

### **Implementation of the Companies Act 2006**

Further to last month's summary, the DTI have announced that certain provisions of the Act relating to the Takeovers Directive and the disclosure by public authorities of information re legal rights are to be effective from 20 May 2006.

Also, a number of sections of the Companies Act 1985 have been repealed including:

- Section 41 (authentication of documents);
- Sections 293 and 294 (provisions relating to directors aged 70 and over in public companies or private companies which are subsidiaries of public companies);
- Provisions in part 10 of, and schedule 13 to, the Companies Act 1985 relating to the disclosure of share dealings by directors and their families:
- Section 311 (prohibition on tax-free payments to directors);
- Sections 323 and 327 (prohibition on directors dealing in share options);
- Sections 343 and 344 (special procedure for disclosure of dealings in favour of directors by banks);
- Section 358 (a power for companies to close the register of members);
- Section 438 (a power for the Secretary of State to bring civil proceedings on a company's behalf);
- Section 720 (a requirement for certain companies, including insurance companies, to publish periodical statements); and
- Section 729 (a requirement that the Secretary of State shall prepare an annual report to Parliament of matters within the Companies Acts).

The most relevant of these is the repeal of Section 311, which prohibited tax-free payments to directors. It is of most benefit to directors who have to be relocated or to expatriate directors.

Further information on the 2006 Act implementation can be found on [www.dti.gov.uk/bbf/co-act-2006/index.html](http://www.dti.gov.uk/bbf/co-act-2006/index.html)

Included in last month's summary was the implementation on 1 January 2007 by SI 2006/3429 "The Companies (Registrar, Languages and Trading Disclosures) Regulations 2006" of the need to include a company's or LLP's details on websites and in e-mail signatures. The details required are the company's LLP name, its place of registration and registration number, and the address of its registered office. These requirements also apply to companies / LLPs being wound-up.

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### **Companies Act 2006 Tables of Destinations and Origins**

Tables of Destinations (i.e. cross-reference from 1985 Act to 2006 Act) and origins (i.e. cross reference from 2006 Act to 1985 Act) are available from [www.opsi.gov.uk/acts/en2006/ukpgaen\\_20060046\\_Destinations\\_en.pdf](http://www.opsi.gov.uk/acts/en2006/ukpgaen_20060046_Destinations_en.pdf) and [www.opsi.gov.uk/acts/en2006/ukpgaen\\_20060046\\_origins\\_en.pdf](http://www.opsi.gov.uk/acts/en2006/ukpgaen_20060046_origins_en.pdf) respectively.

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### **Update of Example Reports by Auditors under Company Legislation**

The APB has issued Bulletin 2007/1 "Example Reports by Auditors under Company Legislation in Great Britain".

These examples replace those contained in Practice Note 8.

Further changes to these reports will be required when the relevant sections of the Companies Act 2006 come into force and it is likely that Practice Note 8 will be completely updated at that time.

The revised reports cover:

- Auditor's report on revised financial statements: revision by replacement
  - Auditor's report on revised financial statements: revision by supplementary note
  - Auditor's report on revised director's report
  - Auditor's statement on a summary financial statement
  - Statement on a company's ability to make a distribution
  - Statement when a private company wishes to re-register as a public company
  - Report on balance sheet prepared other than in respect of an accounting reference period for the purpose of a private company re-registering as a public company
  - Report when a private company wishes to redeem or purchase its own shares out of capital
  - Report when a private company wishes to provide financial assistance for the purchase of its own shares or those of its holding company
  - Report when a public company wishes to allot shares otherwise than for cash
  - Report when non-cash assets are transferred to a public company by certain of its members
  - Report on initial accounts when a public company wishes to make a distribution
  - Report on ceasing to hold office.
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### **Updated FRSSE**

The ASB has published an updated FRSSE (effective January 2007), which is effective for accounting periods beginning on or after 1 January 2007. *Earlier adoption is permitted.*

The main changes relate to:

- **Share-based payment**

Cash-settled share-based payment transactions should be accounted for at the best estimate of the expenditure required to settle the liability at the balance sheet date and should be updated annually until settled. Limited disclosure is required on the principal terms and conditions of such transactions including their current and potential financial effect.

Equity-settled share-based payment arrangements only require disclosure, which is a major concession since there will be no need to value the options granted. The disclosure required is the principal terms and conditions of any arrangements (including the number of employees and / or suppliers potentially involved), the grant date, any performance conditions, and any option exercise prices.

Where the arrangement gives the counter party the choice of whether they receive cash or equity, it should be accounted for as a cash-settled share-based payment.

- **Accounting for services**

The principles of UITF Abstract 40 are now included in the FRSSE, although this will have no impact in practice since accounts intended to show a true and fair view already have to comply with it.

- **Fair value accounting**

The FRSSE does not apply to entities preparing individual or group accounts in accordance with the fair value accounting rules set out in Part D of Schedule 8 of Companies Act 1985.

- **Corresponding amounts**

The FRSSE implements the accounting principles of FRS 28 and confirms that comparatives are not required for the fixed asset, reserves, and investment in subsidiaries and other significant holdings notes.

- **Accounting for pension schemes**

Appendix III now contains an updated illustrative example for the disclosure of a final salary (or defined benefit) pension scheme since the full requirements of FRS17 are now mandatory.

- **Classification of capital instruments as debt or equity**

Appendix III now contains new guidance on the FRS25 requirements.

To make the FRSSE more user friendly the derivation table has been removed from the Appendices and is available from the [www.frc.org.uk/asb/technical/frsse](http://www.frc.org.uk/asb/technical/frsse).

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**Updated Money Laundering Guidance**

The APB have issued an update to Practice Note 12 (Revised) "Money Laundering – Interim Guidance for Auditors".

The guidance takes account of the changes in regulation including the mandatory use of the SOCA reporting forms and the fact that we do not have to report an act that was legal in the country in which it took place but would have been illegal if it took place in the UK.

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**ASB Publishes Review of Narrative Reporting**

The ASB has published a review of narrative reporting by UK listed companies in 2006 which assessed the quality of published Business Reviews in Annual Reports. Their comments will equally apply to the Business Reviews required to be included in the Directors' Reports of medium-sized and large companies.

The main findings were:

*Areas of good reporting*

- Companies are generally good at providing descriptions of their business and markets, together with their strategies and objectives, although some improvements could be made in providing information on their external environment.

- Companies are providing good descriptions of the current development and performance of the business.
- There has been an increase in companies reporting environmental, employee and social issues, although very few discuss their contractual agreements and relationships in any depth.

#### Areas for improvement

- The greatest area of difficulty for companies when producing their narrative reports is the disclosure of forward-looking information. The proposed 'safe harbour' provisions in the Companies Act 2006 may encourage companies to provide greater detail in the future.
- Companies need to improve their descriptions of resources available to the entity, in particular intangible items such as brand strength, corporate reputation and natural resources not reflected in the balance sheet.
- Companies need to describe more carefully their principal risks and uncertainties and set out their approach to managing and mitigating those risks, rather than simply providing a list of all their risks and uncertainties (33 risks in one case).
- Many companies are providing a good deal of information on measures and indicators, but improvements can be made identifying their Key Performance Indicators, both financial and non-financial.

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#### **ASB Guidance on Financial Reporting of Defined Benefit Pension Schemes in Company Accounts**

The ASB has published a Reporting Statement entitled "Retirement Benefits – Disclosures" which is designed to promote greater transparency in reporting on defined benefit pension schemes.

The Reporting Statement is not mandatory and is designed to assist users of financial statements in understanding the risks and rewards and funding obligations arising from defined benefit schemes. The disclosures recommended complement those set out in FRS17 (as amended) and IAS19.

The Reporting Statement sets out six principles to be considered when providing disclosures for DB schemes in the financial statements:

- i. the relationship between the entity and trustees (managers) of the defined benefit scheme;
- ii. the principal assumptions used to measure scheme liabilities;
- iii. the sensitivity of the principal assumptions used to measure the scheme liabilities;
- iv. how the liabilities arising from defined benefit schemes are measured;

- v. the future funding obligations in relation to the defined benefit scheme; and
  - vi. the nature and extent of the risks arising from financial instruments held by the defined benefit scheme.
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### **Risk Management of Assurance Engagements**

The ICAEW Audit & Assurance Faculty has issued Technical Release AAF 04/06 "Assurance Engagements: Management of Risk and Liability".

The Technical Release provides guidance on managing risks on reports requested by clients to provide assurance on specific operations / functions within their organisation or on information produced by them in order to provide comfort either to themselves or to other third parties (such as customers) .

The guidance covers:

- **Accepting an engagement.** The guidance stresses the need to fully understand the purpose for which the assurance is sought, and the parties seeking to benefit from the report and the use that will be made of the report. Once we understand this we can assess:
  - whether we have the technical competence to carry out the work and whether there are any relevant ethical issues that have to be resolved.
  - the risks, particularly where third parties will seek to rely on the work
- **Managing professional liability.** Depending on the circumstances we will need to decide on the arrangements, which could be:
  - A tri-or multi-partite agreement with the client and third parties in which we owe a duty of care to all parties to the agreement
  - An agreement with the client with the facility for third parties to rely on the work
  - An engagement with the client alone accepting a limited and agreed duty of care to third parties
  - An engagement with the client alone disclaiming any duty of care to third parties.

In all cases, we need to seek to limit our liability and ensure that suitable disclaimers are included in the engagement letter and report.

- **Agreeing terms of engagement.** The engagement letter needs to cover inter-alia:
  - The purpose of the report and its agreed use, with accompanying disclosure restrictions setting out the extent to which, the context in which, and the basis on which, the report may be made available to third parties;
  - The directors' and our respective responsibilities;
  - The nature of the engagement and the type of assurance required (i.e. reasonable or limited assurance);
  - Scope of our work;
  - The timescales within which the report will be provided (allowing us sufficient time to plan and complete all the necessary work);
  - A reference to any likely need for management representations;
  - An explanation of the inherent limitations of the work, and for whom the work is being undertaken;
  - Limitations to our liability, including an appropriate liability cap. The letter must exclude liability in respect of any loss or damage caused by, or arising from fraudulent acts, misrepresentation, and concealment of information or deliberate default on the part of the client, its directors, employees or agents.
  - Provisions for an indemnity if considered appropriate. It may be appropriate to obtain an indemnity from the client in respect of claims from third parties arising from the report. Such an indemnity will not prevent a third party from taking action against us, but it will enable us to pass any costs on to the client. We should therefore consider whether the client has the wherewithal to meet any liability and if not, the indemnity may be worthwhile.
  - The criteria used for the evaluation and measurement of the operations / functions or information (and how this information has been prepared);
  - Reference to the appropriate guidance, if any, that we are using to perform the engagement; and
  - Once the engagement has already been entered into, the scope of the work or terms of engagement are only varied after reasonable justification.

We need to carefully consider any requests to change the scope of engagement before it is completed, in particular whether the change will undermine any risk protections in place or add new risks. Any changes should be agreed in writing with all parties to the engagement letter.

- **Form of report.** The report needs to describe for whom the work was done, the procedures performed, the purpose for which the work was done, any limitations on the scope of our work and appropriate disclaimers. We should be careful to minimise any risk of misunderstanding or extending our responsibilities.

The Faculty are planning to issue more specific guidance in the future.

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#### **UITF issues Abstract 44**

The ASB have recently issued UITF Abstract 44 'FRS 20 (IFRS 2) – Group and Treasury Share Transactions'.

The Abstract addresses how to apply FRS 20 'Share-based Payment' to arrangements involving an entity's own equity instruments or equity instruments of another entity in the same group. The Abstract requires a share-based payment arrangement in which an entity receives goods or services as consideration for its own equity-instrument to be accounted for as an equity-settled share-based payment transaction, regardless of how the equity instruments needed are obtained.

The Abstract also provides guidance on whether share-based payment arrangements, in which suppliers of goods and services of an entity are provided with equity instruments of the entity's parent should be accounted for as cash-settled or equity-settled in the entity's financial statements. Where the parent grants the rights they should be treated as equity-settled; where the subsidiary grants rights to its parent's equity the rights should be accounted for as cash-settled.

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#### **Limited Assurance Engagements**

The ICAEW Audit & Assurance Faculty issued Interim Technical Release AAF 03/06 which sets out guidance on a new form of engagement which enables us to provide a limited assurance report for audit-exempt clients.

This guidance is based on the IFAC Review Engagement guidance (International Standard on Review Engagements 2400 'Engagements to Review Financial Statements') and is designed to fill the gap between a compilation engagement (which offers no assurance as to whether the accounts make sense or correspond with our knowledge of the business) and an audit. In reality few users of accounts believed that the accountant had done no work on unaudited accounts and many accountants had done some verification work to satisfy themselves that the accounts were reasonable and corresponded with their knowledge of the clients' business.

With the high (and rising) audit exemption limits, many users (particularly banks and other lenders) want something more than a compilation report, but with the introduction of ISA's clients are loathe to pay for increasingly costly and complicated audits. AAF 03/06 seeks to fill this gap. Also, Ethical Standards make it more difficult for an audit firm to compile and audit the accounts.

Whether Limited Assurance Reports will catch on remains to be seen, but they do offer a viable and acceptable alternative to audit.

The key points of AAF 03/06 are:

- The Report is made to the directors and/or third parties. It should contain a Bannerman disclaimer paragraph, although this will have to be modified in tri- or multi-partite engagements;
- The Report provides assurance that “nothing has come to our attention to refute the directors’ confirmation that the financial statements comply with the Companies Act 1985 and either UK GAAP or the FRSSE”.
- The engagement cannot be relied on to prevent or detect errors, fraud or irregularities and weaknesses in internal controls
- The ethical guidance in the ICAEW Code of Ethics and the Practice Assurance Standards, which will mean that the work done will have to be reviewed, and a sample of engagements will have to be included in the Annual Practice Assurance Review.
- The planning needs to cover:
  - Ethical requirements, particularly where we have a bookkeeping involvement
  - Updating or obtaining a general understanding of the business and operations of the company by discussions with management and review of statutory records
  - Consideration of the company’s organisation, type of accounting records maintained, operating characteristics, the nature of the company’s assets, liabilities, revenues and expenditures, and the accounting principles and practices used (paying particular attention to areas requiring the exercise of judgement and the adequacy of accounting policies adopted).
  - Carrying out walkthroughs where appropriate
  - Consideration of areas where risks of material misstatement may exist and the further enquiries needed to assess the extent of the risks. There is no need for a comprehensive audit-style risk assessment.
  - The nature, extent and timing of further work
  - Calculation of materiality, solely to establish whether there is a need to adjust any misstatements found but not to determine the scope or extent of the substantive work.
- Perform analytical procedures to establish whether the financial statements are consistent and make sense. Where unusual items or disclosures are identified these should be discussed with management, and provided the explanations make sense in the context of our knowledge of the business there is no need to corroborate the explanations or review supporting documentation.
- If significant risks of material misstatement or inconsistencies are identified these should be discussed with management. Based on these discussions we should consider carrying out additional work (including substantive procedures) and consider the impact on our report
- A post balance sheet events review should be performed and the form and content of the financial statements reviewed. The need to complete a disclosure checklist should be considered.
- A letter of representation should be obtained as for an audit.

Where the accounts are affected by a material uncertainty which is adequately explained in the accounts the report should include an explanatory paragraph. However, there is no provision for a report to be qualified. If we have doubt over the validity of the financial statements or identify a material limitation of scope we should consider declining to issue any report and resign from the engagement and not permit our name to be associated with the financial statements.

AAF 03/06 contains example engagement letter, management representation letter and reports. It also has example work procedures.