EXPLANATORY MEMORANDUM TO

THE COMPANIES ACT 2006 (ACCOUNTS, REPORTS AND AUDIT) REGULATIONS 2009

2009 No.

1. This explanatory memorandum has been prepared by the Department for Business, Enterprise and Regulatory Reform and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument amends Parts 15 and 16 of the Companies Act 2006[1] on accounts and audit. Its main purpose is to complete implementation of the EU Company Reporting Directive (Directive 2006/46)[2] by requiring filing at Companies House of, and an auditor's report on, corporate governance statements of publicly traded companies where the corporate governance statements are not included in the directors' report. The instrument also makes some technical amendments to other accounting provisions in Part 15 and regulations made under that Part.

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

3.1 None

4. Legislative Context

4.1 This instrument completes UK implementation of the requirements of Directive 2006/46 which made a number of amendments to the EC Accounting Directives. The bulk of that Directive was implemented by regulations which came into force on 6 April 2008[3] . A transposition note was prepared (an updated version of which is included at Annex A to this Memorandum) setting out how Directive 2006/46 is transposed into UK law.

4.2 Explanatory Memorandum OTNYR EM covering the proposal for Directive 2006/46/EC (2002/0112 (COD)) was submitted on 5 December 2002. The Commons European Scrutiny Committee considered it politically important and cleared it. The Lords Select Committee on the EU did not report on it (Progress of Scrutiny 21.12.02, session 02/03).

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[1] 2006 c.46.

[2] Directive 2006/46/EC of the European Parliament and the Council of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings (OJ L 224 of 16 August 2006, page 1).

[3] S.I.s 2008/393, 2008/409 and 2008/410.

4.3 Following consultation, the Government decided that the provisions of the Directive requiring the preparation of a corporate governance statement by certain publicly traded companies should be implemented by rules made by the Financial Services Authority (FSA). Those rules were made on 29 June 2008 having effect for financial years beginning on or after that date.[4] They implement articles 1.7 and 2.2 of the Directive which introduced a new requirement for companies whose securities are traded on an EC regulated market to prepare a corporate governance statement and include it as a part of the annual directors' report. Such companies have to disclose in the corporate governance statement whether they apply a corporate governance code and explain, as applicable, where they depart from that code. The corporate governance statement also contains disclosure requirements relating to internal control and risk management systems in relation to the financial reporting process, share capital and management structures.

4.4 Companies are given the option by the FSA rules (as permitted by the Directive) to prepare a separate corporate governance statement rather than to include it in the directors' report. The purpose of Part 2 of these Regulations is to implement the requirements of articles 1.7 and 2.2 of the Directive concerning the filing of that separate statement with the registrar of companies and the auditor's report on such a statement (where the statement is part of the directors' report the Companies Act provisions on filing and duties of the auditor with respect to the directors' report automatically apply). These provisions could not have been enacted at the same time as the 2008 regulations implementing the Directive because they are dependent on, and cross-refer to, the FSA rules which were not made until after the regulations. They are also subject to affirmative resolution procedure since they make the requirements of Part 15 of the Companies Act 2006 more onerous (section 473(3)(c)). The FSA rules apply for financial years beginning on or after 29 June 2008, and the amendments in Part 2 of the Regulations concern the auditor's report on, and publication of, the separate corporate governance statements after the year-end. Regulation 1(3) avoids any retroactive application to cover the (unlikely) eventuality that a company's financial year began on 29 June 2008 and ended before the date of coming into force of these Regulations.

4.5 The opportunity is also being taken in Part 3 of the Regulations to make some technical amendments to Part 15 of the Companies Act 2006 and regulations made under it.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

Ian Pearson, the Economic and Business Minister, has made the following statement regarding Human Rights:

[4] Annex C of the Disclosure Rules and Transparency Rules Sourcebook (Corporate Governance Rules) Instrument 2008 (FSA 2008/32).

In my view the provisions of the Companies Act 2006 (Accounts, Reports and Audit) Regulations 2009 are compatible with the Convention rights.

7. Policy background

- ***What is being done and why***

7.1 Part 2 of the Regulations deals with the filing of, and auditor's report on, corporate governance statements where they are separate and not part of the directors' report.

7.2 Corporate governance is the system by which companies are directed and controlled. The aim of Directive 2006/46 was not to adopt a European governance code: because of the differences in company law between Member states, such a code would have to either allow for many different options or confine itself to abstract principles. Instead the aim was to require publicly traded companies to publish annually a coherent, descriptive statement covering the key elements of their corporate governance structure and practices. The code applied in the UK is the Combined Code on Corporate Governance (The Combined Code). The Listing Rules[5] require a listed company incorporated in the UK to state how the company has applied the Code's Principles, and whether it has complied with the Code's Provisions, listing those Provisions that it has not complied with and explaining why not (the so-called "comply or explain" principle). The Combined Code is published by the Financial Reporting Council.

7.3 In accordance with the views of consultees, the Government decided to exercise the Member State option in the Directive to give companies the choice of either including the corporate governance statement in their directors' report or of publishing, at the same time and in the same manner as the directors' report, a separate corporate governance statement cross-referenced in the directors' report. The Government also decided to exercise the Member State option to require a corporate governance statement only of those companies with shares issued on an EU regulated market, rather than debt securities. These options were implemented in the FSA rules. The FSA rules could not, however, amend the Companies Act requirements on filing of documents with the registrar of companies and requirements on auditors. Part 2 of these Regulations therefore amends the Companies Act to complete implementation of the Directive requirements with regard to publication of, and auditors' reports on, corporate governance statements issued separately from the directors' report. What is being implemented is exactly what is required by the Directive. Where the corporate governance statement is a separate report and not part of the directors' report it must be filed with the registrar of companies.[6] The auditor must state in his report whether in his opinion the information required to be shown in the statement with regard to internal control and risk management systems in relation to the financial reporting process and with regard to certain disclosures about share capital required by the Takeovers Directive is consistent with the annual accounts for the year in question: the intention is that the auditor should only be required to check consistency with any relevant information contained in the financial accounts. For the remaining

[5] Listing Rules 9.8.6R

[6] Where the Corporate Governance Statement is part of the Directors' report, the filing and audit requirements are already contained in the Companies Act 2006.

information in the corporate governance statement, the auditor must check that the statement has been produced. This check is to ensure that prima facie a corporate governance statement has been produced and is not intended to be a check of the completeness and accuracy of such a statement. The regulations only require the auditor to do the same check of the above specified information in the corporate governance statement against the accounts as would be required if that same information was contained in a corporate governance statement which formed part of the directors' report.

7.4 Amendment of section 444A of the Companies Act 2006. Regulation 10 amends section 444A of the Act concerning the filing obligations of small companies with respect to the directors' report. The amendment removes a transitional provision requiring that a signed copy of the auditor's report be filed with the registrar of companies. From 1 October 2009 rules of the registrar of companies under Part 35 of the 2006 Act will determine how documents delivered to the registrar are authenticated.

7.5 Amendment of the Small Companies Accounts Regulations and Large and Medium-sized Companies Accounts Regulations made under Part 15 of the Companies Act. While both sets of Regulations specify what is meant by "provisions" for the purposes of various sections of the 2006 Act, in oversight we omitted to do so for the purposes of section 841 (realised losses and profits and revaluations of fixed assets). The amendments in Regulations 11 and 12 address that omission and also update a reference in the directors' remuneration report for quoted companies to a guidance note on pension transfer values which has now been superseded by new regulations which came into force on 1 October 2008.

7.6 A draft Statutory Instrument, with almost identical contents to this (The Companies Act 2006 (Accounts, Reports and Audit) Regulations 2009) was laid before Parliament in February 2009 but was withdrawn before being debated. This was in order to delete one of the regulations, numbered 10 in that Statutory Instrument, which would have amended s413(8) of the Companies Act 2006 which deals with disclosures in the notes to the accounts of banking companies of advances, credits and guarantees for the benefit of directors. The Government is considering the matter further.

8. Consultation outcome

8.1 There was a full public consultation on implementation of Directive 2006/46 in March 2007[7], followed by publication of the Government response to that consultation[8] and publication of draft regulations on the Department's website. The

[7] European Company Law and Corporate Governance. Implementation of Directive 2006/46/EC on Company Reporting – Amending the Accounting Directives: A Consultative Document. March 2007. URN 07/597.

[8] Corporate Governance and Europe. Implementation of Directive 2006/46/EC on Company Reporting – Amending the Accounting Directives: Government Response. July 2007. URN 07/1225/GR.

FSA also consulted on its rules[9]. Given this, and because the other (non-Directive) amendments are minor and technical in nature, these Regulations were published on the Department's web site, allowing 6 weeks for comment, instead of a full consultation. Because of the policy input from stakeholders in the drafting of the Regulations (the need for the amendment contained in Regulation 10 was drawn to our attention by a major accounting firm), only two responses were received and a meeting held with a further stakeholder.

9. Guidance

9.1 The Department will be publicising these Regulations to the professional legal and accounting bodies and major firms as well as to the Financial Reporting Council. The Auditing Practices Board may also publish guidance on the auditor's role in relation to corporate governance statements.

10. Impact

10.1 An Impact Assessment of the effect that the implementation of Directive 2006/46 will have on the costs of business, charities or voluntary bodies was previously prepared dated 4 December 2007. Copies are available from the Department for Business, Enterprise and Regulatory Reform, Corporate Law and Governance Directorate, 1 Victoria Street, London SW1. Copies have also been placed in the libraries of both Houses of Parliament. For this reason no further Impact Assessment has been produced for these Regulations.

10.2 There is no impact on the public sector.

11. Regulating small business

11.1 Regulations 10 and 11 apply to small businesses which have incorporated as companies, but lay no new burden on them.

12. Monitoring & review

12.1 This instrument will be reviewed, from 2011, as part of the Companies Act 2006 evaluation.

13. Contact

13.1 Rufus Rottenberg at the Department for Business and Regulatory Reform tel: 020 7215 0163 or email: rufus.rottenberg@berr.gsi.gov.uk can answer any queries regarding the instrument.

[9] Financial Services Authority. Implementation of the 8th Company Law Directive –Feedback on CP07/24 and final rules Pub Ref: 001473

Annex A

TRANSPOSITION NOTE

IMPLEMENTATION OF DIRECTIVE 2006/46/EC

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

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

No. 2008/409

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

No. 2008/410

The Companies Act 2006 (Amendment) (Accounts and Reports) Regulations 2008

No. 2008/393

The Companies Act 2006 (Accounts, Reports and Audit) Regulations 2009

Annex C of the Disclosure Rules and Transparency Rules Sourcebook (Corporate Governance Rules) Instrument 2008

FSA 2008/32

Transposition Notes

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

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

European Union accounting requirements are based primarily on the 4th, 7th, Bank Accounts and Insurance Accounts Directives. From 6th April 2008 UK implementation of those Directives will be in Parts 15 and 16 of the Companies Act 2006 ("the 2006 Act"), and regulations to be made under Part 15. The transposition of Directive 2006/46, which amends the accounting Directives and which must be transposed no later than 5th September 2008, therefore takes the form of amendments to the 2006 Act, and provisions of the regulations to be made under Part 15.

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

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
1.1	Amends **the Member State Option** in article 11 of the 4th Directive (applied to groups by article 6 of the 7th Directive) to increase the thresholds used to define small companies and groups for the purpose of certain accounting, reporting and audit exemptions. To qualify as small, a company or group is required to meet 2 of the 3 criteria in respect of balance sheet total, net turnover or employee numbers.	The criteria defining small companies in the UK are set out in sections 382 (3) and 477(2) of the 2006 Act. The criteria defining small groups are set out in sections 383 (4) and 479(2) of the 2006 Act.	Secretary of State
	The maximum financial thresholds are raised from EUR 3,650,000 to 4,400,000 in the case of balance sheet totals and EUR 7,300,000 to 8,800,000 in the case of net turnover – the average number of employees remains the same (50).	The financial thresholds for small companies and groups are amended in line with the Directive by regulations 3 and 5 in Part 2 of the Companies Act 2006 (Amendment) (Accounts and Reports) Regulations 2008.	
1.2	Amends the 4th Directive to provide for the financial thresholds used to define small companies in the 4th Directive to be increased by any Directive, and not just by a Directive implementing the formal 5 yearly review process previously provided for in article 53(2) of the 4th Directive.	No action necessary.	

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
1.3	Amends the **Member State Option** in article 27 of the 4th Directive (applied to groups by article 6 of the 7th Directive) to increase the financial thresholds used to define medium-sized companies and groups. To qualify as medium-sized, a company or group is required to meet 2 of the 3 criteria in respect of balance sheet total, net turnover or employee numbers. The maximum financial thresholds are raised from a balance sheet total of EUR 14,600,000 to17, 500,000 and net turnover EUR 29,200,000 to 35,000,000 - the average number of employees remains the same (250).	The criteria defining medium-sized companies are set out in section 465 (3) of the 2006 Act. The criteria defining medium-sized groups are set out in section 466 (4) of the 2006 Act. The financial thresholds are amended by regulation 4 in Part 2 of the Companies Act 2006 (Amendment) (Accounts and Reports) Regulations 2008.	Secretary of State
1.4	Amends the 4th Directive to provide for the financial thresholds used to define medium-sized companies in the 4th Directive to be increased by any Directive, and not just by a Directive implementing the formal 5 yearly review process previously provided for in article 53(2) of the 4th Directive.	No action necessary.	

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

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

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
	New article 43(7b) imposes a **requirement** to disclose transactions entered into with related parties as defined in international accounting standards adopted in accordance with EC Regulation 1606/2002. Information may be aggregated unless separate information is necessary for understanding the impact of transactions on the company.	Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 - Schedule 1 paragraph 72 (non-banking or insurance companies), Schedule 2 paragraph 92 (banking companies), and Schedule 3 paragraph 90 (insurance companies).	
	Member State option to exempt small companies from the disclosure requirement.	Option exercised. No requirement for small companies to make the disclosure.	
	Member State option to exempt medium-sized companies which are not public companies from the disclosure requirement.	Option exercised in regulation 4(2)(b) of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008	

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
1.7	Inserts a new article 46a into the 4th Directive. This imposes a **requirement** for companies whose securities are traded on a regulated market to produce a corporate governance statement either as a separate part of their annual (directors') report, or as a separate statement. The statement must cover- a. The corporate governance code applying to the company. b. Departures from the code and an explanation of the reasons for doing so. c. A description of main features of the company's internal control and risk management systems in relation to the financial reporting process. d. Certain matters related to the company's shares and control structures already required by Directive 2004/25/EC (the Takeovers Directive) e. The operation of the shareholder meeting and key powers and description of shareholders rights and how they are exercised unless information is already fully provided for in national laws or regulations f. The composition and operation of the board of directors and its committees.	Annex C of the Disclosure Rules and Transparency Rules Sourcebook (Corporate Governance Rules) Instrument 2008 (FSA2008/32) made by the Financial Services Authority under Part 6 of the Financial and Market Services Act 2000 as amended by section 1269 of the 2006 Act (corporate governance rules).	Financial Services Authority

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
	Article 46a.2 contains a **Member State Option** to permit information to be set out in a separate report published with the annual report by means of a reference in the annual report to where such document is publicly available on the company's website. In the event of a separate report the corporate governance statement may contain a reference to the annual report where information is required at point d above. There is a requirement for a statutory auditor to express an opinion concerning the consistency with information in the annual report and accounts for the same financial year in the case of points c and d. For remaining information the statutory auditor shall check that the corporate governance statement has been produced.	Option implemented in the FSA rules referred to above and by Part 2 of The Companies Act 2006 (Accounts, Reports and Audit) Regulations 2009 Section 496 of the 2006 Act (auditor's report on directors' report) and sections 497A and 498A as inserted by Part 2 of The Companies Act 2006 (Accounts, Reports and Audit) Regulations 2009.	Financial Services Authority (FSA rules) and Secretary of State (Companies Act Regulations) Secretary of State
	Includes a **Member State Option** to permit companies issuing securities other than shares, admitted to trading on a regulated market, to be exempt from provisions a, b, e and f.	Option implemented in the FSA rules referred to above.	Financial Services Authority

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
1.8	A new Section 10A is inserted into the 4th Directive. New Article 50b imposes a **requirement for** Member States to ensure that the directors have collective responsibility for drawing up and publishing accounts and reports, and the corporate governance statement when provided separately.	Part 15 (Accounts and Reports) of the 2006 Act covers specific responsibilities in respect of accounts and reports: Chapter 4 – collective duty to prepare accounts (sections 394, 399); approval and signing	Secretary of State
		of accounts (section 414) and criminal penalties for failure to comply (section 414(4) and (5)). Chapter 5 – collective duty to prepare directors' report (section 415); approval and signing of directors' report (section 419) and criminal penalties for failure to comply (section 415(4) and (5), section 419(3) and (4)).	

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
	New article 50c imposes a **requirement on** Member States to ensure that their laws, regulation and administrative provisions on liability apply to the administration, management and supervisory bodies of a company for a breach of the duty referred to above at least towards the company.	Chapter 10 – duty to file accounts and reports with registrar of companies, with criminal and civil penalties for non-compliance (sections 451 to 453). Chapter 11 – provisions for civil enforcement of accounting and reporting requirements, which may result in a court order against the directors (section 456).	
1.9	**Requires** that Member States exclude companies trading on a regulated market from the exemptions permitted for small and medium-sized companies.	Sections 384, 467 and 478 of the 2006 Act.	Secretary of State
1.10	**Requires** that Member States lay down rules on penalties applicable to infringements of national provisions adopted pursuant to the Directive.	See the notes against article 1.8 above.	Secretary of State

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
2	Applies provisions set out in Article 1 of the Directive to the 7th Directive on consolidated accounts.	Section 410A(5) inserted by regulation 8 of the Companies Act 2006 (Amendment) (Accounts and Reports) Regulations 2008. Provisions on individual accounts in the regulations made under Part 15 of the 2006 Act are applied to consolidated accounts by- regulation 8 of, and Schedule 6 to, the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008; and Regulation 9 of, and Schedule 6 to, the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. New article 36(2)(f) of the 7th Directive implemented by FSA rules (see entry for Article 1.7 above).	Secretary of State

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
3	Applies the provisions in Article 1 of the Directive to the Bank Accounts Directive covering the annual and consolidated accounts of banks and other financial institutions.	See the notes against Articles 1 and 2 above. For those banking undertakings not governed by the 2006 Act, implementation is by means of the Bank Accounts Directive (Miscellaneous Banks) Regulations 2008 (S.I. 2008/567).	Secretary of State and Financial Services Authority
4	Applies the provisions in Article 1 of the Directive to the Insurance Accounts Directive covering the annual reports and accounts of insurance undertakings.	See the notes against Articles 1 and 2 above. For those insurance undertakings not governed by the 2006 Act, implementation is by means of the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008 (S.I. 2008/565).	Secretary of State and Financial Services Authority

Article of Directive 2006/46/EC	Objective of Article	Implementation	Responsibility
5	Requires that the relevant provisions of the Directive be transposed no later than 5 September 2008. Details of transposition shall be communicated to the Commission.	Parts 15 and 16 of the 2006 Act, and the 2008 regulations referred to above in this Table, came into force on 6th April 2008, and apply to financial years beginning on or after that date. The FSA rules came into force on 29 June 2008 applying to financial years beginning on or after that date. Details of transposition measures have been communicated to the EU Commission by administrative process.	Secretary of State and Financial Services Authority
6	Provides that the Directive comes into force on 5 September 2006.	No action necessary.	
7	Addresses the Directive to the Member States.	No action necessary.	