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Guidance on accounting and reporting requirements of the Companies Act 2006

DBERR have issued an excellent publication, "Guidance for UK Companies on Accounting & Reporting – Requirements under the Companies Act 2006 and the Application of the IAS Regulation, June 2008", available from www.berr.gov.uk/files/file46791.pdf

The main changes to the accounting requirements applicable to accounting periods commencing on or after 6 April 2008 are:

- The threshold for disclosure in the directors' report of political donations and expenditure and charitable donations has been raised from £200 to £2000. A new disclosure requirement for donations to independent election candidates has been introduced.
- The option to include financial instruments in the accounts at fair value has been extended to cover any financial instrument that could be included under IAS adopted by the EU on or before 5 September 2006, provided that the necessary disclosures required by IAS are made.
- The circumstances in which a company that has chosen to prepare its individual accounts using IAS rather than UK GAAP can switch back to UK GAAP have been extended to allow a company to switch back if it ceases to be a subsidiary undertaking.
- The financial thresholds under which companies can qualify as small or medium-sized and under which small companies can qualify for exemption from audit have been increased. The limits for small companies and groups are turnover £6.5m net/£7.8m gross (from £5.6m/£6.72m) and total assets £3.26m net/£3.9m gross (from £2.8m/£3.36m). The limits for medium-sized companies/groups are turnover £25.9m net/£31.1m gross (from £22.8m/£27.36m) and total assets £12.9m net/£15.5m gross (from £11.4m/£13.36m).
- The exemption for medium-sized companies from disclosing turnover in abbreviated profit and loss accounts delivered to the registrar of companies has been removed, although there is still exemption from disclosing detailed particulars of turnover in the notes to the abbreviated accounts.
- There is a new requirement for large and medium-sized companies to disclose in the notes to the accounts the nature and business purpose of any off-balance sheet arrangements, and for large companies to disclose the financial impact of these on the company (see below for more detail).
- There is a new requirement for large companies to make certain disclosures in the notes to the accounts about transactions with related parties (as defined in IAS 24) where these are material and have not been concluded under normal market conditions.
- There is a new requirement for quoted companies to report in their directors' remuneration report on how they have taken pay and employment conditions elsewhere in the company or group into account when setting directors' pay.
- The regulations on Summary Financial Statements ("SFS") make specific provision for small companies that may wish to prepare SFS.

- The regulations on SFS and defective accounts reflect the new provisions in section 146 of the 2006 Act on nomination of persons to enjoy information rights.

Disclosure of off-balance sheet arrangements

Section 410A of the Companies Act requires large and medium-sized companies to disclose in the notes to the accounts the nature and business purpose of any off-balance sheet arrangements, where the risks or benefits arising from those arrangements are material, to the extent necessary for an assessment of a company's financial position. Large companies must also disclose the financial impact of these arrangements on the company, again to the extent necessary for an assessment of a company's financial position.

The Companies Act 2006 does not contain a definition of 'off-balance sheet arrangement'; neither does EU Directive 2006/46 which underlies this requirement. However Directive 2006/46 does give some examples of the types of transaction that may be covered by this disclosure requirement in Recital 9.

"(9) Such off-balance-sheet arrangements could be any transactions or agreements which companies may have with entities, even unincorporated ones, that are not included in the balance sheet. Such off-balance-sheet arrangements may be associated with the creation or use of one or more Special Purpose Entities (SPEs) and offshore activities designed to address, inter alia, economic, legal, tax or accounting objectives. Examples of such off-balance-sheet arrangements include risk and benefit-sharing arrangements or obligations arising from a contract such as debt factoring, combined sale and repurchase agreements, consignment stock arrangements, take or pay arrangements, securitisation arranged through separate companies and unincorporated entities, pledged assets, operating leasing arrangements, outsourcing and the like. Appropriate disclosure of the material risks and benefits of such arrangements that are not included in the balance sheet should be set out in the notes to the accounts or the consolidated accounts."

The ASB's Urgent Issues Task Force has been asked to give guidance on what is meant by an 'off-balance sheet arrangement' but have felt unable to issue an Abstract because of the lack of a definition in the Companies Act 2006 and Directive 2006/46. They have however made the following points:

- When a company provides disclosures in accordance with s410A it should consider the types of transactions envisaged by the EC (as quoted above) and the aim of the legislation;
- S410A applies only where, at the balance sheet date, the risks or benefits arising from arrangements are material;
- disclosure need only be given to the extent necessary for enabling the financial position of the company to be assessed; and
- some Financial Reporting Standards, for example FRS 5 'Reporting the substance of transactions' and SSAP 21 'Accounting for leases and hire purchase contracts', require disclosures that address items not necessarily included in the balance sheet. Consequently companies are already required to provide some disclosures regarding off-balance sheet arrangements. Companies will, in addition, need to consider whether arrangements outside of the scope of these standards require disclosure in accordance with s410A.

FRRP to review qualified accounts of companies within its remit

The FRRP have announced that they have arranged to be notified of qualified audit reports on companies falling within their remit where the qualification arises from non-compliance with accounting standards or the Companies Act. The following fall within their remit:

- PLCs
- companies within a group headed by a PLC
- any private company not qualifying as small or medium-sized under the Companies Act
- any private company within a group which does not qualify as a small or medium-sized group.

The FRRP will write to the companies concerned, drawing attention to the directors' responsibilities under the Companies Act to prepare accounts that comply with the law and accounting standards. The FRRP will tell directors that, at this stage, it will not be opening an enquiry into the accounts which have caused it to write, but that it will review their next set of accounts and will take appropriate action in accordance with its operating procedures if the qualification remains.

The FRRP has power to apply to the court for an order seeking the revision of defective accounts. To date the FRRP has managed to agree appropriate resolution of issues raised with companies without recourse to court action. However the FRRP will be pointing out to directors that if the FRRP is successful in obtaining an order of the court requiring directors to prepare revised accounts it is open to the court to order that the costs of the action and the revision should be paid by the directors personally if they were party to the approval of the defective accounts.

This is a major extension of the work of the FRRP and means that their work will not be limited to quoted or public interest entities only.

Relevance of 'True & Fair' concept confirmed

The FRC have published an opinion by Martin Moore QC that confirms the continuing relevance of the "true and fair" concept to the preparation of audited financial statements following the enactment of the Companies Act 2006 and the introduction of IFRS.

In his opinion, Mr Moore endorses the previous opinions of Lord Hoffman and Dame Mary Arden and confirms the centrality of the true and fair requirement to the preparation of financial statements in the UK, whether they are prepared under UK GAAP or IFRS.

Directors must consider whether, 'taken in the round' the financial statements they approve are appropriate. Similarly, auditors are required to exercise professional judgement before expressing an audit opinion. Consequently, it will not be sufficient for either directors or auditors to reach a conclusion that the accounts are true and fair solely because they were prepared in accordance with applicable accounting standards.

Revisions to APB Ethical Standards

The APB has issued revised Ethical Standards which apply to audits of periods commencing on or after 6 April 2008.

There have been no major changes to the Standards. The key changes are:

- **Networks:** the definition and requirements for network firms have been aligned with the definition included in the current IFAC Code of Ethics. This requires network firms to be independent of each other's clients. Networks have to have global policies and procedures designed to comply with these requirements. Audit firms are required to implement revisions to their policies and procedures by 30th September 2008
 - **Relationships:** easing of requirements relating to inconsequential business relationships and financial interests for partners not involved in the audit
 - **Cooling off periods:** additional requirements regarding 'cooling off' periods when partners join their audit clients
 - **Staff loan assignments:** additional requirements that staff loan assignments should be short and not used to do anything ES 5 (Non-audit services provided to audited entities) would prohibit
 - **Key audit partner:** widening the scope of key audit partner (now called key partner involved in the audit) to include those primarily responsible for the audit of significant affiliates, even if not operating at group level
 - **Audit fees:** inclusion of a new requirement that audit fees should not be influenced by the provision of non-audit services to the audit client
 - **Informed management:** extended discussion of management decisions and clarification about what 'informed management' means.
 - **Valuations:** extended discussions on what valuations are and a prohibition on auditors providing valuation services to listed clients where the valuation is material and impacts on the accounts
 - **Tax accounting:** prohibition on providing tax accounting entries to listed entity audit clients
 - **Contingent fees:** changes in corporate finance contingent fee wording
 - **Exemption limits in ES-PASE:**
 - Alignment of small company exemption limit with that in the Companies Act
 - A reduction in the exemption for pension fund audits entitled to apply the ES-PASE, to those with less than 100 members (from those with less than 1000 members). This was not included in the original consultation but was apparently requested by The Pensions Regulator.
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FRSSE Updated for Companies Act 2006

The Accounting Standards Board (ASB) has issued an updated version of the FRSSE, 'FRSSE (Effective April 2008)' to reflect changes in company law arising from the Companies Act 2006. No changes are being made to the requirements that are based upon Generally Accepted Accounting Practice.

The updated FRSSE applies to accounting periods beginning on or after 6 April 2008; the date from which the accounting and reporting regime for smaller companies in the 2006 Act becomes effective. Early adoption is not permitted; hence smaller companies should continue to use the FRSSE (Effective January 2007) for earlier accounting periods.

The main impact of the 2006 Act is to set out the accounting and reporting requirements for small companies in a separate regulation. This is largely a tidying-up exercise with few substantive changes being made. Where changes have been made, the most significant are:

- increased thresholds for companies and groups to qualify as small;
- revised scope to reflect amended eligibility criteria (limiting the scope for small investment firms and entities such as e-money issuers to use the FRSSE);
- a new requirement to disclose details of any liability limitation agreement (where the accounts subject to audit);
- there is no longer a requirement for the disclosure of authorised share capital;
- revised text for transactions with directors – 'Loans, quasi-loans, credit transactions and guarantees' are now referred to as 'Advances, credit and guarantees';
- a new requirement for separate disclosure of 'political' donations and expenditure' and 'charitable donations'. The threshold for reporting these donations in the directors' report has increased to £2,000 (from £200); and
- a new requirement for disclosures in the directors' report regarding independent election candidates.

Auditors Liability – Recent Case

The Court of Appeal came to an important decision in the Stone & Rolls Ltd v Moore Stephens case which is good news for auditors.

In overturning a High Court decision, the Court of Appeal decided that a company which had committed fraud could not claim against its auditors for failings to detect and report that fraud.

Stone & Rolls Ltd was owner-managed and hence the company itself would have knowledge of the fraud and was therefore not a victim of the fraud perpetrated on a third party (a bank). There was no question of any duty of care being owed directly to the bank by the Auditors.

Auditors and their insurers can be reassured that companies which are, in fact, "villains" rather than "victims" cannot bring claims against their auditors which rely on their own fraud. The confirmation that the court has no option but to put a stop to such claims is to be welcomed. Mummery LJ was forthright in his views in striking out what he described as "an astounding claim" which threatened to turn "the world upside down". He added that auditors owed no duty to take reasonable care to detect the fraud of a fraudster company which was party to, and not a victim of, the fraud.

Changes to Solicitors Accounts Rules

The Solicitors Regulatory Authority ("SRA") has issued some minor revisions to the Solicitors Accounts Rules 1998. The main changes are:

- the SAR applies to deputies under the Court of Protection Rules 2007 and continues to apply to people appointed as receivers under the old regime.
- the Rules have been amended from 14 July 2008 to introduce specific obligations to return client money promptly, as soon as there is no longer any proper reason to retain funds. The new Rule 15(3) does not apply to the return of surplus funds whilst the matter is ongoing.

New Rule 15(4) will require a solicitor to inform a client promptly of the amount of any funds retained at the end of a matter and the reason for that retention. There is also an obligation to report in writing to the client at least annually if such funds continue to be retained with an explanation for the ongoing retention.

Under an amended Rule 22, solicitors will have the option to withdraw from client account left over balances of £50 or less without prior SRA authority, subject to paying the balance to a charity and complying with the other safeguards in new Rule 22(2A). Left over balances that represent costs of less than £50 still require SRA approval to be withdrawn.

Solicitors wishing to take advantage of the changes to Rule 22 will need to set up appropriate internal procedures to ensure compliance with the new Rule.

Small Charities Accounts and Audits

For financial years beginning on or after 1 April 2008 Small Charitable companies will be subject to the same rules as charitable trusts under the Charities Act 2006 (Charitable Companies Audit & Group Accounts Provisions) Order 2008 (SI 2008/S27).

These changes do not apply to registered social landlords.

Charitable Companies will have to file their accounts with the Charities Commissions (attached to the Annual Report), and the same audit and Independent Examination rules will apply to both Charitable Companies and Charitable Trusts.

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