

## **EXPLANATORY MEMORANDUM TO THE PARLIAMENT**

### **FRIENDLY SOCIETIES ACT 1992 (INTERNATIONAL ACCOUNTING STANDARDS AND OTHER ACCOUNTING AMENDMENTS) ORDER 2005**

**2005 No. [XXXX]**

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 Friendly Societies Act 1992 ("the 1992 Act") to:

- permit friendly societies to use International Accounting Standards (IAS) rather than domestic accounting requirements;
- ensure that the use of IAS is fully accommodated within the 1992 Act; and
- update accounting and reporting 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 The Order is made under section 102 of the Friendly Societies Act 1992 which is a power to amend certain provisions of the Act if statutory provisions relating to companies have been modified and it is expedient to amend the Act in order to assimilate the law relating to friendly societies to the law relating to companies. Section 102(4) provides that an order under section 102 may make consequential amendments in other provisions of the Act.

- 3.2 Sections 69J and 69K and new Schedules 13D and 13E are consequential to new sections 69A and 69E. These additions to the Act move provisions that are currently in secondary legislation and apply to all friendly societies, into the Act to ensure that they continue to apply to all friendly societies. The amendments are necessary because new sections 69A and 69E of the 1992 Act permit societies to choose whether to prepare their individual and group accounts in accordance with International Accounting Standards or whether to prepare those accounts in accordance with sections 69B and 69F and regulations made under those sections. As friendly societies that choose to use IAS to prepare their accounts will no longer have to comply with regulations made under the Act regarding the contents of the notes to their accounts it is necessary to move some of the requirements from regulations made under Part 6 of the Act into the Act itself.

#### **4. Legislative Background**

- 4.1 The Statutory Instrument is being made to:

- ensure the effective application for friendly societies of the EU Regulation on International Accounting Standards<sup>1</sup> (the “IAS Regulation”) and to implement Member State options in that Regulation
  - implement parts of the Modernisation of Accounting Directives<sup>2</sup> (the “Modernisation Directive”) for friendly societies
- 4.2 The **IAS Regulation** requires 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 EU (which “issues listed securities”) to prepare their consolidated accounts on the basis of accounting standards issued by the International Accounting Standards Board (IASB) and subsequently adopted by the European Commission. For the purpose of the IAS Regulation, the definition of companies **includes** friendly societies.
- 4.3 The IAS Regulation applies directly to those friendly societies caught by it (i.e. those that issue listed securities and which are required to produce consolidated accounts) and strictly speaking does not need to be implemented in domestic legislation as it is directly applicable. However, certain changes to the 1992 Act are necessary to ensure that the Regulation is fully effective and that friendly societies are able to use IAS either when the Regulation requires them to or if they choose to use IAS.
- 4.4 The IAS Regulation also permits Member States to extend use of IAS to the individual accounts of friendly societies that issue listed securities and to the individual and consolidated accounts of other friendly societies. This option has been taken up.
- 4.5 The **Modernisation Directive** aims to enable undertakings to follow modern, more transparent accounting practices that are consistent with IAS. It will apply to those undertakings which are not required to or which have chosen not to use IAS.
- 4.6 The Modernisation Directive does this 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
- 4.7 This Order has adopted the same approach to implementation of the IAS Regulation and the Modernisation Directive as that taken for companies by the Companies Act 1985 (International Accounting Standards and Other Accounting Amendments) Regulations 2004<sup>3</sup>. Those Regulations give effect to the IAS Regulation and implement the Modernisation Directive for **companies**. A separate Explanatory Memorandum has been produced for those Regulations.
- 4.8 The IAS Regulation and the Modernisation Directive had an implementation deadline of 1 January 2005. Although the statutory instrument has been laid following this date, it applies to financial years of friendly societies ending on or after 1<sup>st</sup> October 2005,

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<sup>1</sup> Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002. OJ L243/1 of 11 September 2002.

<sup>2</sup> Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 83/349/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 2000

<sup>3</sup> S.I. 2004/2947.

thus capturing the same financial year that began on 1 January 2005. As no friendly societies will be directly required to comply with the IAS Regulation (as no friendly societies currently have any securities traded on regulated markets) and as the Modernisation Directive is largely permissive, the impact of later implementation on friendly societies is not significant.

4.9 The Government's approach to the IAS Regulation and the Modernisation Directive has been to ensure that the UK's obligations are met whilst allowing flexibility without imposing unnecessary burdens on friendly societies. In addition, we have sought to ensure that there is consistency between companies and friendly societies, where appropriate. Transposition Notes for the IAS Regulation and the Modernisation Directive are attached in Annexes A1 and A2 respectively.

4.10 Scrutiny of the IAS Regulation:

- DTI Explanatory Memorandum 6365/01 was submitted on 16.03.01. Commons European Scrutiny Committee considered it not legally or politically important and cleared it (Report No. 1, Item 22162, Session 00/01). Lords Select Committee on the EU did not report on it (Progress of Scrutiny 13.04.01, Session 00/01).

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).

## **5. Extent**

5.1 This instrument applies to all of the United Kingdom.

## **6. European Convention on Human Rights**

6.1 The Economic Secretary to the Treasury, Ivan Lewis, has made the following statement under section 19(1)(a) of the Human Rights Act 1998:

In my view the provisions of the Friendly Societies Act (International Accounting Standards and Other Accounting Amendments) Order 2005 are compatible with the Convention rights.

## **7. Policy background**

7.1 During 1999, the European Commission published a communication on "*Financial Services: Implementing the Framework for Financial Markets: Action Plan*". In March 2000, Ministers of Member States at the Lisbon European Council concluded that, in order to accelerate completion of the internal market for financial services, steps should be taken to enhance the comparability of companies' financial statements by 2005. The IAS Regulation is the main result of this decision.

- 7.2 The IAS Regulation introduces important changes in the way companies across the EU and other undertakings such as friendly societies prepare their financial statements. It will apply directly to the consolidated accounts of EU undertakings that issue listed securities. The Government welcomes the adoption of the Regulation and strongly supports the European move to use IASB standards. Global markets require high quality globally agreed accounting standards to work more effectively. Where companies and friendly societies issue listed securities, adherence to global accounting standards should help to reduce the cost of capital by making their accounts more accessible to potential investors across the EU and worldwide. For potential investors, creditors and other users of financial statements, global standards provide a single means by which to compare performance and prospects on a like-for-like basis. Global standards should also help to promote financial stability.
- 7.3 The Government has therefore decided that where friendly societies issue listed securities, they should also be permitted to use IAS for their individual accounts, and that all other friendly societies should be permitted to use IAS for their individual and/or consolidated accounts. Ministers have decided to extend the use of IAS on a permissive rather than mandatory basis because of the potential burden it could impose. This will enable friendly societies to choose to move to IAS when the circumstances are appropriate. However, the ultimate aim is to have a single accounting regime, which will provide greater consistency and transparency. The position will be reviewed around 2008 to see if the time is right to move to mandatory use of IAS.
- 7.4 There is considerable interest in the move to IAS among larger companies and the specialised business and accountancy press, but less interest among friendly societies and the general media. There is a general view that IAS is the way forward. In July 2004, a consultation document was published by the Her Majesty's Treasury on details of the IAS Regulation and the Modernisation Directive. All respondents broadly supported the proposals and the policy that there should be a level playing field between companies and friendly societies. Further details can be found in the summary of responses at [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk) or in the RIA attached at Annex B1.
- 7.5 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 IAS Regulation). In general, the Modernisation Directive amendments are technical amendments to existing accounting requirements.
- 7.6 Directives are not directly applicable in Member States and must be implemented through national law. The Government's general approach to implementing the Modernisation Directive is to facilitate greater convergence between UK accounting standards and IAS, without imposing unnecessary burdens. Those who responded to the July 2004 consultation were largely supportive of the proposals.

## **8. Impact**

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

- IAS Regulation Annex A1
- Modernisation Directive Annex A2

8.2 Regulatory Impact Assessments are attached to this Explanatory Memorandum as follows:

- IAS Regulation Annex B1
- Modernisation Directive Annex B2

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

## **9. Contact**

9.1 Nigel Fawcett at HM Treasury (Tel: 020 7270 4314) or email: [nigel.fawcett@hm-treasury.gov.uk](mailto:nigel.fawcett@hm-treasury.gov.uk) can answer any queries regarding the instrument.