EXPLANATORY MEMORANDUM TO THE

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

2005 No. 2211

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[1] (the "IAS Regulation") and to implement Member State options in that Regulation
- implement parts of the Modernisation of Accounting Directives[2] (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[3]. 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 1st October 2005,

[1] Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002. OJ L243/1 of 11 September 2002.
[2] Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349EEC, 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 200
[3] 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 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) can answer any queries regarding the instrument.

ANNEX A1

IMPLEMENTATION OF THE INTERNATIONAL ACCOUNTING STANDARDS REGULATION [4] IN RELATION TO FRIENDLY SOCIETIES – A TRANSPOSITION NOTE

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

Introduction

1. The Friendly Societies Act 1992 (International Accounting Standards and Other Accounting Amendments) Order 2005 amends the Friendly Societies Act 1992 ("the 1992 Act") in order:

- to ensure the effective application of the IAS Regulation
- to exercise Member State options conferred by Article 5 of the IAS Regulation.

3. Under Article 4 of the IAS Regulation, friendly societies whose securities are admitted to trading on a regulated market in any Member State of the European Union, will be required to prepare their consolidated accounts on the basis of international accounting standards ("IAS") issued by the International Accounting Standards Board (IASB) that are adopted by the European Commission. This will apply to financial years commencing on or after 1 January 2005 and is directly applicable in the UK.

4. Under Article 5 of the IAS Regulation, Member States may extend use of adopted IAS on a permissive or a mandatory basis to the individual accounts of undertakings subject to Article 4, and to the individual and consolidated accounts of other undertakings. The Government has decided that friendly societies, like GB companies, will be permitted to choose whether to prepare their accounts using adopted IAS or continue to prepare their accounts in accordance with the 1992 Act, regulations made under the Act and UK Generally Accepted Accounting Practice (UKGAAP).

Transposition Details: The IAS Regulation

In all cases responsibility for measures taken to give full effect to the IAS Regulation and to implement the options in it lies with Her Majesty's Treasury.

Article	Objectives	Implementation
5	It firstly provides that Member States may permit or require the undertakings governed by Article 4 to prepare their individual accounts in accordance with adopted IAS. It secondly provides that Member States may permit or require other undertakings to prepare their consolidated accounts and/or their individual accounts in accordance with adopted IAS.	Article 2 of the Friendly Societies Act 1992 (International Accounting Standards and Other Accounting Amendments) Order 2005 ("the Order"), inserts new sections 69A to 69I into the 1992 Act. Section 69A permits all friendly societies to prepare individual accounts either in accordance with adopted IAS or in accordance with the Act and UK GAAP. New section 69E permits friendly societies which are not obliged to prepare their consolidated accounts in

[4] Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (O.J. No. L243/1 of 11 September 2002) ("the IAS Regulation").

		accordance with IAS to do so if they wish. New sections 69D and 69H require disclosure in the notes to the accounts where individual or group accounts respectively are prepared in accordance with adopted IAS. New section 69I makes provision for consistency of accounts within a group. Article 7 of and the Schedule to the Order make consequential amendments to the 1992 Act to ensure the full effectiveness of Article 4 and of the exercise of the Member State options in Article 5

ANNEX A2

IMPLEMENTING THE MODERNISATION OF ACCOUNTS DIRECTIVE 2003/51/EC [5] IN RELATION TO FRIENDLY SOCIETIES – A TRANSPOSITION NOTE

THE FRIENDLY SOCIETIES (ACCOUNTS AND RELATED PROVISIONS) (AMENDMENT) REGULATIONS 2005; and

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

Introduction

1. These statutory instruments implement the Modernisation of Accounts Directive in relation to friendly societies. The Friendly Societies (Accounts and Related Provisions) (Amendment) Regulations 2005 implement the parts of the Directive that require amendments to be made to the existing accounting regulations. The rest of the Modernisation of Accounts Directive is being implemented by an Order amending the Friendly Societies Act 1992, the Friendly Societies Act 1992 (International Accounting Standards and Other Accounting Amendments) Order 2005. This is a full transposition note for the Directive, providing cross-references both to the implementing provisions in these regulations and in that order

2. European Union (EU) accounting requirements are based primarily on four Accounting Directives; the Fourth[6] and Seventh[7] Directives on the annual and consolidated accounts of companies: the Directive on the annual and consolidated accounts of banks and other financial institutions[8] ("the Bank Accounts Directive"); and the Directive on the annual and consolidated accounts of insurance undertakings[9] ("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[10]).

5. Not all of the provisions in the Modernisation of Accounts Directive apply to friendly societies. The following articles do not apply: 1.3, 1.4, 1.5, 1.6, 1.8, 1.22, all of article 3, article 4.2 and 4.6. 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. In the table below references to "the Regulations" are to the Friendly Societies (Accounts and Related Provisions) (Amendment) Regulations 2005 and references to "the Order" are to the Friendly Societies Act 1992 (International Accounting Standards and Other Accounting Amendments) Order 2005.

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[5] 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).

[6] 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).

[7] Seventh Council Directive of 13 June 1983 (83/349/EEC) on consolidated accounts (OJ L193/1 of 18.7.1983).

[8] 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.

[9] 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.

[10] Regulation (EC) 1606/2002 of the European Parliament and of the Council, on the application of international accounting standards (OJ L 243, 11/09/2002 p.1 – 4).

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 friendly 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 friendly societies and imposing a requirement to have regard to the substance of the transaction. Implemented by regulation 2 of the 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 2 and 6 of the Regulations.	HM Treasury
1.10	Expands the scope of the fixed assets that can be revalued.	No implementation necessary as paragraph 11(1) of Schedule 6 to the Friendly Societies (Accounts and Related Provisions) Regulations 1994 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 friendly societies. It is implemented by regulations 3 and 4 of the 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 Friendly Societies Act 1992 (International Accounting Standards and Other Accounting Amendments) Order 2005, amend section 71 and insert a new section 71A into the Friendly Societies Act 1992.	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 5 of the Friendly Societies Act 1992 (International Accounting Standards and Other Accounting Amendments) Order 2005, implements these provisions.	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 requires the statutory auditors to express an opinion on the consistency or otherwise of the	The first obligation is already implemented by Schedule 14 of the Friendly Societies Act 1992. The second obligation is implemented by article 5 of the Order.	HM Treasury

	annual report with the annual accounts for the same financial year.		
1.18	Revises requirements regarding the contents of the auditors' report. 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.	Article 5 of the Order implements this provision.	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 friendly societies.	HM Treasury
2.1	Amends the definition of when a parent has a subsidiary undertaking.	This is implemented by paragraph 3 of the Schedule to the Order.	HM Treasury
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 friendly 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.	No implementation required as this exemption was never granted to friendly societies.	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 friendly 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 Order 2004 amend section 71 of and insert a new section 71A into the Friendly Societies Act 1992.	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 the requirements on individual accounts.	The first obligation is already implemented by Schedule 14 of the Friendly Societies Act 1992. The second obligation is implemented by article 5 of the Order.	HM Treasury
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 friendly societies.	HM Treasury
4.3	Changes a title under "Liabilities" in the balance sheet format.	This is implemented by regulation 2 of the Regulations.	HM Treasury
4.4	Permits member states to let insurance undertakings accounts use different valuation methods within one item.	UK are not taking up this option for friendly societies.	HM Treasury
4.5	Requires certain disclosures in the notes to the accounts where the fair	Implemented by regulation 5 of the Regulations	HM Treasury

	value method of valuation is used in relation to certain investments		

ANNEX B1

FINAL REGULATORY IMPACT ASSESSMENT ON THE EXERCISE OF MEMBER STATE OPTIONS IN THE INTERNATIONAL ACCOUNTING STANDARDS REGULATION FOR FRIENDLY SOCIETIES

1. Proposal

1.1 The Friendly Societies Act 1992 (International Accounting Standards and Other Accounting Amendments) Order 2005 insofar as it gives effect to Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of Ministers of 19 July 2002 on the application of International Accounting Standards (the "IAS Regulation").

2. Purpose and intended effect

Objective

2.1 The IAS Regulation requires friendly societies that issue traded securities on a regulated market in the EU to prepare their consolidated accounts in accordance with IAS issued by the International Accounting Standards Board (IASB) and adopted by the European Commission. In addition, Member States can permit or require friendly societies to choose to prepare their individual and consolidated accounts in accordance with adopted IAS (where they are not required to do so). The Government proposes to take a permissive approach. This approach will increase comparability, consistency and transparency of accounts, giving friendly societies the option to use IAS, if they judge that the benefits outweigh the costs of doing so, whilst keeping the burden on them to a minimum.

Devolution

2.2 Responsibility for friendly society law matters lies with the Chancellor of the Exchequer. Friendly society law is an area which is reserved to Westminster under the Scottish, Welsh and Northern Irish devolution legislation and therefore any resulting changes to legislation will also apply in Scotland, Wales and Northern Ireland.

Background

2.3 Friendly societies are mutual organisations, run for and by the benefit of members, providing a wide range of savings, assurance, insurance and healthcare products. As of April 2004, there were 211 friendly societies in total on the register at the Financial Services Authority (FSA).

2.4 During 1999, the European Commission published a communication on "Financial Services: Implementing the Framework for Financial Markets: Action Plan". In March 2000, at the Lisbon European Council, Ministers of Member States concluded that, in order to accelerate completion of the internal market for financial services, steps should be taken to enhance the comparability of financial statements by 2005.

2.5 Consequently, in February 2001 the European Commission published a proposal for a Regulation on the application of IAS in the EU, as a key element of its Financial Services Action Plan. It aimed to harmonise financial reporting in the EU on the basis of globally agreed accounting standards by 2005.

2.6 The IAS Regulation was adopted on 7 June 2002. It requires publicly traded companies and other undertakings with traded securities governed by the laws of a Member State to prepare their consolidated accounts on the basis of accounting standards issued by the IASB and adopted by the European Commission, from 1 January 2005.

2.7 The IAS Regulation contains options allowing Member States to permit or require:

- companies and other undertakings with traded securities to prepare their individual accounts in accordance with adopted IAS;
- other companies and undertakings that do not issue traded securities to prepare their consolidated and/or individual accounts in accordance with adopted IAS.

The Government has taken a permissive approach to the options contained within the IAS Regulation in relation to companies and building societies and proposes to do the same for friendly societies.

2.8 Friendly societies that are not required to or choose not to use IAS will continue to be required to comply with domestic accounting legislation. In the UK, the Accounting Standards Board's (ASB) accounting standards apply to all friendly societies. ASB and IASB standards are in many cases very similar, although there are also a number of differences. The ASB does not believe it is a credible option, except in the short term, to retain two different sets of accounting standards in the UK. It therefore aims to bring UK standards into line with IASB standards. Therefore, friendly societies which choose to continue to prepare their accounts under UK accounting legislation may nonetheless be applying standards which are very similar to adopted IAS.

Risk assessment

2.9 Not extending the option to use IAS could create an artificial barrier to growth. For example, friendly societies without traded securities to which the IAS Regulation did not apply might be deterred from obtaining admission to trading on a regulated market by the need to restate their past accounts to adopted IAS to provide the necessary three year record. It would also be more complicated for any friendly society that chooses to issue traded securities to prepare group accounts if they and their subsidiary companies were unable to prepare their individual accounts to adopted IAS. In addition, level playing field issues arise unless there is consistency between companies and friendly societies.

3. Options

3.1 The IAS Regulation directly requires friendly societies that issue traded securities to use IAS for their consolidated accounts. The focus of this RIA is therefore on the options presented by the same IAS Regulation. Member States can permit or require friendly societies to use IAS, where they are not already required to do so. For purposes of simplicity, three main overarching options are outlined below:

Option 1: No extension

3.2 This option would see the Government not take up the option to permit or require friendly societies to use IAS, where they were not already required to do so.

Option 2: Full mandatory extension

3.3 This option would see the Government take up an option to require all friendly societies to use IAS, where they were not already required to do so by the IAS Regulation.

Option 3: Full permissive extension

3.4 This option would see the Government take up an option to permit all friendly societies to use IAS, where they were not already required to do so by the IAS Regulation, if they identify benefits for their business in doing so.

4. Benefits

Option 1: No extension

4.1 The benefit to business in not extending application of the IAS Regulation is that no cost burden will fall on friendly societies except those that would be required by the IAS Regulation to use adopted IAS in the preparation of their consolidated financial statements if they choose to issue traded securities.

Option 2: Full mandatory extension

4.2 A benefit of extension generally is that for friendly societies that do business or seek capital across borders, compliance with adopted IAS would make their accounts more comparable with those of their competitors in IAS countries. This comparability would assist members, analysts and other user of accounts. In addition, adherence to adopted IAS may help to reduce the cost of capital because their accounts will be more accessible to potential investors across the EU and worldwide. There could also be cost savings as a result of not having to prepare different accounts according to different national standards. In addition, a failure to allow full extension would mean that any friendly societies required to use IAS as a result of issuing a traded security would not have to prepare their accounts using two different accounting methods; both individual and consolidated accounts would be prepared in accordance with adopted IAS. There are also wider benefits in terms to the financial services sector of convergence to a single accounting standard and an improvement in comparability and transparency.

Option 3: Full permissive extension

4.4 This would realise some of the benefits of extension generally, as outlined above. However, extension on a permissive rather than mandatory basis has the benefit of minimising burdens on business. There will be costs for a friendly society in switching to IAS. A permissive approach would mean that friendly societies can switch to IAS when it best suits their own circumstances, and when they judge that the benefits outweigh the costs. For example, a friendly society considering issuing traded securities in the future, may wish to voluntarily adopt IAS so that accounts may be prepared under IAS, prior to an application for listing.

Business Sectors Affected

4.5 This proposal will potentially affect all friendly societies in the UK. In April 2004, there were 211 friendly societies in total on the register at the FSA. It is not possible to predict how many of these will choose to prepare their accounting in accordance with adopted IAS.

Issues of equality and fairness

4.6 The Government does not consider that the proposal will bring any disproportionate benefits or have disproportionate effects on particular groups.

5. Costs

Compliance Costs

Option 1: No extension

5.1 If the application of the IAS Regulation is not extended, there will be no cost to businesses other than that falling on those already covered by the IAS Regulation. The Government is not aware that any friendly societies currently issue traded securities and are therefore directly required to comply with the IAS Regulation. However, not extending the application of the IAS Regulation, at least to some friendly societies, could create an artificial barrier to growth. For example, friendly societies without traded securities to which the IAS Regulation did not apply might be deterred from obtaining admission to trading on a regulated market by the need to restate their past accounts to adopted IAS to provide the necessary three year record. It would also be more complicated for any friendly society that chooses to issue traded securities to prepare group accounts if they and their subsidiary companies were unable to prepare their individual accounts to adopted IAS. In addition, level playing field issues arise unless there is consistency between companies and friendly societies.

Option 2: Full mandatory extension

5.2 Full mandatory extension would increase the burden on friendly societies, especially smaller ones. IASB standards are primarily focused on the reporting requirements of large publicly traded companies, which are involved in complex transactions. Some standards are arguably less relevant to small businesses or require them to account for certain transactions in overly complex ways. As yet, there is no international equivalent to the ASB's Financial Reporting Standard for Small Entities (FRSSE), which brings together in one place, with some simplifications, the accounting requirements from each of the full domestic standards as they apply to small businesses.

5.3 There will be a one-off cost for friendly societies for compliance with the IAS Regulation in terms of changes to accounting systems and IT systems. Consultation respondents were unable to quantify these costs in detail.

5.4 There will also be one-off training costs for staff in being instructed in the standards and in interrogating the data in order to compile accounts to a different accounting regime. Elsewhere[11], the DTI provided anecdotal evidence that suggested small businesses may require 1 person to be trained for 2 days. Medium to large businesses may require 2 staff to be trained for between 3 and 5 days. This gives the following estimates:

- Cost of training course: £750 per day (cost of a one day training package on IAS)
- Cost of staff time per day: £100 per day (assuming staff pay of £25,000 per annum approximately)

5.4 The training costs for small businesses may be approximately £1,700 per business. It is possible that as many small businesses may not have in-house accountancy staff and therefore would not incur a training cost. However, in these cases there may be a need for additional external advice and support. The Government does not have estimates for these potential costs. It is estimated that the cost for medium to large businesses may be between £5,100 and £8,500 per business.

5.5 There will also be costs for accountancy firms in a mandatory change to IAS. There are some 64,000 accountancy businesses or firms in the UK. It will be difficult to divorce the impact of these changes from the similar changes in accounting legislation for companies

[11] p126 of "Modernisation of Accounting Directives/IAS infrastructure", 25 March 2004, URN 04/733. Available at www.dti.gov.uk/consultations or www.hm-treasury.x.gsi.gov.uk/consulations

and building societies as a result of the IAS Regulation. The DTI estimate there will be one-off training costs for two days training for a partner and 2 others in the region of £5,700, broken down as follows

- Cost of training course: £750 per day (cost of a one day training package on IAS)
- Cost of staff time per day: £100 per day (assuming staff pay of £25,000 per annum approximately)
- Cost of partner time: £400 (assuming partner pay of £100,000 per annum approximately)

Option 3: Full permissive extension

5.6 If friendly societies are required to adopt IAS in the preparation of their financial statements, compliance costs will be incurred. Permitting friendly societies to use adopted IAS will impose no compliance costs. Giving friendly societies the ability to choose to use adopted IAS in the preparation of their accounts will allow them the flexibility to prepare accounts in accordance with the accounting framework that is best suited to their needs. They can choose to switch to adopted IAS when they judge that the benefits outweigh the costs for their individual friendly society. There will be a cost to those accountancy firms dealing with businesses that issue (or later choose to issue) traded securities, arising directly from the IAS Regulation. There will be a cost on other accountancy firms in permitting non-publicly traded businesses to use adopted IAS. Those firms will need to become familiar with IAS in order to advise their clients on whether to switch. However, the ASB's convergence programme will mean that IAS and UK GAAP are similar, thereby reducing the cost of becoming familiar with IAS.

Other costs

5.7 We do not consider that there are any costs imposed on sectors other than business.

6. Consultation with small business: the small firm's impact test

6.1 The DTI have already conducted a Small Firm Impact Test on the impact of the IAS Regulation on companies as shown in the following paragraphs. The general principles discussed there also apply to friendly societies.

Stage 1

6.2 The DTI estimated (see 5.4 above) that there may be a one-off training cost of £1,700 for a small business should it choose to use adopted IAS in the preparation of its financial statements. It is possible that as many as 60% of small business may not have in-house accountancy staff and therefore would not incur a training cost. There will be no cost to small business if they choose not to use adopted IAS.

Stage 2

6.3 The DTI 2002 consultation document on IAS and its small firms summary was made widely available. The Small Practitioners Association (SPA), who represent an independent group of small professional practices serving a total of some 90,000 incorporated businesses (the vast majority of which are small) were not in favour of compulsory extension to small companies. The SPA felt there would be little impact on small businesses, as few would choose to move to adopt IAS.

6.4 The London Society of Chartered Accountants (with a membership of 30,000) commented that the application of adopted IAS should be extended to all companies on either a voluntary or compulsory basis, dependent on the options. However, the IAS

Regulation should not be applied to the accounts of small companies (as defined) in the short term until a FRSSE has been developed that is consistent with IAS.

7. Competition assessment

7.1 The proposal has the potential to affect all friendly societies that choose to prepare their financial statements in accordance with adopted IAS. It is not anticipated that the proposal will: affect some of those businesses more than others; affect market structure; change the number or size of those businesses; lead to higher set-up costs for those businesses; or lead to higher on-going costs, than at present.

8. Compensatory simplication measures

8.1 In the report of the Better Regulation Taskforce (published 16 May 2005), one of the two principal conclusions was that the Government should apply a "One in One out" approach to new regulation, with Ministers and departments giving a high priority to simplifying or removing over-complex and burdensome regulation as they do to the introduction of new. These draft Statutory Instruments pre-date this report, but are largely permissive in nature, except for any societies that may in the future issue traded securities. The instruments codify best practice and have a limited cost impact.

9. Enforcement and sanctions

9.1 The Friendly Societies Act 1992 and subsequent Regulations made under this Act contain a number of requirements on accounting and auditing. Breaches of the most important of these requirements are criminal offences for which both the friendly society and any of its officers in default can be prosecuted and fined. Friendly societies are also subject to supervision and regulation by the Financial Services Authority. The Authority receives a copy of each society's annual accounts and has a flexible range of sanctions at its disposal to ensure compliance with the statutory requirements.

10. Monitoring and review

10.1 The Government proposes to review the adoption of the IAS Regulation for companies around 2008 and re-evaluate the extension options, having regard to developments in the ASB's convergence programme and the IASB's development of an International FRSSE. Any decisions on the extension options for friendly societies will be made in light of this review.

11. Consultation

Within Government

11.1 HM Treasury have consulted with the Department for Trade and Industry, the Financial Services Authority and the Department for Enterprise, Trade and Industry in Northern Ireland. As part of the consultation published in March 2004 on the same accounting changes for companies and building societies, the DTI and HM Treasury consulted the Inland Revenue, the Financial Services Authority, the Small Business Service, Companies House and the Department for Enterprise, Trade and Industry in Northern Ireland.

Public consultation

11.2 On 2 September 2002, the DTI published a consultation document on the possible extension of the IAS Regulation to companies. The consultation was sent to approximately 1,000 businesses, professional bodies, and representative organisations and individuals, and

was also made available on the internet. The consultation closed on 26 November 2002. 69 responses were received.

11.3 In July 2004, HM Treasury published a consultation document on the Modernisation Directive and IAS Infrastructure for friendly societies. The consultation document is available on HM Treasury's website, and printed copies are available on request. The consultation closed on 15 September 2004. A total of three organisations responded, including the representative body, the Association of Friendly Societies. Where the consultation asked about the Government's approach to the IAS Regulation for friendly societies, consultation respondents unanimously agreed that the Government should permit all friendly societies to use IAS where they were not already required to do so and that the Government should ensure, where appropriate, consistency between companies and friendly societies. Respondents noted that it was difficult to quantify the costs and benefits of this proposal but did not disagree with the estimates put forward in the partial Regulatory Impact Assessment. A full Summary of Responses is available on HM Treasury website.

12. Summary and Recommendations

12.1 HM Treasury recommends option 3: full permissive extension. Taking a permissive approach will serve to increase comparability, consistency and transparency of accounts. It will give friendly societies the option to use IAS when they judge that the benefits to their business outweigh the costs of doing so.

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

……………………………………………………………………Date:……………………

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FINAL REGULATORY IMPACT ASSESSMENT ON THE MODERNISATION DIRECTIVE AND FRIENDLY SOCIETIES

1. PROPOSAL

1.1 The Friendly Societies Act 1992 (International Accounting Standards and Other Accounting Amendments) Order 2005 and the Friendly Societies (Accounts and Related Provisions) (Amendment) Regulations 2005, insofar as they implement Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 ("the Modernisation Directive").

2. PURPOSE AND INTENDED EFFECT

Objective

2.1 The Modernisation Directive is designed to bring European accounting requirements into line with modern accounting practices. It requires Member States to make certain changes to national law concerning the form and content of friendly society accounts. It also gives Member States options on whether and how they implement certain aspects of it. Adopting a policy of a level playing field with companies in terms of take-up of the Member State options will enable friendly societies to follow modern, more transparent accounting practices that are consistent with International Accounting Standards (IAS) and ensure that they are not disadvantaged relative to companies.

Devolution

2.2. Responsibility for friendly society law matters lies with the Chancellor of the Exchequer. Friendly society law is an area which is reserved to Westminster under the Scottish, Welsh and Northern Irish devolution legislation and therefore any resulting changes to legislation will also apply in Scotland, Wales and Northern Ireland.

Background

2.3 Friendly societies are mutual organisations, run for and by the benefit of members, providing a wide range of savings, assurance, insurance and healthcare products. As of April 2004, there were 211 friendly societies in total on the register at the Financial Services Authority (FSA). 25 of these societies are what are known as directive friendly societies, meaning they are subject to the 1991 Life Insurance Accounts Directive.

2.4 EU accounting requirements are based primarily on the four Accounting Directives:

- 1978 Fourth Directive on Company Accounts[12]
- 1983 Seventh Directive on Consolidated Accounts[13]
- 1986 Directive on Accounts for Banks and other Financial Institutions[14]

[12] Fourth Council Directive of 25 July 1978 (78/660/EEC) based on Article 54(3)g of the Treaty on the annual accounts of certain types of companies. OJ L222/11 of 14 August 1978.
[13] Seventh Council Directive of 13 June 1983 (83/349/EEC) based on Article 54(3)(g) of the Treaty on consolidated accounts. OJ L193/1 of 18 July 1983.

- 1991 Insurance Accounts Directive[15]

2.5 The Modernisation Directive is designed to:

- remove conflicts between the Accounting Directives and International Accounting Standard Board (IASB) standards in existence at the time it was drawn up; and
- ensure that optional accounting treatments currently available under IASB standards in existence at 1 May 2002 are available to EU undertakings which continue to have the Accounting Directives as the basis of their accounts.

2.6 The Modernisation Directive is required to be implemented only insofar as the existing Accounting Directives it is amending already apply to friendly societies. The 1991 Insurance Accounts Directive applies to directive friendly societies (that are insurance undertakings and that are authorised to carry on insurance business). The 1991 Insurance Accounts Directive also applies certain provisions of the 1978 Fourth Directive on Company Accounts to insurance undertakings (including directive friendly societies). The 1978 Fourth Directive on Company Accounts therefore indirectly impacts on directive friendly societies. Friendly societies fall outside of the scope of the other two existing Accounting Directives amended by the Modernisation Directive and it is not proposed to make any changes to friendly society legislation as a result of amendments to these accounting directives.

2.7 The Directive is not directly applicable and must be implemented through amendments to the Friendly Societies Act 1992 ("the 1992 Act") and regulations made under this Act.

2.8 In a number of places, the Modernisation Directive gives Member States options on how to implement it. The Government's general approach to implementing the Directive is to facilitate greater convergence between UK accounting standards and IAS, without imposing unnecessary burdens. In addition, level playing field issues arise unless there is consistency between companies and friendly societies.

Risk Assessment

2.9 The Government is required to implement the Modernisation Directive. Failure to implement the changes required by the Directive would result in infraction proceedings being brought against the UK and would prevent friendly societies from following up-to-date accounting requirements. Failure to implement those proposals not required by the Modernisation Directive but presented as options or as possible extensions would prevent friendly societies from following up-to-date accounting practices.

3. Options

3.1 There are numerous permutations for implementing the provisions of the Modernisation Directive. For simplicity, only three main overarching options of "do nothing", "full implementation" and "full implementation plus two extensions" are discussed.

Option 1: Do nothing

3.2 It is not feasible to "do nothing" for many of the accounting amendments, as that option would lead to infraction proceedings being brought against the UK for failure to implement the Modernisation Directive. Doing nothing on the options presented by the Modernisation

[14] Council Directive of 8 December 1986 (86/635/EEC) on the annual and consolidated accounts of banks and other financial institutions. OJ L372/1 of 31 December 1986.

[15] Council Directive of 19 December 1991 (91/674/EEC) on the annual and consolidated accounts of insurance undertakings. OJ L374/7 of 31 December 1991

Directive risks preventing directive friendly societies from being able to follow up-to-date accounting practices.

Option 2: Implementation of the accounting amendments for directive friendly societies

3.3 This option focuses on implementation of requirements and options contained within the Modernisation Directive for directive friendly societies. As a whole, it would result in compliance with the requirements to implement the Modernisation Directive, reflection of best practice in audit reporting and allowing directive friendly societies to follow up-to-date accounting practices in line with those followed by companies. This option is broken into 5 subsections a – e which are discussed in detail below.

a) Audit Reports

3.4 Audit reports currently differ across Member States. Articles 1.15 and 1.18 of the Modernisation Directive seek to achieve greater harmonisation and reflect best practice in the format and content of audit reports. Audit reports prepared in accordance with UK Statement of Auditing Standards 600 already conform very closely to the requirements of the Modernisation Directive.

3.5 One of the changes is that, in future, the auditors will need to identify the financial reporting framework applied in the preparation of accounts (i.e. whether by IAS or UK GAAP).

3.6 Furthermore, article 1.16 of the Modernisation Directive requires disclosure, whenever non-statutory accounts (e.g. interim accounts) are published, of whether the auditors have drawn attention in their report to any matter by way of emphasis, without qualifying the audit report, as well as of whether the audit report was qualified or unqualified.

b) Presentation of items

3.7 Article 1.2 of the Modernisation Directive gives Member States the option to permit or require the presentation of amounts within items in the profit and loss account and balance sheet to have regard to the substance of the reported transaction. The Government has adopted this option as a requirement, as has already been done for companies and building societies.

c) Fair Value of financial instruments

3.8 Article 4.5 of the Modernisation Directive applies Articles 42a to 42d of the Fourth Accounts Directive to insurance undertakings. This requires Member States to permit or require insurance undertakings to account for their financial instruments at fair value. The Government has adopted a permissive approach, as has already been done for companies and building societies.

d) Fair Value of investment property and biological assets

3.9 Article 1.12 of the Modernisation Directive gives Member States the option to extend the use of fair value accounting to asset categories other than financial instruments. Following adoption of IAS 40 Investment Property and IAS 41 Agriculture, the Government has decided to permit the relevant categories of assets (investment property and biological assets) to be fair valued in both individual and consolidated accounts of directive friendly societies.

e) Directors' Report

3.10 Articles 1.14, 1.17 and 2.10(a) of the Modernisation Directive require directors' reports to contain a fair review of the friendly society's position, including an analysis of the risks and

uncertainties faced, in order to give greater transparency and precision of reporting on performance on financial and non-financial matters.

Option 3: Implementation of the accounting amendments plus extension of two requirements to all friendly societies

3.12 Although the Modernisation Directive is only required to be implemented for directive societies, the Government proposed to extend two of the mandatory aspects of the Directive to non-directive friendly societies. This option realises the same benefits as described in option 2 and would ensure the benefits associated with legislative simplicity are realised for all friendly societies. The two extensions relate to the audit report and the directors' report as outlined in the previous section (2a and 2e respectively).

3.13 In terms of the audit reports, there would be no increase in the accounts which the auditor is required to report on nor on the true and fair opinions which they are required to give. The increased requirements are for the auditors to identify the accounting framework used and describe the scope of the audit. The extension also provides for increased flexibility in the opinions that the auditor can give. As well as being qualified or unqualified, the auditor may also draw special attention to a matter by way of emphasis.

3.14 In terms of the directors' report, all societies are already required to produce a directors' report containing a fair review of the development and performance of the business of the society. The increased requirement is for that review to analyse the development and performance of the business comprehensively and to include a description of the principal risks facing the society.

4. Benefits

Option 1: Do nothing

4.1 There are no benefits in choosing Option 1. To do nothing would prevent friendly societies from following the most up-to-date accounting practices.

Option 2: Implementation of accounting amendments for directive friendly societies

4.2 In addition to the benefits of implementation more widely - ensuring compliance with the requirements to implement the Modernisation Directive, reflecting best practice in audit reporting and allowing directive friendly societies to follow up-to-date accounting practices in line with those followed by companies – there are individual benefits in the various requirements and options of the Directive as outlined below.

4.3 Option 2a makes amendments to the audit report of individual friendly societies and groups. This will more closely align the requirements of the 1992 Act with current practice in audit reporting.

4.4 Option 2b makes amendments to the presentation of items within the format of accounts. These amendments facilitate the convergence of UK accounting standards with IAS bringing the benefits of alignment with IAS previously described. It is also important that formats do not create excessive rigidity and become an obstacle to presenting items in the most meaningful way.

4.5 Option 2c and d will facilitate use of up-to-date accounting practices by allowing directive friendly societies to use fair value accounting for their financial instruments, investment property and biological assets, facilitating convergence with IAS.

4.6 Option 2e will facilitate greater transparency and reporting on performance on financial and non-financial matters. The directors' report will provide additional information encouraging members to exercise effective and responsible control.

4.7 The overall benefits of Options 2a to e are that they will allow directive friendly society law to reflect the requirements of the Modernisation Directive, reflect current best practice in audit reporting, and allow friendly societies to follow up-to-date accounting practices. The changes will also ensure that there is consistency between companies and friendly societies for the purpose of these accounting changes.

Option 3: Implementation of the accounting amendments plus extension of two requirements to all friendly societies

4.8 Extension of option 2a (audit report) to all friendly societies will have the benefit of aligning the requirements of the 1992 Act more closely with current accounting practice in audit reporting.

4.9 Extension of option 2e (directors' report) to all friendly societies will ensure that members of all friendly societies will benefit from greater transparency and reporting on performance on financial and non-financial matters. The directors' report will provide additional information encouraging members to exercise effective and responsible control.

4.10 In general terms, these two extensions will reflect current best practice in audit reporting, and allow friendly societies to follow up-to-date accounting practices. As not extending these requirements would result in greater legislative complexity, friendly societies will also benefit from the resulting legislative simplicity that these extensions introduce.

Business sectors affected

4.11 As of April 2004, there were 211 friendly societies in total on the register at the Financial Services Authority, of which 25 were directive friendly societies. In other words, 25 societies are subject to the 1991 Life Insurance Directive and hence, the changes made to it by the Modernisation Directive. Option 2a will affect all directive and non-directive friendly societies that require an auditors' report. However, in practice, auditors already carry this out although not required under the 1992 Act. These changes simply reflect best practice. Option 2b will affect all directive friendly societies by changing the presentation of items in the format of accounts. Option 2c and d are optional; a directive friendly society may choose to use fair value accounting for financial instruments, investment property and biological assets, but none will be required to do so. Option 2e will affect all directive and non-directive friendly societies by introducing new requirements for the directors' report.

Issues of equality and fairness

4.12 We do not consider that the proposal will bring any disproportionate benefits or have disproportionate effects on particular groups.

5. Costs

Compliance costs

Option 1: Do nothing

5.1 There would be no compliance costs on friendly societies in the “do nothing” option. However, friendly societies would not be able to follow up-to-date accounting practices and may be disadvantaged relative to companies (for whom these changes have already been made).

Option 2: Implementation of accounting amendments for directive friendly societies.

5.2 Option 2a (audit reports) has minimal cost and no significant additional resources would appear to be necessary, as those requirements are a reflection of best practice already in use.

5.3 There will be a small training and IT cost to Option 2b (presentation of items). The amendments are not intended to make any generic changes in the presentation of specific items in the accounts. The changes will clarify the balance sheet and profit and loss formats specified by the 1992 Act by requiring that the presentation of items within the accounting formats have regard to their economic substance.

5.4 Option 2c and d (fair value) will have a cost in the training of staff and updating of IT systems for those friendly societies that decide to take up the fair value option. The DTI estimated the cost for companies to be in the region of £600 per company. (1 day’s training at £500 plus cost of staff time at £100).

5.5 Friendly societies are already required to prepare a directors’ report. Option 2e will increase the costs associated with this. Costs relating to business risk assessments and identifying key performance indicators will be greater for those friendly societies that need to introduce systems in order to meet the new requirements. It is difficult to get a hard idea of what impact the revised audit requirement would have and what additional work auditors would carry out in order to arrive at an opinion on the consistency of the directors’ report with the annual accounts. It appears that many friendly societies already comply with these changes as current best practice. For those that do not, the Government estimates the cost of preparing a directors’ report could increase by an average of between £500 and £1,000, although this would vary according to the size of the friendly society.

Option 3: Implementation of accounting amendments plus extension of two requirements to all friendly societies

5.6 In addition to the costs of implementation for directive friendly societies at detailed in paragraphs 5.2 and 5.5, take up of this option and the extension of these two requirements would result in greater costs for non-directive friendly societies. Extension of option 2a (audit reports) would have minimal cost as those requirements are a reflection of best practice already in use but we estimate that extension of option 2e (directors’ report) could result in greater costs of up to £1,000 (as outlined in paragraph 5.5) for non-directive friendly societies.

Other costs

5.8 The Government considers that there are no costs imposed on sectors other than business.

6. Consultation with small business: the small firm’s impact test

6.1 The DTI have already conducted a Small Firm Impact Test on the impact of the Modernisation Directive on small firms where it was concluded that the proposals to implement the Modernisation Directive would have little or no cost implications for small businesses.

7. Competition assessment

7.1 The proposal has the potential to affect all friendly societies. It is not anticipated that the proposal will: affect some of those businesses more than others; affect market structure; change the number or size of those businesses; lead to higher set-up costs for those businesses; or lead to higher on-going costs, than at present.

8. Compensatory simplication measures

8.1 In the report of the Better Regulation Taskforce (published 16 May 2005), one of the two principal conclusions was that the Government should apply a "One in One out" approach to new regulation, with Ministers and departments giving a high priority to simplifying or removing over-complex and burdensome regulation as they do to the introduction of new. These draft Statutory Instruments pre-date this report, but are largely permissive in nature. The instruments codify best practice and have a limited cost impact.

9. Enforcement and sanctions

9.1 The Friendly Societies Act 1992 and subsequent Regulations made under this Act contain a number of requirements on accounting and auditing. Breaches of the most important of these requirements are criminal offences for which both the friendly society and any of its officers in default can be prosecuted and fined. Friendly societies are also subject to supervision and regulation by the Financial Services Authority. The Authority receives a copy of each society's annual accounts and has a flexible range of sanctions at its disposal to ensure compliance with the statutory requirements.

10. Monitoring and review

10.1 The EU Contact Committee on the Accounting Directives will keep the Accounting Directives under review and consider the need for further changes.

11. Consultation

Within Government

11.1 HM Treasury have consulted with the Department for Trade and Industry, the Financial Services Authority and the Department for Enterprise, Trade and Industry in Northern Ireland. As part of the consultation published in March 2004 on the same accounting changes for companies and building societies, the DTI and HM Treasury consulted the Inland Revenue, the Financial Services Authority, the Small Business Service, Companies House and the Department for Enterprise, Trade and Industry in Northern Ireland.

Public consultation

11.2 In July 2004, HM Treasury published a consultation document on the Modernisation Directive and IAS infrastructure for friendly societies. The consultation document is available on HM Treasury's website, and printed copies are available on request. A total of three organisations responded, including the representative body, the Association of Friendly

Societies. All respondents were in broad agreement with the Government's proposals. Consultation respondents agreed that the same Member State options implemented for companies should be implemented for friendly societies to ensure a level playing field. Consultation respondents also agreed that the proposal to extend two of the requirements to non-directive friendly societies already reflected best practice currently in place and that the proposal was unlikely to introduce significant costs. Respondents noted that it was difficult to quantify the costs and benefits of this proposal but did not disagree with the estimates put forward in the partial Regulatory Impact Assessment. A full summary of responses is available on the HM Treasury website.

12. Summary and Recommendations

12.1 The Government recommends Option 3. This option will allow friendly society law to reflect the requirements of the Modernisation Directive, reflect current best practice in audit reporting, and enable friendly societies to follow up-to-date accounting practices.

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

……………………………………………………………………….. Date: ………………………….

Ivan Lewis, the Economic Secretary to the Treasury

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