
EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations amend Part 7 of the Companies Act 1985 (“the 1985 Act”) on accounts and audit in order to—

introduce a new requirement for directors of quoted companies to prepare operating and financial reviews (“OFRs”) for financial years;

implement requirements relating to the directors' report in articles 1.14, 1.17 (in part) and 2.10 of Directive [2003/51/EC](#) of the European Parliament and of the Council of 18th June 2003 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 (Official Journal No. L178/16 of 17th July 2003) (“the Accounts Modernisation Directive”);

make minor and consequential amendments to Part 7.

Part 1 of the Regulations (regulation 1) is introductory. It includes provision applying the amendments to the 1985 Act made by Parts 2, 3, 4 and 6 of the Regulations to companies' financial years beginning on or after 1st April 2005. The amendments in Part 5 of the Regulations (revision of defective reports and reviews) are to apply in respect of annual accounts, directors' reports and OFRs for companies' financial years beginning on or after 1st April 2006, save that the amendments to section 245 of the 1985 Act in regulation 14, which permit quoted companies voluntarily to revise their OFRs, will apply from 1st April 2005.

Part 2 of the Regulations (regulations 2 to 7) replaces section 234 of the 1985 Act, inserts new sections 234ZZA and 234ZZB, and amends Schedule 7 to the 1985 Act in order to provide for further disclosures in the directors' report in implementation of articles 1.14, 1.17 (in part) and 2.10 of the Accounts Modernisation Directive. New section 234 contains a re-worded offence of failing to comply with the 1985 Act's requirements in respect of the preparation and content of the directors' report.

Regulation 3 implements the second part of article 1.17 of the Accounts Modernisation Directive, requiring auditors to report on whether information in the directors' report is consistent with the annual accounts.

The existing exemption for small companies in section 246(4)(a) of the 1985 Act from the requirement to give a fair review in the directors' report is applied to the enhanced disclosure requirements (regulation 4). Medium-sized companies are exempted from making the disclosures concerning non-financial information (regulation 5 amending section 246A of the 1985 Act). Small and medium-sized companies will not be prevented from taking advantage of these exemptions even if they are part of an ineligible group (regulation 6 amending section 247A of the 1985 Act).

Part 3 of the Regulations (regulations 8 to 11) introduces a new requirement in section 234AA for quoted companies to prepare an OFR complying with the requirements of new Schedule 7ZA to the 1985 Act inserted by regulation 9. A quoted company is defined in section 262 of the 1985 Act as a company whose equity share capital has been included in the official list in accordance with the provisions of Part 6 of the Financial Services and Markets Act 2000 (c. 8), is officially listed in an EEA State, or is admitted to dealing on either the New York Stock Exchange or the exchange known as Nasdaq.

Failure to comply with the requirements of the 1985 Act concerning the preparation and contents of the OFR will constitute a criminal offence (section 234AA(5)). New section 234AB imposes a

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criminal penalty for failure to comply with requirements in that section for the approval and signature of the OFR.

Regulation 10 inserts a new subsection (3A) into section 235 of the 1985 Act to provide for a review by a quoted company's auditors of the OFR.

Regulation 11 inserts a new section 256A into the 1985 Act providing that directors who comply with a reporting standard for the OFR issued by a body or bodies specified in an order made by the Secretary of State are presumed (unless the contrary is proved) to have complied with the provisions of the 1985 Act relating to the contents of an OFR.

Part 4 of the Regulations (regulations 12 and 13) amends the regulation-making power for summary financial statements in section 251 of the 1985 Act to make provision concerning the operating and financial review and the amended directors' report. Regulation 13 makes transitional provision for regulations made under section 251 before the date on which these Regulations come into force.

Part 5 of the Regulations (regulations 14 to 18) amends sections 245 to 245C and 245F of the 1985 Act to provide for the voluntary revision by the directors of a defective OFR, and for the compulsory revision of defective directors' reports and OFRs by application to the court by the Secretary of State or a person authorised by her.

Part 6 of the Regulations (regulation 19 and the Schedule) makes minor and consequential amendments to Part 7 resulting from the introduction of the OFR. Paragraph 5(c) of the Schedule reinstates the second paragraph of section 242(1) of the 1985 Act which was omitted in error by regulation 10(8) of the Directors' Remuneration Report Regulations 2002 (S.I.2002/1986). Paragraph 6 makes a minor amendment to section 245F of the 1985 Act (inserted by section 12 of the Companies (Audit, Investigations and Community Enterprise) Act 2004 (c. 27)) to take account of EC Regulation No.1606/2002 of the European Parliament and of the Council of 19th July 2002 on the application of international accounting standards (Official Journal No. L243/1 of 11th September 2002).

A full regulatory impact assessment of the effect that this instrument will have on the costs of business is available from the Department of Trade and Industry, Corporate Law and Governance Directorate, Elizabeth House, 39 York Road, London SE1 7LJ (it is also available electronically at www.dti.gov.uk/cld). A copy has also been placed in the libraries of both Houses of Parliament.