**EXPLANATORY MEMORANDUM TO THE**

**BUILDING SOCIETIES (ACCOUNTS AND RELATED PROVISIONS) (AMENDMENT) REGULATIONS 2004**

**2004 No. 3199**

**1.** This Explanatory Memorandum has been prepared by Her Majesty's Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

## 2. Description

2.1 This Statutory Instrument amends the Building Societies (Accounts and Related Provisions) Regulations 1998 to update accounting requirements in certain areas to bring them more into line with current practice.

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

3.1 Some of the powers used to make these Regulations are being repealed and re-enacted between these Regulations being made and their coming into force. Those powers are at sections 73(6), (7) and (8) of the Building Societies Act 1986. They are being repealed by The Building Societies Act 1986 (International Accounting Standards and Other Accounting Amendments) Order 2004. This is an Order which is subject to the affirmative resolution procedure. It has been scrutinised by the JCSI and is due to be debated by the House of Commons on 8th December 2004 and by the House of Lords on 13th December 2004. The Order re-enacts these powers in new sections 72C and 72G of the Building Societies Act 1986. The Regulations only quote the existing powers on the basis that section 17(2) of the Interpretation Act 1978 will apply

> (a) so that the reference to the repealed subsections will be construed as a reference to the provision re-enacted; and
> (b) to give effect to the Regulations as if they were made under the repealed provision.

3.2 The Government was required to implement the Fair Value Directive, one of the directives being implemented by this instrument, by 1 January 2004. Paragraph 4.7 below explains why there has been a delay in implementation. The Government has undertaken to the European Commission to implement the Fair Value Directive by 1 January 2005.

## 4. Legislative Background

4.1 The Statutory Instrument is being made to:

- implement in part the Directive amending existing accounting directives on the annual and consolidated accounts of certain types of companies, banks and other

financial institutions and insurance undertakings[1] (the "Modernisation Directive"), and

- implement the Directive amending existing accounting directives as regards the valuation rules (the "Fair Value Directive")[2].

4.2 The **Modernisation Directive** aims to enable undertakings to follow modern, more transparent accounting practices that are more consistent with International Accounting Standards. It will apply to those undertakings which are not required to or which have chosen not to use International Accounting Standards (IAS).

4.3 The Modernisation Directive achieves this objective by amending the four EU Directives that form the basis of European accounting requirements:

- 1978 Fourth Directive on Company Accounts
- 1983 Seventh Directive on Consolidated Accounts
- 1986 Directive on Accounts for Banks and other Financial Institutions
- 1991 Insurance Accounts Directive

4.4. The **Fair Value Directive** also amends the existing EU Accounting Directives to permit certain financial instruments to be recorded at fair value (essentially their current market price, as opposed to the historical purchase price).

4.5 This instrument **partly** implements the Modernisation Directive. Other parts of the Modernisation Directive are being implemented by the Building Societies Act 1986 (International Accounting Standards and Other Accounting Amendments) Order 2004 for which a separate Explanatory Memorandum has been produced.

4.6 These Regulations and the Order described above follow the Companies Act 1985 (International Accounting Standards and Other Accounting Amendments) Regulations 2004 which implements the Modernisation Directive and the Fair Value Directive for **companies**[3]. A separate Explanatory Memorandum has been produced for those regulations.

4.7 The Modernisation Directive must be implemented by 1 January 2005. The Fair Value Directive has an implementation date of 1 January 2004 but the Government decided to defer implementation for one year in response to concerns raised by consultees over implementation for 2004, particularly in light of the far-reaching changes to accounting taking effect on 1st January 2005 as a result of the EU Regulation on International Accounting Standards.

4.8 Most of the requirements of the Fair Value Directive will not apply to accounts prepared in accordance with IAS. The Government decided that it would be

[1] Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings. OJ L178/16 of 17 July 2003.

[2] 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 accountings of certain types of companies as well as of banks and other financial institutions. OJ L282/28.

[3] S.I. 2947/2004. These Regulations also give effect to the EU Regulation on International Accounting Standards for companies (Regulation (EC) 1606/2002). The Building Societies Act 1986 (International Accounting Standards and Other Accounting Amendments) Order 2004 gives effect to the EU Regulation on IAS for building societies.

undesirable to introduce accounting changes in law that would in some cases only apply for a year.

4.9 Furthermore, the Government considered that the new legislative provisions should preferably be supported by accounting standards. The relevant international standard (IAS 39) has been undergoing substantial revision, which has prevented the UK Accounting Standards Board from implementing a UK standard based on it. The Government was persuaded by the arguments of consultees that it was more advisable to defer implementation until the accounting standards were more settled.

4.10 The Government's approach to the Modernisation Directive and the Fair Value Directive has been to ensure that the UK's obligations are met whilst allowing flexibility and reducing unnecessary burdens on building societies. In addition, we have sought to ensure that there is consistency between companies and building societies, where appropriate.

4.11 Scrutiny of the Modernisation Directive:

- DTI Explanatory Memorandum 9730/1/02 REV1 COM (2002) 25912 final was submitted on 26.02.02. Commons European Scrutiny Committee considered it politically important and cleared it (Report No 37, Item 23522, Session 01/02). Lords Select Committee on the EU cleared it on 09.07.02 (Progress of Scrutiny 22.07.02, Session 01/02).
- DTI Explanatory Memorandum OTNYREM was submitted on 05.12.02. Commons European Scrutiny Committee considered it politically important and cleared it (Report No. 5, Item 24060, Session 02/03). Lords Select Committee on the EU did not report on it (Progress of Scrutiny 21.12.02, Session 02/03).

4.12 Scrutiny of the Fair Value Directive:

- DTI Explanatory Memorandum 6511/00 COM (2000) 80 final was submitted on 10.04.00. Commons European Scrutiny Committee considered it not legally or politically important and cleared it (Report No. 14, Item 21048, Session 99/00). Lords Select Committee on the EU did not report on it (Progress of Scrutiny 21.04.00, Session 99/00).

## 5. Extent

5.1 This instrument applies to all of the United Kingdom.

## 6. European Convention on Human Rights

6.1 Not applicable.

## 7. Policy background

7.1 The **Modernisation Directive** is designed to remove conflicts between the Accounting Directives and IAS in existence at the time it was drawn up and ensure that optional accounting treatments currently available under IAS in existence at 1 May 2002 are available to EU undertakings which continue to have the Accounting Directives as the basis of their accounts (i.e. those undertakings which will not prepare their accounts in accordance with the EU Regulation on IAS). In general, the Modernisation Directive amendments are technical amendments to existing accounting requirements.

7.2 The **Fair Value Directive** amends the Accounting Directives to permit certain financial instruments to be recorded at fair value in accordance with IAS 32 (*Financial Instruments: Disclosure and Presentation*) and IAS 39 (*Financial Instruments: Recognition and Measurement*). The Government is permitting all companies and building societies to use fair value accounting for certain financial instruments in both their annual and consolidated accounts.

7.3 Directives are not directly applicable in Member States and must be implemented through national law. Interest in these changes for building societies is largely confined to building societies. Consultation respondents were largely supportive of the proposals.

## 8. Impact

8.1 Transposition Notes are attached to this Explanatory Memorandum as follows:

- Modernisation Directive — Annex A
- Fair Value Directive — Annex B

8.2 Regulatory Impact Assessments were produced jointly with the Department for Trade & Industry to cover the impact of these changes on both companies and building societies.

8.3 There is no impact on the public sector as this Statutory Instrument only applies to building societies.

## 9. Contact

9.1 Ian Noon at HM Treasury (Tel: 18002 020 7270 5897 or email: ian.noon@hm-treasury.x.gsi.gov.uk) can answer any queries regarding the instrument.

IMPLEMENTING THE MODERNISATION OF ACCOUNTS DIRECTIVE 2003/51/EC [4] IN RELATION TO BUILDING SOCIETIES– A TRANSPOSITION NOTE

THE BUILDING SOCIETIES (ACCOUNTS AND RELATED PROVISIONS) (AMENDMENT) REGULATIONS 2004

## Introduction

1. The Building Societies (Accounts and Related Provisions) (Amendment) Regulations 2004 implement parts of the Modernisation of Accounts Directive. The parts which are implemented by these regulations are those which require amendments to be made to the Building Societies (Accounts and Related Provisions) Regulations 1998[5]("the 1998 Regulations"). The rest of the Modernisation of Accounts Directive is being implemented by an Order amending the Building Societies Act 1986 (the Building Societies Act 1986 (International Accounting Standards and Other Accounting Amendments) Order 2004). That Order is being made by way of affirmative resolution procedure and is due to be debated during December. This is a full transposition note for the Directive, providing cross-references both to the implementing provisions in these Regulations and in that Order. A partial transposition note was provided with the draft of the Order. These Regulations also implement the Fair Value Directive[6] for which a separate transposition note has been prepared.

2. European Union (EU) accounting requirements are based primarily on four Accounting Directives; the Fourth[7] and Seventh[8] Directives on the annual and consolidated accounts of companies: the Directive on the annual and consolidated accounts of banks and other financial institutions[9] ("the Bank Accounts Directive"); and the Directive on the annual and consolidated accounts of insurance undertakings[10] ("the Insurance Accounts Directive").

3. The Modernisation of Accounts Directive amends the Accounting Directives in order to remove conflicts between the Accounting Directives and international accounting standards ("IAS") in existence at the time it was drawn up. It also ensures that optional accounting treatments available under IAS in existence at 1 May 2002 are available to EU undertakings which continue to have the Accounting Directives as the basis of their accounts (i.e. those undertakings which will not prepare their accounts in accordance with the IAS Regulation).

5. Not all of the provisions in the Modernisation of Accounts Directive apply to building societies. The following articles do not apply: 1.3, 1.4, 1.5, 1.6, 1.8, 1.13 and all of article 4. Where any other provisions of the directive are omitted from the table below, this is because the changes they make are either minor or consequential in nature.

[4] Directive 2003/51/EC of the European Parliament and Council amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings (OJ L178 of 17.7.2003).
[5] S.I. 504/1998.
[6] Directive 2001/65/EC of the European Parliament and of the Council amending Directives 78/660/EEC, 83/349/EEC and 86/635/EEC as regards the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions (OJ L283 of 27.10.2001.
[7] Fourth Council Directive of 25 July 1978 (78/660/EEC) on the annual accounts of certain types of companies (OJ L222/11 of 14.8.1978).
[8] Seventh Council Directive of 13 June 1983 (83/349/EEC) on consolidated accounts (OJ L193/1 of 18.7.1983).
[9] Council Directive of 8 December 1986 (86/635/EEC) on the annual accounts and consolidated accounts of banks and other financial institutions. OJ L372/1 of 31 December 1986.
[10] Council Directive of 19 December 1991 (91/674/EEC) on the annual accounts and consolidated accounts of insurance undertakings. OJ L374/7 of 31 December 1991.

| Article | Objectives | Implementation | Responsibility |
|---|---|---|---|
| 1.1 | Allows Member States to permit or require the inclusion of other statements in annual accounts. | UK not taking up this option for building societies. | HM- Treasury |
| 1.2 | Allows Member States to permit or require the presentation of amounts in the accounts to have regard to the substance of the transaction. | UK are taking up this option for building societies and imposing a requirement to have regard to the substance of the transaction. Implemented by regulation 7 of these Regulations. | HM- Treasury |
| 1.7, 1.9 and 1.11 | These articles make changes in terminology relating to provisions and change the definition of provisions. | Are implemented by regulations 5 and 6 and paragraph 6 of the Schedule to these Regulations. | HM- Treasury |
| 1.10 | Expands the scope of the fixed assets that can be revalued. | No implementation necessary as paragraph 28(1) of Schedule 7 to the Building Societies (Accounts and Related Provisions) Regulations 1998 already permits intangible fixed assets, other than goodwill, to be included at their current cost. | HM- Treasury |
| 1.12 | Allows Member States to permit valuation of specific categories of assets by fair value principles. | UK are taking up this option for building societies. It is implemented by regulation 8 of these Regulations inserting new paragraph 31D into Schedule 7 of the 1998 Regulations. | HM- Treasury |
| 1.14 | Amends the requirements in relation to the contents of the annual report so that more detail is required and more analysis of the business risks are included. | Articles 3 and 4 of the Building Societies Act (International Accounting Standards and Other Accounting Amendments) Order 2004, amend section 75 and insert a new section 75A into the Building Societies Act 1986. | HM-Treasury |
| 1.15 and 1.16 | There is no longer a requirement for a statement in the published auditors' report of whether the accounts have been qualified or not reported on. There is an expanded requirement regarding the disclosure of audit information when accounts are not published in full. It must be disclosed whether the audit report was qualified, unqualified or whether no opinion was given. It must also be disclosed if auditors have drawn attention to any matter in their report without qualifying the report. | Article 7 of the Building Societies Act (International Accounting Standards and Other Accounting Amendments) Order 2004, inserts a new section 81A into the Building Societies Act 1986. | HM-Treasury |
| 1.17 | Requires auditors of accounts to be approved by Member States to carry out statutory audits on the basis of Directive 84/253/EEC. Further | The first obligation is already implemented by Schedule 11 of the Building Societies Act 1986. The second obligation | HM-Treasury |

| | | | |
|---|---|---|---|
| | requires the statutory auditors to express an opinion on the consistency or otherwise of the annual report with the annual accounts for the same financial year. | is already implemented by section 78(7) of the Building Societies Act 1986. | |
| 1.18 | Revises requirements regarding the contents of the auditors' report. Most importantly the auditor must now state which financial reporting framework has been used and say whether the accounts give a true and fair view in accordance with that framework. | Articles 5 and 6 of the Building Societies Act 1986 (International Accounting Standards and Other Accounting Amendments) Order 2004 amend section 78 of and insert a new section 78A into the Building Societies Act 1986. | HM-Treasury |
| 1.20 | Prevents Member States from allowing entities whose securities are admitted to trading on a regulated market, from benefiting from certain exemptions re disclosure. | No implementation required as these exemptions were never granted to building societies. | HM-Treasury |
| 2.1 | Amends the definition of when a parent has a subsidiary undertaking. | Regulation 12 of the Companies Act 1985 (International Accounting Standards and Other Accounting Amendments) Regulations 2004 amends the relevant definitions and applies it for the purposes of the Building Societies Act 1986. | DTI |
| 2.3 | Prevents Member States from allowing entities whose securities are admitted to trading on a regulated market, from benefiting from certain exemptions regarding the obligation to prepare consolidated accounts. | No implementation required as these exemptions were never granted to building societies. | HM-Treasury |
| 2.6 | Removes an exemption which allowed a subsidiary undertaking to be excluded from its parents consolidated accounts if its activities were so incompatible with those of the parent that inclusion would fail to meet the requirement to give a true and fair view in the consolidated accounts. | This is implemented by regulation 2 of these Regulations, which revokes paragraphs (7) and (7A) of regulation 4 of the 1998 Regulations. | HM-Treasury |
| 2.7 | Allows Member States to permit or require the inclusion of other statements in consolidated accounts. | UK are not taking up this option for building societies. | HM-Treasury |
| 2.10 | Amends the requirements in relation to the contents of the consolidated annual report so that more detail is required and more analysis of the business risks are included. | Articles 3 and 4 of the Building Societies Act 1986 (International Accounting Standards and Other Accounting Amendments) Order 2004 amend section 75 of and insert a new section 75A into the Building Societies Act 1986. | HM-Treasury |
| 2.11 | This Article amends the requirements in respect of auditing of consolidated accounts in the same way that articles 1.15 to 1.18 amend | Those requirements which are not already implemented by section 78(7) of and Schedule 11 to the Building Societies | HM-Treasury |

| | | | |
|---|---|---|---|
| | the requirements on individual accounts. | Act 1986 are implemented by articles 5, 6 and 7 of the Building Societies Act 1986 (International Accounting Standards and Other Accounting Amendments) Order 2004. | |
| 2.12 | Prevents certain exemptions regarding publication of accounts from applying to entities which have their securities traded on a regulated market. | No implementation necessary as the exemptions were never applied to building societies. | HM-Treasury |
| 3.1 | Applies provisions enabling Member States to permit financial instruments to be valued using the fair valuation method. | This is implemented by regulation 8 of these Regulations. | HM-Treasury |
| 3.2 | Allows Member States to permit or require an alternative balance sheet presentation. | UK are not taking up this option for building societies. | HM-Treasury |
| 3.4 | Allows Member States to permit or require a statement of performance instead of a profit and loss account. | UK are not taking up this option for building societies. | HM- Treasury |

IMPLEMENTING THE FAIR VALUE DIRECTIVE 2001/65EC [11] IN RELATION TO BUILDING SOCIETIES– A TRANSPOSITION NOTE

THE BUILDING SOCIETIES (ACCOUNTS AND RELATED PROVISIONS) (AMENDMENT) REGULATIONS 2004

## Introduction

1. The Building Societies (Accounts and Related Provisions) (Amendment) Regulations 2004 implement the Fair Value Directive in relation to building societies. These Regulations also implement the Modernisation of Accounts Directive[12] for which a separate transposition note has been prepared.

2. European Union (EU) accounting requirements which govern building societies are based primarily on three Accounting Directives; the Fourth[13] and Seventh[14] Directives on the annual and consolidated accounts of companies and the Directive on the annual and consolidated accounts of banks and other financial institutions[15] ("the Bank Accounts Directive").

3. The Fair Value Directive amends the Accounting Directives in order to permit undertakings which draw up their accounts using the framework established by the Accounting Directives, rather than using international accounting standards ("IAS"), to use the valuation method of fair value in their accounts in respect of certain financial assets and liabilities. The major provisions of the Fair Value Directive have been implemented as shown in the table below.

| Article | Objectives | Implementation | Responsibility |
|---|---|---|---|
| 1.1 | Allows Member States to permit or require the valuation of financial instruments, including derivatives, at fair value. | Regulation 8 of these Regulations implements this by permitting building societies to use fair value if they choose to do so. Regulation 8 inserts a new Part 6A into Schedule 7 of the Building Societies (Accounts and Related Provisions) Regulations 1998. | HM- Treasury |
| 1.2 | These articles provide for additional information to be provided in the notes to the accounts if the fair value method of valuation is not used in relation to certain financial instruments. | No further implementation necessary as Schedule 5 to the Building Societies (Accounts and Related Provisions) Regulations 1998 already requires such information to be provided. | HM- Treasury |
| 1.3 | An exemption from the disclosure in | The exemption does not apply | HM- Treasury |

[11] Directive 2001/65/EC of the European Parliament and Council amending Directives 78/660/EEC, 83/349/EEC and 86/635/EEC as regards the valuation rules for the annual and consolidated accounts of certain types of companies, banks and other financial institutions (OJ L283 of 27.10.2001).
[12] Directive 2003/51/EC of the European Parliament and of the Council amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings (OJ L178 17/07/2003).
[13] Fourth Council Directive of 25 July 1978 (78/660/EEC) on the annual accounts of certain types of companies (OJ L222/11 of 14.8.1978).
[14] Seventh Council Directive of 13 June 1983 (83/349/EEC) on consolidated accounts (OJ L193/1 of 18.7.1983).
[15] Council Directive of 8 December 1986 (86/635/EEC) on the annual accounts and consolidated accounts of banks and other financial institutions. OJ L372/1 of 31 December 1986.

| | | | |
|---|---|---|---|
| | notes provision inserted by article 1.2. | to building societies. | |
| 1.4 | A requirement for the directors' report to include the society's financial risk management policies and its exposure to various types of risk. | Regulation 10 of these Regulations implements this provision by amending Schedule 8 to the Building Societies (Accounts and Related Provisions) Regulations 1998. | HM- Treasury |
| 2 | This article imposes the same requirements that were imposed by article 1 for individual accounts, in relation to consolidated accounts. | The amendments made to the 1998 Regulations by regulation 8 of these Regulations apply to consolidated accounts of building societies as well as individual accounts and therefore implement this article | HM- Treasury |