a particular body comes within the requirement in the IAS Regulation, there are four points to consider.

(i) Does the body come within the relevant definition of company? For the purposes of Article 4 of the IAS Regulation, “company” has the same meaning as in Article 48 (old Article 58) of the Treaty of Rome:

“Companies or firms” means companies or firms constituted under civil or commercial law, including co-operative societies, and other legal persons governed by public or private law, save for those which are non-profit-making”.

If the answer is no, the body is not required to use IAS. If the answer is yes, move on to the next step.

(ii) Is the company governed by the law of a Member State? In other words, has the company been incorporated in a Member State? If the answer is no, the company is not required to use IAS. If the answer is yes, move on to the next step.

(iii) Are any securities of the company admitted to trading on a market listed at Annex B? “Securities” means debt securities as well as shares. If the answer is no, the company is not required to use IAS. If the answer is yes, move on to the next step.

(iv) Does the company have to prepare consolidated accounts? The requirement to prepare consolidated accounts is set out in the EC 7th Directive as implemented in section 227 of the 1985 Act for ordinary companies, and section 255A for banking and insurance groups. Certain exemptions from the requirement are also conferred, in particular by section 228, new section 228A to be inserted by the regulations and section 229(5). If the company is not required by the 1985 Act to prepare consolidated accounts, it is not required to use IAS. If the company is required to prepare consolidated accounts, and does so on the basis of IAS, it will look to the requirements of IAS to determine its subsidiary undertakings to be included in the consolidation.

This is represented in diagrammatic form at Annex A.

C The option to use IAS

4.9 Beyond the requirements in Article 4 of the IAS Regulation, new sections 226(2) and 227(3) of the 1985 Act permit a company required by the 1985 Act to prepare accounts to choose whether to prepare its individual and/or consolidated accounts in accordance with IAS or in accordance with the accounting requirements of the 1985 Act. If a company elects to use IAS (or is required to do so by the IAS Regulation), it must state in the notes to its accounts that they have been prepared in accordance with IAS (new sections 226B for individual accounts and 227B for consolidated accounts). The company should also ensure that it is clear which parts of the 1985 Act it must still comply with (see section 4D, in particular paragraph 4.21).

Use of IAS in both individual and consolidated accounts

4.10 Where companies prepare both individual and consolidated accounts, the choice between IAS and the accounting requirements of the 1985 Act operates separately for each.

4.11 If a company comes within Article 4 of the IAS Regulation, it must use IAS for its consolidated accounts. However, it still has the choice of using IAS or UK GAAP for its individual accounts. If a company has chosen to use IAS for its individual accounts under new section 226(2), it does not have to use IAS for its consolidated accounts. And if it has chosen to use IAS for its consolidated accounts under new section 227(3), it does not have to use IAS for its individual accounts.

4.12 The 1985 act requires that consolidated and individual accounts (where required) are published together (section 240(2)). This will continue to apply where the consolidated and individual accounts are prepared using different frameworks. In such circumstances, the 1985 Act does not specify whether the accounts should be presented as separate sections of the report or combined into a single set of primary statements and notes. However, in practice it is expected that the statements will be clearer if the separate sections approach is taken.

Consistency within a group

4.13 A parent company must ensure that its individual accounts and the individual accounts of all its subsidiary undertakings are prepared using the same financial reporting framework, be it IAS or UK GAAP, except to the extent that in the directors' opinion there are good reasons for not doing so (new section 227C(1) of the 1985 Act). Therefore, if a parent company chooses to use IAS for its individual accounts, it must also ensure that the individual accounts of all its subsidiary undertakings are prepared using IAS (but see paragraphs 4.14 and 4.15 below for certain exceptions to this requirement).

4.14 There are three specific exceptions to this requirement in new section 227C(2)-(4). It does not apply:

- if the parent company does not prepare group accounts;
- to the accounts of subsidiary undertakings that are not required to be prepared under Part VII of the 1985 Act (for example foreign subsidiaries);
- to any subsidiary undertakings that are charities (so charities and subsidiary undertakings that are not charities are not required to use the same accounting framework).

4.15 There is also one partial exception to this requirement in new section 227C(5). If the parent company prepares both consolidated and individual accounts under IAS, it is not required to ensure that all its subsidiary undertakings also use IAS. However, it must ensure that all its subsidiary undertakings use the same accounting framework, again unless there are good reasons for not doing so.

4.16 If the directors believe that there are good reasons for not preparing all individual accounts within a group using the same accounting framework, they are not required to do so. This provision is intended to provide a degree of flexibility where there are genuine

(including cost/benefit) grounds for using different accounting frameworks within a group of companies. Examples of “good reasons” could include:

- a group using IAS acquired a subsidiary undertaking that had not been using IAS; in the first year of acquisition, it might not be practical for the newly acquired company to switch to IAS straight away;
- the group contains subsidiary undertakings that are themselves publicly traded, in which case market pressures or regulatory requirements to use IAS might come into play, without necessarily justifying a switch to IAS by the non-publicly traded subsidiaries;
- a subsidiary undertaking or the parent was planning to list and so might wish to convert to IAS in advance, but the rest of group wasn't listing;
- the group contains minor or dormant subsidiaries where the costs of switching accounting framework would outweigh the benefits.

The key point is that the directors of the parent company must be able to justify any inconsistency, to shareholders, regulators or other interested parties.

One way choice?

4.17 If a company has prepared its accounts using IAS for a financial year, it cannot switch back to UK GAAP in subsequent financial years (new section 226(4) for individual accounts and 227(5) for consolidated accounts). There are three exceptions to this rule in new section 226(5) and new section 227(6):

- The company becomes a subsidiary undertaking of an undertaking that does not prepare its accounts in accordance with adopted IAS. This is intended to deal with situations where a subsidiary undertaking is sold by a group generally using IAS, to another group or entity not using IAS. It is not intended that companies switch between accounting regimes on the basis of an internal group restructuring.
- The company or any parent undertaking ceases to be publicly traded (e.g. in a de-listing).

D Parts of the 1985 Act that still apply and parts that don't

General outline

4.18 Companies that are required to use IAS or choose to use IAS will need to prepare their accounts in accordance with the requirements of IAS rather than the 1985 Act. IAS deals with the form and content of accounts. Therefore, in broad terms, the provisions in the 1985 Act relating to the form and content of accounts (in particular the accounts formats in Schedules 4, 4A, 8, 9 and 9A) will no longer apply to companies using IAS. For example, instead of the profit and loss account and balance sheet required by the 1985 Act, companies will need to prepare the primary financial statements and supporting notes required under IAS.

4.19 It follows from this that the provisions on abbreviated accounts for small and medium sized companies based on the 1985 Act formats also do not apply. Similarly, accounts

disclosure requirements in the Schedules relating to items in the accounts are no longer relevant *except* where they relate to items beyond the scope of the IAS Regulation (such as the disclosure requirements relating to particulars of staff, and to the emoluments and other benefits to directors, which continue to apply).

4.20 Those aspects of the 1985 Act that deal with matters outside the scope of IAS will continue to apply when accounts are prepared under IAS. For example the requirements relating to the directors' report, publication (as opposed to preparation) of accounts, audit and certain disclosures that are beyond the scope of IAS (for example, disclosures on employee numbers and management remuneration) remain applicable to companies preparing accounts under IAS.

List of sections

4.21 Those provisions in Part VII (Accounts and Audit) of the 1985 Act that will continue to apply to companies preparing accounts under IAS are as follows:

- sections 221 and 222 (duty to keep accounting records)
- sections 223 to 225 (a company's financial year and accounting reference periods)
- sections 226, 226A and 226B (preparation of individual accounts)
- sections 227, 227A and 227B (preparation of group accounts)
- section 227C (consistency of accounts within group)
- sections 228 and 228A (exemption for parent companies included in larger groups)
- section 229 (subsidiary undertakings included in the consolidation)
- section 230(1), (3) and (4) (treatment of individual profit and loss account where group accounts prepared)
- sections 231, 231A and 232 and Schedules 5 and 6 (disclosure in notes to accounts)
- section 233 (approval and signing of accounts)
- sections 234 and 234A and Schedule 7 (directors' report)
- [section 234ZA (statement as to disclosure of information to auditors) to be inserted by clause 9 of the Companies (Audit, Investigations and Community Enterprise) Bill]
- sections 234B and 234C (directors' remuneration report)
- sections 235 to 237 (auditors' report and duties of auditors)
- sections 238 and 239 (persons entitled to receive or demand copies of accounts and reports)
- section 240 (requirements in connection with publication of accounts)
- section 241 (accounts and reports to be laid before company in general meeting)
- section 242 (accounts and reports to be delivered to the registrar of companies)
- section 242A (civil penalty for failure to deliver accounts)
- section 242B (delivery and publication of accounts in euros)
- section 244 (period allowed for laying and delivering accounts and reports)
- sections 245 to [245F to be inserted by the Companies (Audit, Investigations and Community Enterprise) Bill] (revision of defective accounts and reports)
- section 246(1), (4), (5)(a) and (b), (6), (8)(b) and (c) and (9) (certain exemptions for small companies)
- section 247 to 247B (qualification of company as small or medium-sized), so far as applicable to exemptions from audit, from certain directors' report disclosures, and for exemption from obligation to prepare group accounts)
- sections 249A to 249E (exemptions from audit) (save insofar as they apply to companies that are charities)

- section 251 (summary financial statements)
- sections 252 and 253 (private company's election to dispense with laying of accounts and reports before general meeting)
- section 254 (certain unlimited companies exempt from requirement to deliver accounts and reports to registrar of companies)
- section 255A(4), (5) and (5A) (definition of banking and insurance groups)
- section 255B (modification of disclosure requirements in Schedule 5 and 6 in relation to banking company or group)
- sections 258 and 259 (interpretation of "parent undertaking", "subsidiary undertaking", and other expressions) insofar as they apply to the provisions referred to in this subsection
- section 260 (meaning of participating interest)
- section 261 (notes to the accounts)
- sections 262 and 262A (minor definitions), insofar as they apply to the provisions referred to in this subsection.

Publication exemptions

4.22 The 1985 Act requirements in respect of laying and delivering accounts continue to apply to parent companies preparing accounts under IAS. However, the section 243 requirement for the accounts of subsidiary undertakings to be appended in certain cases has been repealed.

4.23 Section 230 of the 1985 Act provides that, where consolidated accounts are prepared, the parent company's individual profit and loss account and related notes may be omitted from the annual report. Companies that prepare group and individual accounts, and present the latter in accordance with IAS, can continue to take advantage of this exemption. The omission of the profit and loss account (referred to within IAS as the income statement) might be considered to be inconsistent with certain aspects of IAS, for example the requirement in IAS 1 in relation to a fair presentation. However, IAS does not in itself require the preparation of separate financial statements but permits the omission of certain elements. In other words, the separate financial statements required to be published under the 1985 Act are an extract of the full IAS separate financial statements. This exemption should not affect the ability of a parent company to be treated as a "first-time adopter" and hence to take advantage of exemptions for first time use under the provisions of IFRS1. The company will need to provide the disclosure required by section 230(4), ie that advantage has been taken of the publication exemption in section 230(1). Auditors will also need to describe the accounting framework that has been used within their audit reports. In respect of the individual accounts, the reference to the framework will need to make clear that its basis is IAS as adopted for use in the EU and as applied in accordance with the provisions of the 1985 Act.

4.24 The exemption in the 1985 Act relates only to the profit and loss account. By virtue of section 261(2), the exemption also extends to the notes to the profit and loss account. The individual IAS accounts would however still need to include the other primary statements and note disclosures required by IAS, including a cash flow statement and a statement of changes in shareholders' equity.

Special considerations for small companies

4.25 There are several points that small companies considering switching to IAS should note.

4.26 At present, IAS does not provide a simplified regime for small companies. There is no equivalent to the exemptions available to small companies in the 1985 Act nor to the ASB's Financial Reporting Standard for Small Entities. Therefore, small companies electing to use IAS will have to use the full set of adopted IAS. However, the IASB is looking at this area and issued a discussion paper on 5 July 2004 (at www.iasb.org/current/dp_pv.asp).

4.27 The thresholds in section 247(3) and section 249(3) of the 1985 Act defining small and medium companies and groups are based on turnover, balance sheet total and employee number figures. The thresholds themselves will not change. However, in some cases the thresholds refer to particular items in the accounts formats in the 1985 Act. If a small company switches to IAS, these formats will no longer be relevant. Compliance with the thresholds will be determined using the equivalent items derived from IAS accounts. For example, the aggregate of amounts shown as assets in a balance sheet prepared using IAS will need to be used instead of the balance sheet total. Also, IAS uses the term revenue rather than turnover.

4.28 As stated above in paragraph 4.19, the provisions on abbreviated accounts do not generally apply, as the format of accounts on which they are based do not apply to companies using IAS.

4.29 However, a small company that elects to use IAS will continue to be permitted to omit its profit and loss account from its published accounts (the IAS equivalent is an income statement), including supporting notes. It will also be permitted to continue to use the exemptions in relation to its directors' report.

4.30 The exemption for unlisted small groups from the requirement to prepare consolidated accounts continues to be available to a small parent company.

4.31 The exemptions for small companies in relation to statutory audit of the accounts will also continue to be available where the accounts are prepared in accordance with IAS.

5. CHANGES TO CONSOLIDATION RULES

5.1 Several changes have been made to the rules on when a parent/subsidiary relationship exists, when subsidiary undertakings can be exempted from inclusion in consolidated accounts, and the circumstances in which a parent company is permitted not to prepare consolidated accounts.

Participating interest

5.2 The requirement in section 258(4) of the 1985 Act for a participating interest to exist in order for an undertaking to be a subsidiary of another undertaking is being removed and the circumstances in which a parent-sub subsidiary undertaking relationship exists are being extended. At present, a parent/subsidiary relationship exists in various circumstances, including where a participating interest is held, and the “parent” actually exercises dominant influence. As amended, a parent/subsidiary relationship will exist where the parent has the power to exercise dominant influence or control, whether or not a participating interest is held. The intention of this change is to align more closely the definition of a subsidiary undertaking in the 1985 Act with that contained in IAS 27 *Consolidated and Separate Financial Statements*. In IAS 27, a subsidiary is defined as an entity that is controlled. Control is in turn defined as the “power to govern the financial and operating policies of an entity so as to obtain benefit from its activities”. It is not intended that the new 1985 Act definitions will commonly create parent/subsidiary relationships in circumstances in which IAS 27 would not.

Exemption for parent companies included in non-EEA group accounts

5.3 An exemption from the requirement to prepare consolidated accounts is to be made available to a parent company governed by GB law, which is also a subsidiary undertaking of a parent undertaking not governed by EEA law. In order to qualify for exemption, the company must meet all of the conditions listed in section 228A.

5.4 One of the conditions is that accounts of the exempted intermediate parent (and its subsidiary undertakings) are included in consolidated accounts of a larger group. The consolidated accounts and, where appropriate, the annual report of that larger group must be drawn up in accordance with the provisions of the Seventh Directive or “in a manner equivalent” to that Directive. It is considered that, in most circumstances, financial statements of the larger group prepared on the basis of IAS would meet this equivalence test.

5.5 The concept of equivalence of accounting frameworks also appears in the EU’s Transparency Obligations Directive and Prospectus Directive. In these cases, equivalence refers to non-EU accounting frameworks and their equivalence or otherwise to IAS. Work on the assessment of equivalence for this purpose has been commenced by the Committee of European Securities Regulators, in accordance with a mandate provided by the EC. The outcome of this work might also, by extension, have an impact on an assessment of the equivalence of specific accounting frameworks to the Seventh Directive.

5.6 The exemption does not apply to a company whose securities are admitted to trading on a regulated market of any EEA State (see Annex B for current list of regulated markets).

Exclusion from consolidation if held for resale

5.7 Section 229(3) of the 1985 Act has been amended to make it possible for a subsidiary undertaking to be excluded from consolidation where the parent company's interest in it is held exclusively with a view to subsequent resale irrespective of whether or not it has previously been included in consolidated accounts.

Exclusion from consolidation on the basis of incompatible activities

5.8 Section 229(4) of the 1985 Act has been repealed. Therefore, it is no longer possible for an undertaking to be excluded from the consolidated accounts of the parent company if its activities are so incompatible with those of the parent that inclusion would not give a true and fair view of the undertakings in the consolidated accounts, taken as a whole.

6. CHANGES TO ACCOUNTING PROVISIONS FOR NON-IAS ACCOUNTS

6.1 The changes described below apply only to accounts prepared in accordance with the 1985 Act, not to accounts prepared in accordance with IAS.

Dividends

6.2 The requirement in paragraph 3(7) of Schedule 4 to the 1985 Act for companies to show paid and proposed dividends as separate items in the profit and loss account has been removed. Now, companies are required to show in the notes to the accounts:

- any amount set aside to reserves or withdrawn from reserves, or proposed to be set aside or withdrawn,
- the aggregate amount of dividends paid in the financial year (other than those for which a liability existed at the immediately preceding balance sheet date);
- the aggregate amount of dividends liable to be paid at the balance sheet date; and
- the aggregate amount of dividends proposed before the date of approval of the accounts, and not otherwise disclosed under the previous two categories.

Presentation of items

6.3 A new paragraph 5A has been inserted into Schedule 4 to the 1985 Act to amend the existing requirements so that the presentation of items within the balance sheet and profit and loss account must have regard to the economic substance of the reported transaction or arrangement. This provision relates only to the presentation of items within the accounting formats, not to their recognition or measurement. Its intention is to align more closely the presentation of balance sheets and profit and loss accounts with the requirements of IAS.

6.4 One effect of the new requirement is that some preference shares will be shown as liabilities in the balance sheet rather than as part of share capital and reserves. This will be the case where the preference shares in question would fall to be treated as liabilities in accordance with IAS 32 *Financial Instruments: Disclosure and Presentation*.

6.5 Certain provisions of the 1985 Act in relation to capital maintenance operate by reference to items as stated in companies' accounts (section 270(2) of the 1985 Act). Therefore, this reclassification will affect the application of the "net assets test" in section 264 of the 1985 Act (which applies only to public limited companies). The interaction of section 264 and section 270(2) is such that, where preference shares are classified as liabilities, they should be treated as such for the purposes of the net assets test, and should not be treated as part of called-up share capital and undistributable reserves for that purpose.

6.6 Preference shares should continue to be included in the disclosures required by paragraph 38 of Schedule 4 to the 1985 Act (in respect of 1985 Act accounts).

Fair Value options

6.7 A new section D has been inserted into Schedule 4 to the 1985 Act. This allows companies to choose to value some of their financial instruments, investment property and living plants and animals at fair value. There is no requirement in the legislation to use fair value; it is an optional accounting treatment. However, the ASB's accounting standards may in practice determine the circumstances in which fair value measurement is applied. Equivalent amendments are made for small companies, banking and insurance companies.

6.8 Companies that choose to take up the option will be required to make a number of disclosures about their use of fair value (see paragraph 6.13 below). Even where companies choose not to use fair value, certain disclosures must be made about the fair value of derivatives (see paragraph 6.15 below).

6.9 "Financial instrument" includes cash, loans and receivables, equity instruments and debt securities as well as financial derivatives such as futures, options and swaps. Those financial instruments that are not permitted to be fair valued are listed at paragraph 34A of new section D.

6.10 "Fair value" can be described as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Paragraph 34B of new section D sets out how the fair value of a financial instrument should be determined. The fair value of investment property or living plants and animals should be determined using the relevant international accounting standards (currently IAS 40 *Investment Property* and IAS 41 *Agriculture* respectively).

6.11 New section D also permits the use of a fair value hedge accounting system for financial instruments (paragraph 34C).

6.12 Paragraph 34E requires that changes in the fair value of a financial instrument or asset must be included in the profit and loss account except in certain specified circumstances. In these circumstances, changes in value must be recorded in a separate fair value reserve. Changes in value in an available for sale financial asset that is not a derivative may be recorded in the fair value reserve.

6.13 Companies that choose to use fair value for financial instruments, investment property or living plants and animals must disclose certain information about their use of fair value in the notes to the accounts. For financial instruments, the information that must be disclosed is set out in new paragraph 45A of section D. It includes the assumptions underlying the valuation models used, the fair value of each category of financial instruments and changes in value, and the extent and nature of derivatives. For investment property and living plants and animals, the information that must be disclosed is set out in new paragraph 45D. It includes the balance sheet items affected and the basis of valuation adopted.

6.14 Many of the new technical accounting terms concerning fair value that are included in the 1985 Act are not defined in that Act or in the Fair Value Directive (e.g. financial instruments, hedge accounting). Instead, users will need to look at the relevant accounting standards and related guidance.

Derivatives

6.15 There is a new requirement in paragraph 45B of new section D for companies to disclosure information on derivatives that have not been fair valued. For each class of derivatives, they must state the fair value of the derivatives in that class (if it can be determined as set out in paragraph 34B) and the extent and nature of the derivatives. Small companies are exempted from this requirement.

7. FINANCIAL INSTRUMENTS DISCLOSURES IN THE DIRECTORS' REPORT

7.1 There is a new requirement in paragraph 5A of Schedule 7 to the 1985 Act to disclose information about financial instruments in the directors' report. Companies must disclose certain information about the use of financial instruments by themselves and their subsidiary undertakings where this is material for an assessment of the company's (and the group's if appropriate) financial position. This includes information about their financial risk management objectives and the exposure of the company to risks. Small companies are not required to make this disclosure.

7.2 This new requirement will apply regardless of whether accounts are prepared in accordance with the 1985 Act or IAS.

8. CHANGES TO AUDIT REPORT REQUIREMENTS

8.1 Section 235 of the 1985 Act includes a new requirement (section 235(1A)) for the audit report to identify the financial reporting framework applied in the preparation of the accounts (ie whether IAS as adopted for use in the EU or UK GAAP), and the auditing standards in accordance with which the audit was conducted. The audit report must state whether the accounts give a true and fair view in accordance with the financial reporting framework used to prepare the accounts (section 235(2)). As Recital 10 of the Modernisation Directive makes clear, the requirement that an audit opinion states whether the annual or consolidated accounts give a true and fair view in accordance with the relevant financial reporting framework clarifies the context in which the audit opinion was given; it does not represent a restriction of the scope of that opinion.

8.2 The 1985 Act requirement is for accounts to give a “true and fair view”. The IAS requirement is for accounts to “present fairly”. New section 262(2A) makes clear that these two terms should be read as having the same meaning. This is supported by the IASB’s framework document, which refers to “the application of the principal qualitative characteristics and of appropriate accounting standards normally [resulting in] financial statements that convey what is generally understood as a true and fair view of, or as presenting fairly such information” (*IASB Framework for the Preparation and Presentation of Financial Statements*, paragraph 47).

8.3 There is a new requirement in section 235(2A) that the auditors’ report be qualified or unqualified, and that it include a reference to any matters to which the auditors want to draw attention without actually qualifying the accounts.

8.4 Section 236 now requires that audit reports be dated as well as signed.

8.5 The requirements on the publication of non-statutory accounts in section 240(3)(d) of the 1985 Act have been amended slightly. Previously, a company had to include a statement indicating whether the auditors had reported on the full statutory accounts, and state whether that report was qualified. Now, a company must state whether the auditors’ report was qualified or unqualified, and whether the auditors have drawn attention in their report to any matter by way of emphasis, without qualifying the audit report.

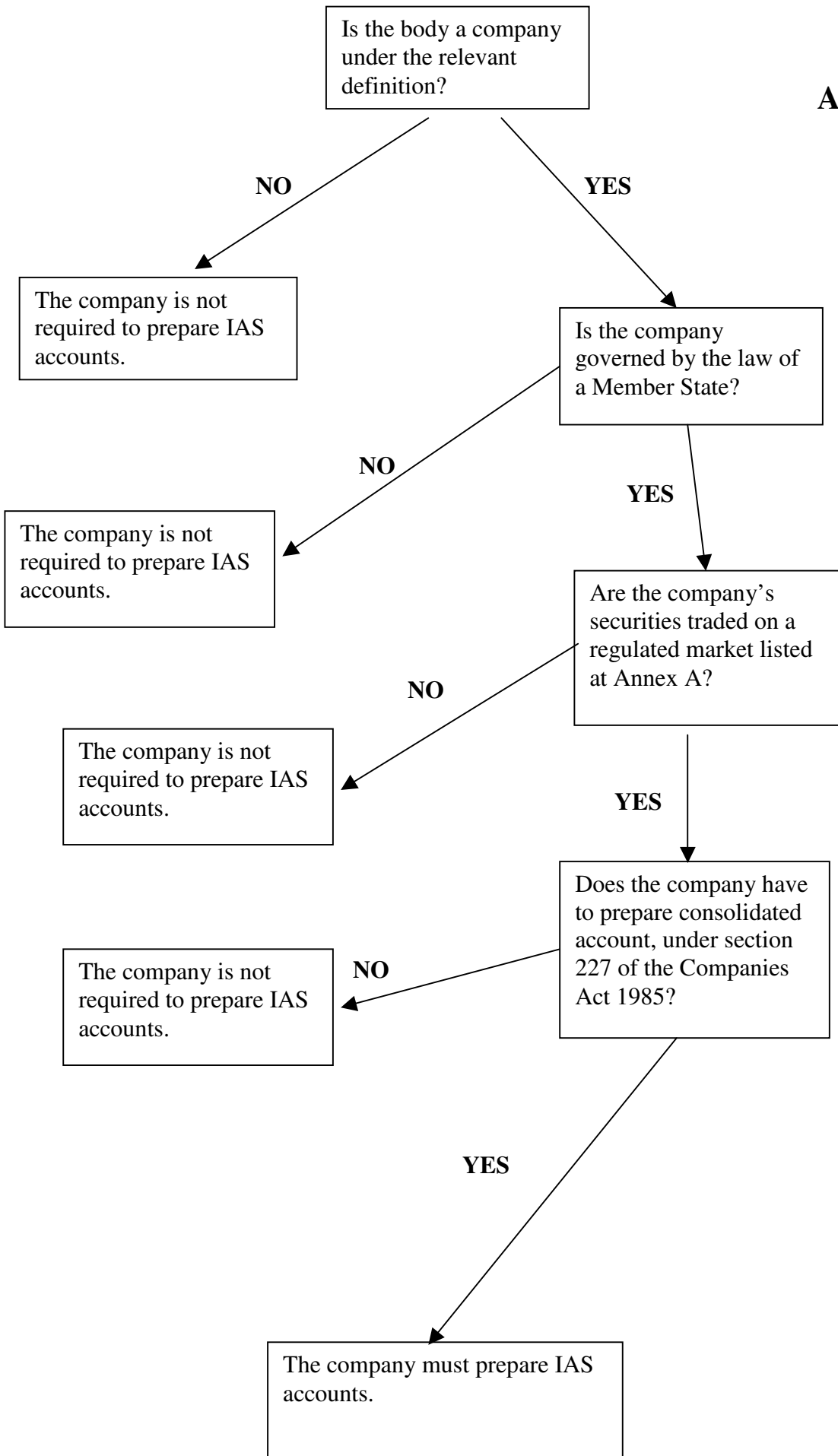
9. OTHER CHANGES TO REPORTING REQUIREMENTS

Automatic three month extension for companies with overseas interests

9.1 Section 244(3) of the 1985 Act allowed the right to claim an automatic three month extension of the period allowed for laying and delivering reports and accounts where the company had overseas interests. This automatic right is being repealed. However, companies may continue to apply for an extension on a discretionary basis under section 244(5).

Voluntary revision of summary financial statements

9.2 Section 245 of the 1985 Act allows voluntary revision of annual accounts or the directors' report but did not previously expressly permit voluntary revision of summary financial statements. It is being amended to extend voluntary revision to summary financial statements.



ANNEX B

LIST OF REGULATED MARKETS

List of Regulated Markets under Article 16 of the Investment Services Directive (ISD) (Council Directive 93/22/EEC) at 17.02.2004 (OJ C72/3 of 23.3.04)

Country	Title of Regulated Market	Operating entity	Competent authority for designation and oversight of market
Austria	<ol style="list-style-type: none"> 1. Amtlicher Handel (official market) 2. Geregelter Freiverkehr (semi-official market) 3. Dritter Markt (third market) 	Wiener Börse AG (1-3)	Finanzmarktaufsichtsbehörde
Belgium	<ol style="list-style-type: none"> 1. Bourse de valeurs mobilières d'Euronext Brussels: <ul style="list-style-type: none"> • Le premier marché (official market) • Le second marché • Le nouveau marché • le marché trading facilities 2. Le Marché des Instruments derives d'Euronext Bruxelles 3. Le marché secondaire hors bourse des 	<ol style="list-style-type: none"> 1. Euronext Brussel SA 2. Euronext Brussels SA 3. Fonds des rentes 	<ol style="list-style-type: none"> 1. Bourse: Législateur = Ministre des Finances; Autorité de Marché = Autorité de Marché d'Euronext Bruxelles. 2. Marché des Instruments derives Ministre des Finances sur avis de la CBF. Autorité de Marché = Autorité de Marché d'Euronext Bruxelles. 3. Ministre des Finances sur proposition du Comité des fonds des rentes.

Country	Title of Regulated Market	Operating entity	Competent authority for designation and oversight of market
	<p>obligations linéaires, des titres scindés et des certificats de trésorerie</p> <p>4. Nasdaq Europe</p>	<p>4. Nasdaq SA</p>	<p>4. Nasdaq Europe: Ministre des Finances sur avis de la CBF. Autorité de Marché = Autorité de Marché de Nasdaq Europe.</p>
Denmark	<p>1. Københavns Fondsbørs</p> <ul style="list-style-type: none"> • Equity market; • Bond market; • Derivatives market <p>2. XtraMarket - Authorised marketplace for unlisted units of investment associations (UCTIS) and Special Purposes Associations</p> <p>3. Dansk Autoriseret Markedsplads A/S (Danish Authorised Market Place Ltd. (DAMP)) [authorised market place = regular trade in securities admitted for trading but not listed on stock exchange]</p>	<p><u>1-2. Copenhagen Stock Exchange Ltd.</u></p> <p>3. Danish Authorised Market Place Ltd. (DAMP)</p>	<p>Finanstilsynet (Danish financials supervisory authority)</p>
Finland	<p>1. Arvopaperipörssi (Stock Exchange);</p>	<p><u>For both 1 & 2:</u></p>	<p>Designation: Ministry of Finance.</p>

Country	Title of Regulated Market	Operating entity	Competent authority for designation and oversight of market
	<ul style="list-style-type: none"> • Päälista (Main List for equity and Debt Instruments); • I-, NM-, Pre- ja Meklarien lists (parallel Lists I-, NM-, pre- and Brokers' list for equity and debt instruments); <p>2. Optioyhteisö (Option Corporation). (Derivatives exchange and clearing house).</p>	Helsingin Arvopaperi- ja johdannaispörssi, selvitysyhtiön Oy, (Helsinki Securities and Derivatives Exchange, Clearing House Ltd)	<p>Oversight:</p> <ul style="list-style-type: none"> • Approval of rules: Ministry of Finance; • Supervision of compliance: Rahoitustarkastus/ Finnish Financial Supervision Authority.
France	<p>1. <u>Bourse de Paris:</u></p> <ul style="list-style-type: none"> • Premier marché (official list); • Second marché; • Marché des EDR (European Depositary Receipts). <p>2. Nouveau marché</p> <p>3. MATIF</p> <p>4. MONEP</p>	Euronext Paris (1-4)	<p>Proposition de l'Autorité des des marchés financiers (AMF) (cf. article L.4211 du code monétaire et financier).</p> <p>Approbation par le Ministre de l'economie et des finances.</p>
Germany	<p>1. Börse Berlin-Bremen (Amtlicher Handel, Geregelter Markt)</p> <p>2. Düsseldorfer Börse (Amtlicher Handel, Geregelter Markt)</p>	<p>1. Berliner Börse AG.</p> <p>2. Börse Düsseldorf AG.</p>	Börsenaufsichtsbehörden de Länder (stock exchange supervisory authorities of the deferral states) and the Bundesanstalt für Finanzdienstleistungsaufsicht (BAFin).

Country	Title of Regulated Market	Operating entity	Competent authority for designation and oversight of market
	<p>3. Frankfurter Wertpapierbörse (Amtlicher Markt, Geregelter Markt)</p> <p>4. Eurex Deutschland</p> <p>5. Hanseatische Wertpapierbörse Hamburg (Amtlicher Markt, Geregelter Markt, Startup market)</p> <p>6. Niedersächsische Börse zu Hannover (Amtlicher Markt, Geregelter Markt)</p> <p>7. Börse München (Amtlicher Markt, Geregelter Markt)</p> <p>8. Baden-Württembergische Wertpapierbörse (Amtlicher Markt, Geregelter Markt)</p>	<p>3 & 4. Deutsche Börse AG.</p> <p>5. BöAG (Börsen AG)</p> <p>6. BöAG (Börsen AG)</p> <p>7. Bayerische Börse AG</p> <p>8. Börse-Stuttgart AG</p>	<p>State authorities:</p> <p>1. Senatsverwaltung für Wirtschaft und Technologie, Berlin.</p> <p>2. Finanzministerium des Landes Nordrhein-Westfalen, Düsseldorf.</p> <p>3 & 4. Hessisches Ministerium für Wirtschaft, Verkehr und Landesentwicklung, Wiesbaden.</p> <p>5. Freie und Hansestadt Hamburg, Wirtschaftsbehörde.</p> <p>6. Niedersächsisches Ministerium für Wirtschaft, Technologie und Verkehr, Hannover.</p> <p>7. Bayerisches Staatsministerium für Wirtschaft, Verkehr und Technologie, München.</p> <p>8. Wirtschaftsministerium in Baden-Württemberg, Stuttgart.</p>
Greece	1. Athens Stock Exchange (A.S.E)/Thessaloniki Stock Exchange Centre (T.S.E.C.)	1 and 2. Athens Stock Exchange	Capital market Commission

Country	Title of Regulated Market	Operating entity	Competent authority for designation and oversight of market
	<ul style="list-style-type: none"> • Main Market • Parallel Market • Parallel Market for Emerging Markets • New Market <p>2. Athens Derivatives Exchange (A.D.EX)</p> <p>3. Electronic Secondary Securities Market (HDAT-Bond Market, under the competence and supervision of the Bank of Greece)</p>	3. Bank of Greece	
Ireland	<p>Irish Stock Exchange comprising:</p> <ul style="list-style-type: none"> • Official List • Exploration Securities Market • Developing Companies Market • ITEQ 	Irish Stock Exchange Ltd.	The Irish Financial Services Regulatory Authority authorises "regulated market" and (with exc. of listing conditions) vets and approves rules for operation of the different segments as prepared by the ISE.
Italy	<p>1. Stock Exchange, divided into the following segments:</p> <ul style="list-style-type: none"> • Electronic share market (MTA); • Electronic covered warrants market (MCW); • After-Hours Market (TAH); • Electronic bond and government 	<p>(1-4) Borsa Italiana S.p.A.</p> <p>(5-6) Società per il Mercato dei Titoli di Stato - MTS S.p.A.:</p>	<p>CONSOB authorises companies which manage markets, and approves</p> <p>For wholesale markets for Government securities, operating company is authorised by Treasury having regard to the opinion of CONSOB and Banca d'Italia.</p>

Country	Title of Regulated Market	Operating entity	Competent authority for designation and oversight of market
	<p>securities market (MOT);</p> <ul style="list-style-type: none"> • Electronic market for Eurobonds, foreign bonds and asset-backed securities (EuroMOT). <p>2. <u>Mercato Ristretto (second market).</u></p> <p>3. Derivatives market (DEM).</p> <p>4. Nuovo Mercato (New Market - NM).</p> <p>5. Wholesale Market for Corporate and International Organisations Bonds.</p> <p>6. Wholesale Market for Corporate and International Organisations Bonds.</p>		
Luxembourg	Bourse de Luxembourg: Official List	Société de la Bourse de Luxembourg S.A.	Commission de surveillance du Secteur Financier
Netherlands	<p>1. Euronext Amsterdam Cash Market:</p> <ul style="list-style-type: none"> • Official market • Domestic market for unlisted securities 	Euronext N.V. and Euronext Amsterdam N.V.	<p>Recognition by the Minister of Finance after advice from the Netherlands Authority for the Financial Markets.</p> <p>Supervision by the</p>

Country	Title of Regulated Market	Operating entity	Competent authority for designation and oversight of market
	<ul style="list-style-type: none"> • Euro NM Amsterdam 2. Euronext Amsterdam derivatives Market. 		Netherlands authority for the Financial Markets and The Netherlands Ministry of Finance.
Portugal	<ol style="list-style-type: none"> 1. Mercado de Cotações Oficiais (Official Quotation Market) 2. Segundo Mercado (Second Market) 3. Novo Mercado (New Market) 4. Mercado de Futurose e Opções (Futures and Options Market) 5. MEDIP - Mercado Especial de Dívida Pública (Special Market for Public Debt) 	<p>Markets 1-4: Euronext Lisboa - Sociedade Gestora de Mercados Regulamentados SA</p> <p>Market 5: MTS Portugal - Sociedade Gestora Mercado Especial Dívida Pública SA</p>	Finance Ministry authorises markets on basis of proposal from Comissão do Mercado de Valores Mobiliários (CMVM) - latter responsible for regulation and oversight of market.
Spain	<p>A. Bolsas de Valores (all comprise first, second and new market segments)</p> <ol style="list-style-type: none"> 1. Bolsa de Valores de Barcelona; 2. Bolsa de Valores de Bilbao; 3. Bolsa de Valores de Madrid; 4. Bolsa de Valores de Valencia. 	<ol style="list-style-type: none"> A1. Sociedad Rectora de la Bolsa de Valores de Barcelona S.A. A2. Soc. Rectora de la Bolsa de Valores de Bilbao S.A. A3. Soc. Rectora de la Bolsa de Valores de Madrid S.A. A4. Soc. Recotora de la Bolsa de Valores 	<p>CNMV (Comisión Nacional del Mercado de Valores)</p> <p>Banco de España responsible for market for public debt.</p>

Country	Title of Regulated Market	Operating entity	Competent authority for designation and oversight of market
	<p>B. Mercados oficiales de Productos Financieros Derivados</p> <ol style="list-style-type: none"> 1. MEFF Renta Fija; 2. MEFF Renta Variable. <p>C. Mercados FC&M de Futuros y Opciones sobre Cítricos [commodity derivatives not covered by section B annex ISD: related markets do not fall within ISD definition of "regulated market"]</p> <p>D. AIAF Mercado de Renta Fija.</p> <p>E. Mercado de Deuda Pública en Anotaciones.</p>	<p>de Valencia S.A.</p> <p>B1. Soc. Rectora de Productos Financieros Derivados de RENTA Fija S.A.</p> <p>B2. Soc. Rectora de Productos Financieros Derivados de Renta Variable S.A.</p> <p>C. (FC&M) Soc. Rectora del Mercado de Futuros y Opciones sobre Criticos SA.</p> <p>D. AIAF Mercado de Renta Fija.</p>	
Sweden	<p><u>1. Stockholmsbörsen:</u></p> <ol style="list-style-type: none"> 2. Nordic Growth Market 3. Aktietorget 	<ol style="list-style-type: none"> 1. Stockholmsbörsen Aktiebolag 2. Nordic Growth Market NGM-Aktiebolag. 3. Aktietorget Aktiebolag. 	Finansinspektionen (Financial Supervisory Authority)

Country	Title of Regulated Market	Operating entity	Competent authority for designation and oversight of market
United Kingdom	<ol style="list-style-type: none"> 1. Domestic Equity Market 2. European Equity Market 3. Gilt Edged and Sterling Bond Market 4. Alternative Investment Market (AIM) 5. International Retail Service 6. International Order Book 7. The London International Financial Futures and Options Exchange (LIFFE) 8. Virt-x 9. EDX 	<p>Markets 1-6. London Stock Exchange Ltd.</p> <p>7. LIFFE Administration and Management.</p> <p>8. Virt-x Exchange Limited</p> <p>9. EDX London Limited</p>	<p>Entities operating regulated markets are recognised investment exchanges within the meaning of s285 of the Financial Services Act 2000 and are regulated by the Financial Services Authority (FSA).</p>
Iceland	<ol style="list-style-type: none"> 1. Verðbréfaþing Íslands hf. (kauphöll Íslands. - official market) 2. Tilboðsmarkaður VpÍ (Regulated OTC Market - not official listing) 	<ol style="list-style-type: none"> 1. Kauphöll Íslands. 2. Kauphöll Íslands. 	<p>Fjármála-eftirlitið (Financial Supervisory Authority)</p>
Norway	Oslo Stock Exchange	Oslo Børs ASA	Kredittilsynet (The

Country	Title of Regulated Market	Operating entity	Competent authority for designation and oversight of market
	<ul style="list-style-type: none"> • Equity Market • Derivative Market • Bonds Market 		Banking, Insurance and Securities Commission of Norway)