EXPLANATORY MEMORANDUM TO
THE COMPANIES (REVISION OF DEFECTIVE ACCOUNTS AND REPORT) (AMENDMENT) REGULATIONS 2005

2005 No. 2282

1. This explanatory memorandum has been prepared by the Department of Trade and Industry and is laid before Parliament by Command of Her Majesty.

2. DESCRIPTION

2.1 The Companies (Revision of Defective Accounts and Report) Regulations 1990, SI 1990/2570 ("the 1990 Regulations") set out procedures for the voluntary revision of annual accounts, summary financial statements and directors' reports, but not the directors' remuneration report and the Operating and Financial Review (OFR). This Statutory Instrument establishes procedures for the voluntary revision of the directors' remuneration report and the OFR, and makes certain amendments to the procedures for revising summary financial statements.

3. MATTERS OF SPECIAL INTEREST TO THE JOINT COMMITTEE ON STATUTORY INSTRUMENTS

3.1 None.

4. LEGISLATIVE BACKGROUND

4.1 Section 245 of the Companies Act 1985 ("the 1985 Act") as recently amended[1] allows directors to revise their accounts, directors' report, directors' remuneration report and OFR where they consider that the original accounts or reports did not comply with the requirements of the 1985 Act. It also enables voluntary revision of summary financial statements even where the accounts and reports on which they are based are not being revised.

4.2 Section 245 gives the Secretary of State the power to make regulations providing for the application of the 1985 Act provisions where there is voluntary revision. The 1990 Regulations cover matters such as the method of revision, the functions of the auditors in relation to the revised documents and the steps directors should take to bring revisions to the attention of shareholders.

4.3 The 1990 Regulations deal with voluntary revision of annual accounts and directors' reports and of summary financial statements where the accounts and reports on which they

[1] By regulation 10 of the Companies Act 1985 (International Accounting Standards and Other Accounting Amendments) Regulations 2004 (S.I. 2004/2947) and regulation 14 of the Companies Act 1985 (Operating and Financial Review and Directors' Report etc) Regulations 2005 (S.I. 2005/1011).

are based have been revised. They do not deal with the directors' remuneration report and the OFR. These Regulations remedy that situation by establishing a regime for revision of the directors' remuneration report and the OFR. They also amend the provisions for revision of summary financial statements, to deal expressly with the situation where these need to be revised, but the full accounts and reports on which they were based do not, and provide that summary financial statements can be revised by way of a supplementary note as an alternative to issuing a revised full statement.

5. EXTENT

5.1 This instrument applies to Great Britain.

6. EUROPEAN CONVENTION ON HUMAN RIGHTS

6.1 No statement is required.

7. POLICY BACKGROUND

7.1 From time to time, companies may need to revise their accounts or reports, if they discover that these contain errors or in some way do not comply with the requirements of the 1985 Act. In order to encourage openness and transparency, section 245 of the 1985 Act explicitly permits voluntary revision. The 1990 Regulations set out procedures for voluntary revision, to ensure that companies are not discouraged from making voluntary revisions by uncertainty about how to do so, and to ensure consistency in the way it is done.

7.2 Although section 245 of the 1985 Act covers voluntary revision of the directors' remuneration report and the OFR, the 1990 Regulations do not. Therefore, companies proposing to make revisions to them currently face uncertainty as to how to proceed. These Regulations address this uncertainty by establishing a regime for revision of the directors' remuneration report and the OFR. This regime is closely based on the regime for revision of the accounts and directors' reports.

7.3 In addition, the Regulations make it clear how directors should proceed when summary financial statements need to be revised, but not the accounts or reports on which they are based. In response to comments from consultees, they also provide for the revision of summary financial statements by issuing a supplementary note rather than sending out a complete new version of the summary financial statement. This is the case for the full accounts and reports, and there is no reason why it should not also be possible for summary financial statements.

7.4 A public consultation was held on this issue in Spring 2005 (*Company Reporting: A consultation on extending use of summary financial statements and other minor changes, March 2005, URN 05/900*). Interest was largely confined to the accountancy bodies, major accountancy firms and a few large companies. This is essentially a minor technical reporting issue, so there was no media interest. Those who responded to the consultation were overwhelmingly in favour of the proposals on voluntary revision of defective accounts. A summary of responses can be found at www.dti.gov.uk/cld.

8. IMPACT

8.1 A Regulatory Impact Assessment is attached at Annex A.

8.2 There is no impact on the public sector as this Statutory Instrument only applies to companies.

9. CONTACT

Valerie Carpenter at the Department of Trade & Industry (telephone 020 7215 0225 or email valerie.carpenter@dti.gsi.gov.uk) can answer any queries regarding this Statutory Instrument.

FULL AND FINAL
REGULATORY IMPACT ASSESSMENT
ON VOLUNTARY REVISION OF
DIRECTORS' REMUNERATION REPORT & THE OPERATING AND FINANCIAL REVIEW

1. Proposal

1.1 To establish procedures for the voluntary revision of the Directors' Remuneration Report (DRR) and Operating & Financial Review (OFR). This has been implemented by the Companies (Revision of Defective Accounts and Report) (Amendment) Regulations 2005, which amends secondary legislation pursuant to the Companies Act 1985 (the 1985 Act).

2. Purpose and intended effect

Objective

2.1 The objective of the regulations is to establish procedures for the voluntary revision of the DRR and OFR. These changes are consequential to the changes made to the 1985 Act by the Directors' Remuneration Report Regulations 2002, SI 2002/1986 (the DRR Regulations) and the Companies Act 1985 (Operating and Financial Review and Directors' Report etc) Regulations 2005, SI 2005/1011 (the OFR Regulations). The regulations also make certain amendments to the procedures for revising summary financial statements (SFS) to deal expressly with the situation where these need to be revised but the full accounts and reports on which they were based do not, and to provide that SFS can be revised by way of a supplementary note.

2.2 The DRR Regulations and the OFR Regulations introduced requirements for the preparation of a DRR and OFR by quoted companies, and also established that directors may voluntary revise those reports should they be defective. The objective of this proposal is to bring the DRR and OFR within the scope of existing regulations that set out the detailed process to be followed in making a voluntary revision of accounts and directors' reports. This is considered necessary to address uncertainty as to how to proceed where directors wish to make voluntary revision.

Devolution

2.3 Company law matters relating to Scotland are reserved to the UK Parliament under the Scotland Act 1998. Those relating to Wales have not been transferred to the National Assembly for Wales under the Government of Wales Act 1998. Therefore any changes to company legislation will also apply in Scotland and Wales. Company law in Northern Ireland is a transferred matter under the Northern Ireland Act 1998. Whilst the Northern Ireland Assembly and Executive are suspended, these functions will be discharged by the Northern Ireland Departments, subject to the direction and control of the Secretary of State for Northern Ireland.

Background

Directors' Remuneration Report

2.4 The DRR Regulations came into force on 1 August 2002 and apply to quoted companies with financial years ending on or after 31 December 2002. The DRR Regulations require quoted companies to publish a DRR for each financial year. The report has to be divided into two main parts: one part containing information which is not subject to audit and which includes a policy section; and a part which is subject to audit and which includes detailed information about directors' remuneration. The DRR must include a detailed statement of the company's future policy on directors' remuneration and full details of each director's pay package for the financial year in question. Remuneration committee details must also be provided. The report must also include a performance line graph, which shows how the company has performed in comparison with an appropriate share market index over the past five years. By improving transparency and accountability, and by the disclosure of linkages to performance in the setting of directors' pay, the regulations are intended to strengthen the corporate governance framework in this area.

Operating and Financial Review

2.5 The OFR Regulations introduced a new requirement into the 1985 Act for directors of quoted companies to prepare an OFR for financial years beginning on or after 1 April 2005.

2.6 Directors of quoted companies are required to provide a balanced and comprehensive analysis of their business to shareholders, including the company's objectives, strategies and key drivers of the business. It will focus on more qualitative and forward-looking information than has traditionally been included in annual reports in the past.

2.7 The objective of the OFR is to increase good corporate governance by improving the quality, usefulness and relevance of information provided by quoted companies, thus improving the understanding of the business and its prospects and encouraging shareholders to exercise effective and responsible control.

SFS

2.8 The Companies Act 1989 introduced into the 1985 Act provisions allowing listed companies to send an SFS to assenting shareholders instead of the company's full accounts and reports. An SFS contains the key information from the company's annual accounts and is an optional, additional document. Companies must still prepare full accounts.

2.9 Previously, only listed public companies were permitted to prepare an SFS, but this option has been extended to all companies whose accounts are audited by the Companies (Summary Financial Statement) (Amendment) Regulations 2005.

Voluntary Revision

2.10 Voluntary revision of defective accounts and reports is explicitly permitted by the 1985 Act. The basic permission is included in primary legislation, and more detailed requirements as to how the 1985 Act's requirements are to apply to revised accounts and reports are set out in regulations - the Companies (Revision of Defective Accounts and Report) Regulations 1990, SI 1990/2570 (the 1990 Regulations).

2.11 The 1990 Regulations establish an approach under which a revision can be made either by replacement of the original accounts/reports or by supplementary note indicating corrections to be made to the original. The revised accounts/report should be prepared as if the preparation date is the same as the original (i.e. no adjustments should be made for later events). Certain statements should be included in the revised accounts/report or note to make clear that it replaces (or supplements) the original report, that it does not deal with events subsequent to the date of the original report, and to explain the defect(s) and amendment(s) made.

2.12 The 1990 Regulations also cover the audit requirements for revised accounts/reports, distribution to shareholders and other entitled persons, and filing with the registrar of companies.

2.13 An ability to make voluntary revisions is desirable for companies and for users of accounts and reports. Where defects are discovered, a voluntary revision regime enables directors to ensure that they have properly discharged their statutory obligations, and promotes greater accuracy of information provided to shareholders and placed on the public record. Revision also ensures that defects and corrective actions are brought to the attention of shareholders and other users of accounts and reports. The detailed provisions in legislation provide clarity to companies as to how to proceed.

Risk Assessment

2.14 Voluntary revision is relatively uncommon. In respect of accounts, data from Companies House filings indicates that approximately 0.5% of original accounts and reports are voluntarily revised (around 7,500 revised accounts were submitted in 2004, compared to 1.4 million accounts filed).

2.15 Extending the scope of the 1990 Regulations is considered to be a minor, consequential change. Whilst there is limited experience of voluntary revision of the DRR (and none of the statutory OFR), it is considered likely that a company would, in revising those documents, follow closely the procedures for accounts and directors' reports in the absence of specific guidance. The existing regime for voluntary revisions is well established and has, to the DTI's knowledge, operated without significant difficulty. However, without these changes, there is a risk that companies seeking to make voluntary revisions would face uncertainty. As a consequence, they are likely to spend more time deciding how to proceed and possibly incur higher costs in seeking professional advice.

3. Options

3.1 Two main options were considered.

Option 1: Do nothing

3.2 This option would mean that the procedures for revising defective DRRs and OFRs (and SFS in certain circumstances) would not be clear, and companies could spend more time deciding how to proceed and incur higher costs seeking advice.

Option 2: Make the consequential amendments

3.3 This option would establish with certainty the procedures for revising DRRs and OFRs (and SFS in certain circumstances), benefiting any company that has to make revisions. The process would follow well-established procedures for revising accounts and other reports.

4. Benefits

Option 1: Do nothing

4.1 There would be no benefits arising from this option.

Option 2: Make the consequential changes

4.2 This option will provide clarity and certainty to companies needing to revise their DRR or OFR (or SFS in certain circumstances) and is therefore likely to result in slightly lower costs in respect of internal time and professional advisers' fees. It is estimated (based on a revision rate error rate of 0.5%) that around 6 –7 OFRs and DRRs will be revised each year, and that the proposed clarification will result in cost savings of £500 to £1000 per revision. This implies savings of £6,000 to £14,000 per annum.

Business Sectors Affected

4.3 These regulations will potentially affect quoted companies in Great Britain. There are currently approximately 1300 GB quoted companies. It is not possible to say how many of these will at some time in the future voluntarily revise their DRR or OFR (or SFS in certain circumstances), although data based on revised accounts indicates a revision rate of around 0.5%. Extrapolating this to the DRR and OFR would mean around 6 or 7 voluntary revisions per annum.

Issues of Equity and Fairness

4.4 The Government considers that the provisions will not bring disproportionate benefits or have disproportionate effect on particular groups.

5. Costs

Compliance Costs

Option 1: Do nothing

5.1 There could be costs arising from this option, in terms of time spent deciding how to proceed with a revision and additional professional fees. Such costs are difficult to quantify but are likely to be relatively minor given the existing procedures for revising accounts and other reports. It is estimated that the costs would be incurred by only 6 or 7 companies per annum for each of the OFR and DRR (see paragraph 4.3 above).

Option 2: Make the consequential changes

5.2 There would be no costs arising from this option. The changes are clarificatory and consequential.

Other Costs

5.4 The DTI considers that these changes would not impose costs on any non-business sector.

Costs for a Typical Business

5.5 The DTI considers that these changes would not impose any costs on a typical business.

6. Consultation with small business: The Small Firm's Impact Test

6.1 These regulations will have no impact on small businesses. Such businesses are not required to prepare a DRR or an OFR, and have not been permitted to issue SFS (although they will be able to do so in future, few if any are likely to take up the option – see separate RIA on *Updating the Summary Financial Statements Regulations, URN 05/1398*).

7. Competition Assessment

7.1 The regulations have the potential to affect all companies that produce DRRs, OFRs and SFS. It is not anticipated that the regulations will: affect some of these businesses more than others; affect market structure; change the number or size of those businesses; lead to higher start-up costs for those businesses; or lead to higher on-going costs than at present.

8. Enforcement and Sanctions

8.1 In Great Britain there is already a well-regarded enforcement regime in place for ensuring that company financial statements meet the requirements of existing legislation. In addition to criminal penalties, the Financial Reporting Review Panel (FRRP) has legal authority to review companies' accounts and if necessary to go to court to compel a company to revise its accounts. The FRRP shares this responsibility with the Secretary of State. By administrative agreement, the FRRP deals with the accounts of public and large private companies, and the Secretary of State (through Companies House) with the rest.

9. Monitoring and Post-Implementation Review

9.1 Government officials will engage in ongoing post-implementation dialogue with stakeholders from business and the accountancy profession to confirm that the changes have achieved their intended effect.

9.2 The Regulations affect the accounting and reporting requirements for companies. Annual accounts and reports are prepared some months after the end of the accounting and reporting period. Several annual accounting and reporting cycles will need to elapse before it becomes clear whether the changes have achieved their intended effect. Therefore, it would not be sensible to carry out a review before late 2008/early 2009.

10. Consultation

Within Government

10.1 The proposals were discussed with officials at HM Treasury, the Financial Services Authority and the Department of Enterprise, Trade and Industry of Northern Ireland prior to public consultation.

Public Consultation

10.2 The legislative changes that introduced the DRR and the OFR were both the subject of extensive formal and informal consultation exercises in 2001 and 2004 respectively, *(Directors' Remuneration, December 2001, URN 01/1400 and Draft Regulations on the Operating and Financial Review and Directors' Report, May 2004, URN 04/1003).*

10.3 On 17 March 2005 the Department of Trade and Industry published a consultation document on this proposal. The consultation was announced by way of a press notice announcing wider company law reforms. Notice of the consultation was sent to approximately 1200 companies, professional bodies, representative organisations, and individuals. The consultation document was available to download from the Department's website, (http:www.dti.gov.uk/consultations), and photocopies were provided to those without internet access. The deadline for comments was 10 June 2005.

10.4 Twenty-five responses were received. These were overwhelmingly in favour of the proposals in Option 2. An additional enhancement to the voluntary revision regime was suggested – revision of summary financial statements by way of a supplementary note rather than having to send out another set of summary financial statements (as can already be done for full financial statements). The Government has incorporated this amendment into the regulations.

11. Implementation Plan

11.1 The Regulations will be laid in early August and will come into force on 1 October 2005, the next available common commencement date.

11.2 Guidance on the Regulations will be available on the DTI website when the Regulations are laid (www.dti.gov.uk/cld). It will be incorporated in *"Guidance for British Companies on Changes to the Accounting and Reporting Provisions of the Companies Act 1985"*, which was published in October 2004 to accompany the Companies Act 1985 (International Accounting Standards and Other Accounting Amendments) Regulations 2004 (SI 2004/2947). The new sections of the guidance will be flagged up so that users can easily identify them.

11.3 The usual three month period between regulations being made (and guidance being published) and coming into force has been shortened in this case because these Regulations are largely facilitative, and therefore do not have an immediate impact on companies.

12. Summary and Recommendation

12.1 The table below shows a summary of the costs and benefits of the proposal:

Option	Total cost per annum	Total benefit per annum
1. Do nothing	Possible additional time and professional fees for companies needing to revise DRR or OFR.	None
2. Make the proposed consequential amendments	**None**	Clarity and certainty for companies – quantifiable savings of £6k to £14k p.a.

12.2 The Government has implemented Option 2. It will provide clarity and certainty for companies needing to revise their DRR or OFR. They will be able to follow well-established existing procedures for revising accounts and other reports. Option 1 (do nothing) would have provided no benefits, and may have imposed additional costs on companies in more time spent preparing accounts and higher professional fees.

13. Declaration

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

SIGNED ……..

DATED ……..

GERRY SUTCLIFFE, PARLIAMENTARY UNDER-SECRETARY OF STATE (MINISTER FOR EMPLOYMENT RELATIONS AND CONSUMER AFFAIRS)

Any comments on this Regulatory Impact Assessment should be addressed to:

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