

DIRECTIVE 2006/46/EC OF THE EUROPEAN PARLIAMENT AND OF THE

COUNCIL

of 14 June 2006

amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings

CONSULTATION DOCUMENT

August 2008

SECTION 1: EXECUTIVE SUMMARY

Purpose of the consultation

1.1 The European Parliament adopted Directive 2006/46/EC (“the Directive”) on 14th June 2006. The Department of Enterprise, Trade and Employment (‘the Department’) is seeking comments on its proposals in relation to the implementation of the Directive, which will inform its approach to this exercise. The Directive amends the following Directives:

- Directive 78/660/EEC (“the 4th Directive”) on the Annual Accounts of certain types of Companies;
- Directive 83/349/EEC (“the 7th Directive”) on Consolidated Accounts;
- Directive 86/635/EEC (“the Credit Institutions Directive”) on the Annual and Consolidated Accounts of Banks and other Financial Institutions; and
- Directive 91/674/EEC (“the Insurance Undertakings Directive”) on the Annual Accounts and Consolidated Accounts of Insurance Undertakings.

1.2 In line with the scope of the Directive, the proposed implementing regulations will contain proposals to make the appropriate amendments to the Credit Institutions Directive and the Insurance Undertakings Directive. It should be noted, however, that responsibility for these Directives rests with the Department of Finance.

1.3 The formal consultation period ends on **5th September 2008**.

About the Directive

1.4 The Directive introduces a number of amendments intended to enhance confidence in financial statements and annual reports published by European companies. The following are the principal provisions of the Directive:

- An extension of the Member State option to permit/require fair value accounting for financial instruments in local (non-IFRS) GAAP to all instruments permitted to be fair valued in accordance with International Financial Reporting Standards¹ (IAS 39) as adopted by the EU;
- New disclosure requirements in relation to off-balance sheet arrangements and related party transactions;
- A requirement for companies admitted to trading on a regulated market to produce an annual corporate governance statement;
- A requirement that the directors are collectively responsible for preparing and publishing the annual accounts and the annual (directors’) report;

¹ Reference to International Financial reporting Standards (IFRS)/International Accounting Standards (IAS) is a reference to those standards as adopted by the EU.

- A Member State option to increase the maximum thresholds for availing of various reporting exemptions for small and medium-sized companies to new maximum amounts.

1.5 The full text of the Directive can also be accessed via the following link:

http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_224/l_22420060816en00010007.pdf

1.6 The Directive must be implemented into national legislation by 5th September 2008. It will be implemented by Regulations amending the various items of Irish legislation which implemented the other Directives listed in paragraph 1.1 above. The provisions of the Directive will also be incorporated in the Consolidated Company Law Bill to be issued following on from the work of the Company Law Review Group.

1.7 There is an other minor company law issue proposed to be dealt with in conjunction with the transposition of the Directive. This issue is explained in section 4 of this document.

How to respond

1.8 Comments are welcome on all aspects of the proposal, and in particular on the specific questions posed in this document. A summary of the consultation questions is provided in Appendix A.

1.9 When responding, please indicate whether you are responding as an individual or representing the views of an organisation.

1.10 Responses should be submitted as early as possible, and to arrive with the Department by 6th September at the latest, preferably by email, to:

nuala_moloney@entemp.ie, or
alan_power@entemp.ie

or by post to:

Nuala Moloney
Company Law (EU/Legislation) Section,
Department of Enterprise, Trade and Employment,
Earlsfort Centre,
Lower Hatch Street,
Dublin 2.

Your attention is drawn to the fact that information provided to the Department may be disclosed in response to a request under the Freedom of Information Act. Therefore, should you consider that any information you provide is commercially sensitive, please identify same, and specify the reason for its sensitivity. The Department will consult with you regarding information identified by you as sensitive before making a decision on any Freedom of Information request.

An electronic version of this document can be found at:

<http://www.entemp.ie/publications/index.htm>.

SECTION 2: DEPARTMENT APPROACH TO AND OVERVIEW OF DIRECTIVE

Department's overall approach to the Directive

2.1 The Department considers that the corporate governance amendments provided for in the Directive will enhance quality corporate reporting, and contribute to investor confidence in EU capital markets.

The Department, in implementing the Directive, is striving to achieve a balance between disclosure obligations, and the need to avoid unnecessary burdens on business, and in particular on smaller scale enterprises.

Overview of the Directive

2.2 The overall objective of the Directive is to “modernise company law and enhance corporate governance in the Community” (recital 1). It includes, however, various options permitting Member States to exempt small and medium-sized companies from some of the new requirements introduced by the Directive, whilst also providing Member States with an option to increase the thresholds defining small and medium-sized companies in national legislation.

2.3 The articles in the Directive are arranged as follows:

- Article 1 (of the Directive) deals with required amendments to, and Member State Options contained within, the provisions of the 4th Directive, which was transposed into Irish law by the Companies (Amendment) Act 1986 ('1986 Act').
- Article 2 (of the Directive) deals with required amendments to, and Member State options contained within, the provisions of the 7th Directive, which was transposed into Irish law by the European Communities (Companies: Group Accounts) Regulations, 1992 ('1992 Regulations') (S.I. No. 201 of 1992).
- Articles 3 and 4 (of the Directive) amend the provisions of the Credit Institutions Directive and the Insurance Undertakings Directive respectively, which were transposed into Irish law by the European Communities (Credit Institutions: Accounts) Regulations 1992 and the European Communities (Insurance Undertakings: Accounts) Regulations 1996, respectively. Both the Credit Institutions Directive and the Insurance Undertakings Directive apply various requirements of the 4th Directive to the annual accounts of credit institutions and insurance undertakings, respectively, by cross-referencing to the relevant articles in the 4th Directive. Articles 3 and 4 of the Directive update these cross-references to reflect the amendments made to the 4th Directive by Article 1 of the Directive.

2.4 Specific measures contained in the Directive are:

- An extension of the Member State *option* to permit or require fair value accounting for financial instruments to a larger category of financial instruments for all companies² ;
- New disclosure requirements for all companies relating to off-balance sheet arrangements;
 - Member States have the *option* to exclude the individual financial statements of small companies from the requirement to provide these disclosures and to reduce the amount of disclosure required in the individual financial statements of medium-sized companies;
- New disclosure requirements relating to related party transactions for companies producing financial statements in accordance with national legislation implementing the Accounting Directives i.e. the ‘Companies Act accounts’;
 - Member States have the *option* to exclude the individual financial statements of small companies and medium companies (other than medium-sized companies which are public companies limited by shares or public companies limited by guarantee and having a share capital) from the requirement to provide these disclosures, to reduce the amount of disclosure required in the individual financial statements of medium-sized companies which are public companies limited by shares or public companies limited by guarantee and having a share capital and to exempt disclosure of transactions entered into between two or more members of a group provided the subsidiaries involved are wholly owned subsidiaries;
- A requirement, applicable to all companies whose securities are traded on a regulated market in the EU, to produce an annual corporate governance statement in the annual (directors’) report or in a separate report, referring to the corporate governance code applied by the company and explaining the extent of non-compliance with that code. It will also have to include a description of the main features of the company’s internal control and risk management systems in relation to the financial reporting process (and in relation to groups, a description of the main features of the group’s internal control and risk management systems in relation to the process for preparing consolidated accounts). Furthermore, the statement will have to provide information on:
 - Certain matters related to the company’s share and control structures (already required by the Takeovers Directive);
 - The composition and operation of the board of directors and its committees; and

² In this document, except where the contrary is indicated, ‘all companies’ means companies within the scope of the Companies (Amendment) Act 1986, the European Communities (Companies: Group Accounts) Regulations 1992, the European Communities (Credit Institutions: Accounts) Regulations 1992 and the European Communities (Insurance Undertakings: Accounts) Regulations, 1996.

Re ‘all companies’ cited at paragraph 2.4 second bullet point; paragraph 3.12, introduction; paragraph 3.21.1; and paragraph 3.22, introduction: These provisions do not apply to entities within the scope of the European Communities (Credit Institutions: Accounts) Regulations 1992.

- The operation of general meetings and shareholders' rights;
- A requirement that the directors are collectively responsible for preparing and publishing the annual accounts and the annual (directors') report;
- A Member State *option* to increase the financial thresholds used to define small and medium-sized companies in the context of the 4th and 7th Directives up to new maximum amounts.

SECTION 3: KEY MEASURES OF THE DIRECTIVE TO BE IMPLEMENTED

Article 1(5) of the Directive: Fair Value Accounting

3.1 Article 1(5) of the Directive provides Member States with the option to permit or require fair value accounting for a larger category of financial instruments than is permitted at present, together with associated disclosure requirements. As discussed in the following paragraphs, both International Accounting Standard (IAS) 39 *Financial Instruments: Measurement* for accounts prepared in accordance with IFRS and Financial Reporting Standard (FRS) 26: *Financial Instruments: Measurement* for accounts prepared in accordance with Irish GAAP provide for a more extensive application of fair value accounting for financial instruments than is permitted under current Irish legislation. The Directive permits, but does not require, Member States to bring national legislation into line with the above extant accounting standards.

3.2 Companies which prepare their financial statements in accordance with IFRS issued by the International Accounting Standards Board (IASB) and adopted by the EU are required or permitted to use fair values in accounting for a wide range of financial instruments. The abovementioned *option* under Article 1(5) of the Directive, if adopted, would allow companies preparing “Companies Act accounts” under Irish GAAP, in accordance with the Companies Acts and the standards issued by the UK Accounting Standards Board (ASB), to value the same range of financial instruments at fair value as those companies applying International Accounting Standard (IAS) 39 *Financial Instruments: Measurement*.

3.3 FRS 26 *Financial Instruments: Measurement*, issued by the ASB, is based on IAS 39. Companies currently applying FRS 26 are still, however, subject to the provisions of the 1986 Act which restrict the use of fair value measurement.

3.4 The Schedule to the 1986 Act, Part IIIA, paragraph 22A, permits the use of fair values for certain financial instruments but excludes:

- Financial liabilities, except those held as part of a trading portfolio and those which are derivatives;
- Non-derivative financial instruments held to maturity;
- Loans and receivables originated by the company and not held for trading purposes;
- Interests in subsidiary undertakings, associated undertakings and joint ventures;
- Equity instruments issued by the company;
- Contracts for contingent consideration in a business combination; and
- Other financial instruments with such special characteristics that the instruments, according to what is generally accepted, should be accounted for differently from other financial instruments.

3.5 Part IIIA of the Schedule to the 1986 Act (inserted by the *European Communities (Fair Value Accounting) Regulations 2004 – S.I. 765 of 2004*) and Part I, Chapter II, Section B of the Schedule to the European Communities (Credit Institutions: Accounts) Regulations 1992 (inserted by the *European Communities (Credit Institutions) (Fair Value Accounting) Regulations 2004 – S.I. 720 of 2004*) transposed the ‘Fair Value Directive’ (Directive 2001/65/EC). The Fair Value Directive enabled Member States to permit or require valuation of financial instruments at fair values and to require additional appropriate disclosures for financial instruments.

3.6 The *European Communities (International Financial Reporting Standards and Miscellaneous Amendments) Regulations 2005 – S.I. 116 of 2005* - gave full effect to the IAS Regulation (1606/2002/EC) which requires that the consolidated financial statements of companies traded on regulated markets in the EU be prepared in accordance with IFRS. It also allowed Member States a number of options with regard to other companies not explicitly required to use IFRS – the Irish Government chose to permit but not require the use of IFRS in such cases.

3.7 The EU initially adopted the then existing International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS) issued by the IASB with certain specific exceptions (‘carve-outs’) in relation to IAS 39 *Financial Instruments: Recognition and Measurement*. The carve-outs related to two issues, namely the fair valuation of a company’s own liabilities and the accounting treatment of portfolio hedging, and primarily affected financial institutions such as banks and insurance companies.

3.8 The IASB subsequently amended the fair value option in IAS 39 to restrict the ability of entities to fair value financial assets and liabilities to those financial instruments where the information provided will be more relevant because either:

- Fair valuation will reduce recognition or measurement inconsistencies; or
- The relevant financial assets or liabilities are managed or evaluated on a fair value basis.

3.9 These changes have been adopted under the IAS Regulation and, therefore, the Directive amends the 4th Directive to enable Member States to “*permit or require valuation of financial instruments, together with the associated disclosure requirements which are provided for in international accounting standards adopted in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards*” (Article 1(5)).

3.10 This amendment flows through to the following Accounting Directives:

- The 7th Directive on Consolidated Accounts;
- The Credit Institutions Directive; and
- The Insurance Undertakings Directive.

3.11 In addition, the Fair Value Directive was extended to insurance undertakings by Article 4 of Directive 2003/51/EC (‘EU Accounts Modernisation Directive’) and it is

proposed that this be transposed into Irish law³ by making similar adjustments to the European Communities (Insurance Undertakings: Accounts) Regulations 1996 as those made to the European Communities (Credit Institutions: Accounts) Regulations 1992 by the *European Communities (Credit Institutions) (Fair Value Accounting) Regulations 2004 – S.I. 720 of 2004*, as amended by these proposals.

3.12 Proposal: All companies, including credit institutions and insurance undertakings preparing “Companies Act accounts” - both individual and group accounts - will be permitted, but not required, to use fair value accounting for all classes of financial instruments that are permitted to be fair valued in accordance with IAS 39 / FRS 26.

Consultation Question 1

Do you believe the option to permit fair value accounting in Irish law as set out at 3.12 above should be adopted? If not, please state your reasons.

³ BACKGROUND: APPLICATION OF FAIR VALUE ACCOUNTING OPTIONS TO THE ANNUAL ACCOUNTS AND CONSOLIDATED ACCOUNTS OF INSURANCE UNDERTAKINGS

The European Communities (Fair Value Accounting) Regulations, 2004 SI 765 of 2004 and the European Communities (Credit Institutions) (Fair Value Accounting) Regulations 2004 SI 720 of 2004 (together ‘The Fair Value Regulations’) implemented Directive 2001/65/EC (‘the Fair Value Directive’) as regards the accounts of companies subject to the 4th and 7th Directives, banks and other financial institutions. Consequently, certain financial instruments are permitted under Irish law to be recorded at fair value in a manner similar to the provisions of IAS 39 *Financial Instruments: Recognition and Measurement*. This is discussed in further detail in paragraphs 3.1 to 3.9 above.

Article 4 of Directive 2003/51/EC (‘the Modernisation Directive’) required that the provisions of the Fair Value Directive be extended to entities subject to the Insurance Undertakings Directive (transposed into Irish law by the European Communities (Insurance Undertakings: Accounts) Regulations 1996).

Statutory Instrument No. 116 of 2005 European Communities (International Financial Reporting Standards and Miscellaneous Amendments) Regulations 2005 transposed the Modernisation Directive into Irish Law. These regulations did not, however, transpose the amendments contained in article 4 relating to applying the provisions of the Fair Value Directive to Insurance Undertakings.

As a consequence of the provisions of the Fair Value Directive not being extended to Insurance Undertakings, significant use has been made of the true and fair view override in order to allow the accounts of such undertakings to depart from the provisions of the European Communities (Insurance Undertakings: Accounts) Regulations 1996, which do not permit the use of fair value accounting, in order for those accounts to give a true and fair view.

Articles 1(6), 2(1), 3 and 4 of the Directive: Disclosure Requirements

Off balance sheet arrangements, including special purpose entities

3.13 Article 1(6) of the Directive amends Article 43 of the 4th Directive (introducing paragraph 7a into that article) to include a requirement for disclosure of off-balance sheet arrangements. This requirement will apply to all companies incorporated in the EU; thus it will apply equally to Irish companies preparing their individual or consolidated accounts in accordance with:

- The Companies (Amendment) Act 1986 ('1986 Act');
- The European Communities (Companies: Group Accounts) Regulations 1992 – S.I. 201 of 1992 ('1992 Regulations');
- The European Communities (Credit Institutions: Accounts) Regulations 1992 – S.I. 294 of 1992 ('Credit Institutions Accounts Regulations');
- The European Communities (Insurance Undertakings: Accounts) Regulations 1996 – S.I. 23 of 1996 ('Insurance Undertakings Accounts Regulations'); or
- IFRS as adopted by the EU (pursuant to EU Regulation 1606/2002 and S.I. 116 of 2005).

3.14 Recital 8 to the Directive states "Off-balance sheet arrangements may expose a company to risks and benefits which are material for an assessment of the financial position of the company and, when the company belongs to a group, the financial position of the group as a whole."

3.15 Recital 9 discusses the concept of off-balance sheet arrangements in terms of "transactions or agreements which companies may have with entities, even unincorporated ones, that are not included in the balance sheet". The recital refers to the creation or use of Special Purpose Entities ('SPEs') for economic, legal, tax or accounting purposes and cites examples of off-balance sheet arrangements such as risk and benefit-sharing arrangements and obligations arising from:

- Debt factoring;
- Combined sale and repurchase agreements;
- Consignment stock arrangements;
- Take or pay arrangements;
- Securitisation arranged through separate companies or unincorporated entities;
- Pledged assets;
- Operating lease arrangements;
- Outsourcing etc.

3.16 SPEs are consolidated into group financial statements where the substance of the relationship between the entity and the SPE is that the entity is able to control the activities of the SPE.

3.17 Part IV of the Schedule to the 1986 Act and the 1992 Regulations already include requirements to disclose various matters which could be considered to be within the scope of this Directive, such as information on related undertakings, derivatives and financial instruments, guarantees and financial commitments. However, the disclosure requirements of Article 1(6) of this Directive goes further than existing legislation. Accounting standards contain detailed requirements on the recognition and de-recognition of financial instruments and the consolidation of SPEs. Thus, the provisions of the Directive in this regard may be considered to require disclosure of other material arrangements that are not required to be disclosed through these more specific measures.

3.18 Article 1.6 provides for a Member State option to limit the disclosures required of small and medium-sized companies (in accordance with section 8 of the 1986 Act) to information about the nature and business purpose of the off-balance sheet arrangement.

3.19 The amendment to the 4th Directive in relation to the disclosure of off-balance sheet arrangements is made to Article 43(1) of that Directive. Article 44(1) of the 4th Directive gives Member States the option to exempt small companies (in accordance with section 8 of the 1986 Act) from the disclosure of various notes to their abridged accounts, and the option is extended to include the disclosure of the nature and business purpose of the off-balance sheet arrangement.

3.20 As noted in paragraph 3.13 above, the disclosure of off-balance sheet arrangements is also required for group accounts. Article 2.1 of the Directive amends Article 34 of the 7th Directive. Article 3 amends the Credit Institutions Directive and Article 4 amends the Insurance Undertakings Directive to require these disclosures in both the individual and group accounts of banks and other financial institutions and insurance undertakings respectively.

3.21 Proposal:

- 1. Implement the Directive's requirements without further elaboration. The requirement to disclose "off-balance sheet arrangements", as set out in Article 1(6) and elaborated on in recitals 8 and 9 of the Directive, must be transposed into Irish law. Company law will be amended to introduce the disclosure requirements for all companies, irrespective of whether they prepare their financial statements in accordance with IFRS or Irish GAAP.**
- 2. Take advantage of the member state option to limit the disclosure requirements imposed on small and medium-sized companies, as defined in section 8 of the 1986 Act, to information regarding the nature and business purpose of the arrangements.**
- 3. Exclude small companies, as defined in section 8 of the 1986 Act, from the obligation to include the limited disclosures of "off-balance sheet arrangements" in their abridged financial statements.**

Consultation Question 2

Do you agree that, with regard to the disclosure of “off-balance sheet arrangements”, it is appropriate to avail of the options with regard to small and medium-sized companies, as set out in paragraph 3.21? If not, please state which options you consider should not be taken up and the reasons for this.

Related party transactions

3.22 Article 1(6) of the Directive amends Article 43 of the 4th Directive (introducing paragraph 7b into that article) to include a requirement for disclosure of transactions entered into by the company with related parties if they are material and have not been concluded under normal market conditions. This requirement will apply to all companies incorporated in the EU; thus it will apply equally to Irish companies preparing their accounts in accordance with:

- The Companies (Amendment) Act 1986 (‘1986 Act’);
- The European Communities (Companies: Group Accounts) Regulations 1992 – S.I. 201 of 1992 (‘1992 Regulations’);
- The European Communities (Credit Institutions: Accounts) Regulations 1992 – S.I. 294 of 1992 (‘Credit Institutions Accounts Regulations’); and
- The European Communities (Insurance Undertakings: Accounts) Regulations 1996 – S.I. 23 of 1996 (‘Insurance Undertakings Accounts Regulations’).

3.23 Companies preparing their accounts in accordance with IFRS as adopted by the EU (pursuant to EU Regulation 1606/2002 and SI No 116 of 2005) are already subject to IAS 24 *Related Party Disclosures*. The provisions of IAS 24 are similar to those included in the Directive; thus amendment of Irish legislation with regard to these companies is not necessary. In fact, unlike Article 1(6), IAS 24 requires disclosure of material transactions regardless of whether or not the transactions are concluded under normal market conditions.

3.24 The disclosures required by Article 1(6) are:

- The amount of such transactions;
- The nature of the related party relationship; and
- Other information about the transactions necessary for an understanding of the effects of related party transactions on the financial position of the company.

3.25 Article 1(6) states that the definition of related party is to be taken from “international accounting standards adopted in accordance with Regulation (EC) No 1606/2002”, which means from IAS 24 *Related Party Disclosures*. This standard defines related parties of a company to include:

- Parties which the company controls;
- Parties that have control, joint control or significant influence over the company;
- Parties subject to common control with the company;
- Key managers of the company and their immediate family; and

- The company's associates and joint ventures.

3.26 As noted in paragraph 3.22 above, the disclosure of related party transactions is also required for group accounts. Article 2.1 of the Directive amends Article 34 of the 7th Directive. Article 3 amends the Credit Institutions Directive and Article 4 amends the Insurance Undertakings Directive to require these disclosures in both the individual and group accounts of banks and other financial institutions and insurance undertakings respectively.

3.27 For both individual and group accounts, information about individual transactions may be aggregated according to their nature, except where separate information is necessary for an understanding of the effects of the related party transactions on the financial position of the company or the undertakings included in the consolidation taken as a whole. Intra-group transactions, in so far as they are consolidated into the group financial statements, are not required to be disclosed under Article 2(1).

3.28 Article 1(6) includes four Member State *options* with regard to related party disclosures in the individual accounts of companies (not available for group accounts), namely:

- All small companies, with the exception of those which are public companies, can be excluded from the obligation to disclose related party transactions (see paragraph 3.29 below, however).
- All medium sized companies, with the exception of those which are public companies, can be excluded from the obligation to disclose related party transactions (see paragraph 3.29 below, however).
- The disclosure required of medium-sized companies which are public companies can be restricted by Member States. At a minimum, such companies must make related party disclosures regarding transactions entered into directly or indirectly with:
 - Major shareholders; and
 - Members of the administrative, management and supervisory bodies (i.e., boards of directors).
- Member States can exempt all transactions entered into between two or more members of a group provided that subsidiaries which are party to the transaction are wholly owned by such a member.

3.29 It should be noted, however, that neither IAS 24 nor Irish GAAP - FRS 8 *Related Party Disclosures* / Financial Reporting Standard for Smaller Entities (FRSSE) - provide any exemptions from disclosures based on size.

3.30 One significant difference between IAS 24, the proposal in Article 1(6) and FRS 8 is the exemption with regard to intra-group transactions. Under IAS 24, transactions between group members must be disclosed in individual accounts regardless of whether the subsidiaries involved are wholly owned members of the group. Article 1(6) permits Member States to exempt companies in their individual accounts from disclosing transactions between group members provided those members are wholly owned

subsidiaries. However, FRS 8 exempts “*subsidiary undertakings 90 per cent or more of whose voting rights are controlled within the group. These subsidiaries do not have to disclose transactions with other group companies and investees of the group qualifying as related parties.*” Thus, the proposed requirements of the Directive are more stringent than those currently contained in FRS 8 in this regard.

3.31 Proposal:

- 1. Implement the Directive’s requirements without further elaboration. The requirement to disclose “related party transactions”, as set out in article 1(6) and elaborated on in recitals 6 and 7 of the Directive must be transposed into Irish law. Company law will be amended to introduce the disclosure requirements for companies, preparing their financial statements in accordance with Irish GAAP.**
- 2. Avail of all the Member State options provided for in Article 1(6), on the basis set out in paragraph 3.28 above.**

Consultation Question 3

Do you agree that, with regard to the disclosure of “related party transactions”, it is appropriate to avail of all of the options provided for in Article 1(6), as set out in paragraph 3.28 above? If not, please state which options you consider should not be taken up and the reasons why not.

Articles 1(7) and 2(2): Corporate Governance Statement

3.32 Article 1(7) inserts a new Article 46a in the 4th Directive requiring a corporate governance statement in the annual (directors') report⁴ of companies (excluding Investment Funds) whose equity securities are admitted to trading on a regulated market.

3.33 This corporate governance statement will be issued either in a separate section of the directors' report, or as a separate statement published with or referred to in the directors' report. The statement will, at a minimum, contain:

- a) A reference to the corporate governance code to which the company is subject under national law, and/or the corporate governance code which the company has voluntarily decided to apply, and/or all relevant information about the corporate governance practices applied beyond the requirements under national law.
- b) An explanation by the company, to the extent that it departs from an above-mentioned corporate governance code, as to which parts of the corporate governance code it departs from and the reasons for doing so.
- c) A description of the main features of the company's internal control and risk management systems in relation to the financial reporting process. Article 2(2) also requires, in relation to groups, a description of the main features of the group's internal control and risk management systems in relation to the process for preparing consolidated accounts.
- d) Information already required by Directive 2004/25/EC ('the Takeovers Directive') related to the company's share and control structures - (1) significant direct and indirect shareholdings (including indirect shareholdings through pyramid structures and cross-shareholdings) within the meaning of Article 85 of Directive 2001/34/EC; (2) the holders of any securities with special control rights and a description of those rights; (3) any restrictions on voting rights, such as limitations of the voting rights of holders of a given percentage or number of votes, deadlines for exercising voting rights, or systems whereby, with the company's cooperation, the financial rights attaching to securities are separated from the holding of securities; (4) the rules governing the appointment and replacement of board members and the amendment of the articles of association; (5) the powers of board members, and in particular the power to issue or buy back shares.
- e) Unless the information is fully provided for in national laws or regulations, the operation of shareholders' meeting and its key powers, and a description of shareholders' rights and how they can be exercised.
- f) The composition and operation of the board and its committees.

⁴ References to the "annual report" in the Directive are equivalent to references to the "directors' report" in Irish company law.

3.34 Article 2(2) inserts an additional disclosure requirement in the corporate governance statement relating to group accounts of entities admitted to trading on a regulated market. It requires a description of the main features of the group's internal control and risk management systems in relation to the process for preparing consolidated accounts.

3.35 Much of the information required by Article 1(7) is currently required of companies with equity securities admitted to trading on a regulated market of the Irish Stock Exchange (excluding Investment Funds). The requirement to collate all the information into a single statement is, however, new. The Combined Code on Corporate Governance sets out standards of good practice in relation to issues such as board composition and development, remuneration, accountability and audit and relations with shareholders.

3.36 All companies with equity securities admitted to trading on a regulated market of the Irish Stock Exchange (excluding Investment Funds) are required under Listing Rules (LR 6.8.3(6)) to include in the annual report "*a statement of how the listed company has applied the principles set out in Section 1 of the Combined Code, in a manner that would enable shareholders to evaluate how the principles have been applied.*". LR 6.8.3(7) further requires such companies to state whether they have complied for the whole period and, if not, to set out the provisions with which the company did not comply, the period of, and the reasons for, any such non-compliance. LR 6.8.4 requires companies incorporated outside Ireland whose equity securities have a primary listing and trade on the main market of the Irish Stock Exchange (excluding Investment Funds) to explain, inter-alia, whether or not they comply with the corporate governance regime of their country of incorporation and the significant ways in which their actual corporate governance practices differ from those set out in the *Combined Code*.

3.37 The table below sets out the current requirements for companies with equity securities admitted to trading on a regulated market of the Irish Stock Exchange (excluding Investment Funds) equivalent to the requirements set out in Article 1(7) with regard to the corporate governance statement.

Comparison of Directive requirements with current position in Ireland with regard to certain companies

Requirements of Article 1(7) – see para. 3.32	Current position in Ireland
<p>a) and b) The corporate governance code that applies to the company including an explanation as to the extent to which the company is compliant therewith.</p>	<p>Listing Rule (LR) 6.8.3 requires</p> <p>(6) a statement of how the <i>listed company</i> has applied the principles set out in Section 1 of the <i>Combined Code</i>, in a manner that would enable shareholders to evaluate how the principles have been applied.</p> <p>(7) a statement as to whether the <i>listed company</i> has:</p> <p>(a) complied throughout the accounting period with all relevant provisions set out in Section 1 of the <i>Combined Code</i>; or</p> <p>(b) not complied throughout the accounting period with all relevant provisions set out in Section 1 of the <i>Combined Code</i> and if so, setting out:</p> <p>(i) those provisions, if any, it has not complied with;</p> <p>(ii) in the case of provisions whose requirements are of a continuing nature, the period within which, if any, it did not comply with some or all of those provisions; and</p> <p>(iii) the company's reasons for non-compliance.</p>
<p>c) A description of the main features of the company's internal control and risk management systems in relation to the financial reporting process (and, in relation to groups, a description of the main features of the group's internal control and risk management systems in relation to the process for preparing consolidated accounts)</p>	<p>There is no specific provision relating to disclosure of the main features of the company's internal control and risk management systems in relation to the financial reporting process (or for groups, the process for preparing consolidated accounts).</p> <p>However, Combined Code provision C.2.1 requires that "The board should, at least annually, conduct a review of the effectiveness of the group's system of internal controls and should report to shareholders that they have done so. The review should cover all material controls, including financial, operational and compliance controls and risk management systems."</p> <p>The Turnbull Guidance (October 2005), which sets out best practice on internal control for listed companies, provides further guidance as to the information that should be disclosed.</p>
<p>d) Information already required by Directive 2004/25/EC ('the Takeovers Directive') related to the company's share and control structures</p>	<p>Required under Regulation 21 of the European Communities (Takeover Bids (Directive 2004/25/EC)) Regulations 2006 S.I. No. 255 of 2006 (the "Takeover Bids Regulations") to be included in the directors' report. The Regulations came into operation on 20 May 2006.</p>

Comparison of directive requirements with current position in Ireland with regard to certain companies (contd.)

<p>e) Unless the information is fully provided for in national laws or regulations, the operation of shareholder meeting and its key powers, and a description of shareholders' rights and how they can be exercised</p>	<p>Shareholder participation in company meetings and the conduct of those meetings in listed companies is governed by a mixture of statutory provision, companies' memorandum and articles of association and common law provisions, as well as the Listing Rules and the Combined Code.</p> <p>The main statutory provisions regarding the operation of shareholders' meetings are contained in Part V of the Companies Act 1963, sections 130 to 146. Shareholders' rights are governed by section 78 of the Companies Act 1963 and sections 38 and 39 of the Companies (Amendment) Act 1983.</p>
<p>f) The composition and operation of the board and its committees</p>	<p>The following disclosures are required by the Combined Code to be included in the annual report of listed companies:</p> <ul style="list-style-type: none"> • a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management (code provision A.1.1); • the identity of the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the nomination, audit and remuneration committees; details on the number of meetings of the board and those committees and individual attendance by directors (code provision A.1.2); • a description of the work of the nomination, remuneration and audit committees (code provisions A.4.6, B.1.4 and C.3.3 respectively).

3.38 Member States have a number of *options* with regard to the implementation of Article 1(7):

- Under Article 1(7)(2), the disclosures, except for the information required by the Takeover Bids Regulations to be given in the directors' report, can be made in a separate report published together with the directors' report or a reference can be made in the director's report to the location of a separate document which must be publicly available on the company's website.
- Under Article 1(7)(3), Member States may exempt companies which have only issued securities other than shares admitted to trading on a regulated market, from certain of the requirements of Article 1(7), unless such companies have issued shares which are traded on a multilateral trading facility. These requirements are:
 - The requirements covering compliance or explanation of non-compliance with a corporate governance code (points a) and b) in the table above);
 - The requirement to include a description of the operation and key powers of shareholders' meeting, shareholders' rights and the exercise thereof (point e). above); and
 - The composition and operation of the board (point f) above).

3.39 Article 1(7)(2) of the Directive includes certain of the disclosure items from the corporate governance statement within the scope of the auditors' responsibilities under Article 51(1) of the 4th Directive with regard to the auditor's opinion on the consistency of the directors' report with the annual accounts. The auditor's opinion will consequently encompass a consideration of the information provided in points c) and d) in paragraph 3.33 above, namely:

- Point c): the description of the main features of the company's internal control and risk management systems in relation to the financial reporting process; and
- Point d): the disclosures with regard to the company's share and control structures.

3.40 With regard to the remaining disclosures required in accordance with Article 1(7)(1), the auditor's responsibility is to "check that the corporate governance statement has been produced".

3.41 Proposal:

- 1. Take advantage of the member State options provided for in Article 1(7)(3) to minimise the disclosure requirements on companies which only have securities other than shares traded on a regulated market (e.g. companies which only have "debt listings"), on the basis set out in 3.38 above.**
- 2. Permit companies to choose whether to encompass the corporate governance statement in the directors' report or to publish it in a separate document in accordance with Article 1(7)(2).**

Consultation Question 4

Do you agree that companies should have the option of publishing the corporate governance statement separately to the directors' report? If you believe that publication should be restricted to the directors' report, please state your reasons.

Consultation Question 5

Do you agree that it is appropriate to avail of all of the options provided for in Article 1(7)(3) to minimise the disclosure requirements on companies which only have securities other than shares traded on a regulated market, as set out in paragraph 3.38 above? If not, please state which options should not be taken up and why.

Articles 1(8) and 2(3): Collective Responsibility of Directors

3.42 Articles 1(8) and 2(3) require Member States to ensure that the board members are collectively responsible, at least towards the company, for ensuring that the annual accounts (both individual and consolidated), directors' report and, where produced separately, the corporate governance statement required by Article 1(7) are published in accordance with the relevant Directive and, where applicable, with the requirements of IFRS as adopted by the EU.

3.43 This provision serves only to prevent Member States from having a system of responsibility limited to individual board members and does not preclude the courts or other enforcement bodies from imposing penalties on individual board members. It applies to all limited companies incorporated in an EU Member State.

3.44 Whilst not explicitly stated in Irish legislation, current Irish practice recognises collective board responsibility. Sections 148 and 150 of the Companies Act 1963 ('1963 Act') impose the obligation on the directors of a company to prepare individual company and consolidated accounts respectively. Section 156 of the 1963 Act requires two directors to sign the accounts whilst section 158 of the 1963 Act establishes the directors' responsibilities for producing and signing the directors' report. Sections 128 of the 1963 Act and 248 of the Companies Act 1990 establish the directors' responsibilities with regard to filing the accounts and reports with the Companies Registration Office.

3.45 Proposal: Implement the Directive's requirement without further elaboration. The provisions in articles 1(8) and 2(3) covering the directors' duty and liability for preparing and publishing the annual accounts and the directors' report must be transposed into Irish law. Company law will be amended to reflect these specific requirements for the collective responsibility of the board of directors in this regard.

SECTION 4: OTHER COMPANY LAW MEASURE TO BE IMPLEMENTED

Consequential Amendments from the recent approval by the IASB of an amendment to IAS 27 *Consolidated and Separate Financial Statements*

4.1 In May 2008, the IASB issued an amendment to IAS 27 *Consolidated and Separate Financial Statements*. The amendments will, subject to endorsement by the EU, be mandatory for those companies preparing their financial statements in accordance with IFRS as adopted by the EU for financial reporting periods commencing on or after 1st January 2009. These amendments specifically require :

1. the cost of investment in a previous parent to be accounted for at previous carrying value when a new parent is introduced above an existing group in a group reconstruction and
2. distributions from subsidiaries to be accounted for in profit or loss whether or not they are from pre-acquisition profits.

These new requirements will be in conflict with certain provisions of the Companies Act 1963. The Department of Enterprise, Trade and Employment is currently considering how best to resolve these conflicts, which potentially may involve amending current requirements of section 62 and section 149(5) of the Companies Act 1963.

4.2 The potential amendments would involve amending section 62 of the 1963 Act to allow relief from the requirement to establish share premium for a limited number of internal group reconstructions, and amending section 149(5) of the 1963 Act to require that dividends received by a parent out of pre-acquisition profits of a subsidiary are not distributable, but may be recognised as income in accordance with IAS 27 Revised.

4.3 This would require to be done through primary legislation.

Consultation Question 6

Do you consider this to be a significant issue?

SECTION 5: ISSUE OF THRESHOLDS FOR SMALL AND MEDIUM SIZED COMPANIES

Articles 1(1) to 1(4) of the Directive: Small and Medium-Sized Company Thresholds

5.1 Articles 11 and 27 of Directive 78/660/EEC (“the 4th Directive”) provide Member States with an option to grant various company reporting exemptions to small and medium-sized companies subject to maximum thresholds (expressed as turnover, balance sheet total and average number of employees) as set out in those articles. Articles 1(1) to 1(4) of the Directive 2006/46/EC (“the Directive”) increase the maximum turnover and balance sheet thresholds to:

	Turnover (€)	Balance sheet total (€)
Small companies	8,800,000	4,400,000
Medium-sized companies	35,000,000	17,500,000

The ‘*average numbers of employees*’ criteria remain unchanged, namely, not exceeding 50 for small companies and not exceeding 250 for medium-sized companies.

5.2 Currently, under section 8 of the 1986 Act, the maximum thresholds defining small and medium companies are:

	Turnover (€)	Balance sheet total (€)
Small	3,809,214	1,904,607
Medium-sized	15,236,857	7,618,428

Companies must meet at least two of the three criteria in the current and preceding financial years (except for a company in its first financial year) in order to qualify as small or medium-sized.

5.3 Most companies defined as “small” are currently permitted to file only an abbreviated balance sheet for filing with the Companies Registration Office (sections 10 and 11 of the 1986 Act). There are also exemptions under section 12 of the 1986 Act with regard to disclosures in the notes to the accounts.

5.4 Most medium-sized companies also have the option to file less detailed accounts with the Companies Registration Office (an abridged balance sheet and an abridged profit and loss account) and to avail of the exemption from providing particulars of turnover in the notes to the accounts.

5.5 The factors to be considered in making a decision as to whether or not to take advantage of the increased thresholds are:

- Possible risks of reducing reporting requirements of small and medium sized companies, such as the impact of more limited information being made publicly available on, for example, lenders and other creditors;
- Potential benefits accruing to small and medium-sized companies such as increased flexibility and reduced costs from removing some of the reporting burdens.

Consultation Question 7

*Do you consider that it is appropriate to take advantage of the increased thresholds?
Please give your reasons.*

SECTION 6: TIMETABLE FOR IMPLEMENTATION

6.1 Member States are required to bring into force the laws, regulations and administrative provisions to comply with the Directive by 5th September 2008.

6.2 Proposal: Apply the requirements of the Directive to the financial statements and directors' reports of companies whose financial years commence on/after the date of commencement of the implementing Regulations.

Consultation Question 8

Do you agree with the proposal to make the amendments in the Directive effective for the financial statements and directors' reports for financial years beginning on/after the date of commencement of the implementing regulations? If not, please state your reasons.

Appendix A

List of consultation questions

Fair value accounting

Consultation Question 1: Do you believe the option to permit fair value accounting in Irish law as set out at 3.12 above should be adopted? If not, please state your reasons.

Disclosure requirements relating to off-balance sheet arrangements

Consultation Question 2: Do you agree that, with regard to the disclosure of “off-balance sheet arrangements”, it is appropriate to avail of the options with regard to small and medium-sized companies, as set out in paragraph 3.21? If not, please state which options you consider should not be taken up and the reasons for this.

Disclosure requirements relating to related party transactions

Consultation Question 3: Do you agree that, with regard to the disclosure of “related party transactions”, it is appropriate to avail of all of the options provided for in Article 1(6), as set out in paragraph 3.28 above? If not, please state which options you consider should not be taken up and the reasons why not.

Corporate Governance Statement

Consultation Question 4: Do you agree that companies should have the option of publishing the corporate governance statement separately to the directors’ report? If you believe that publication should be restricted to the directors’ report, please state your reasons.

Consultation Question 5: Do you agree that it is appropriate to avail of all of the options provided for in Article 1(7)(3) to minimise the disclosure requirements on companies which only have securities other than shares traded on a regulated market, as set out in paragraph 3.38 above? If not, please state which options should not be taken up and why.

Consequential Amendments from the recent approval by the IASB of an amendment to IAS 27 Consolidated and Separate Financial Statements

Consultation Question 6: Do you consider this to be a significant issue?

Small and Medium-sized Company Thresholds

Consultation Question 7: Do you consider that it is appropriate to take advantage of the increased thresholds? Please give your reasons.

Timetable for implementation

Consultation Question 8: Do you agree with the proposal to make the amendments in the Directive effective for the financial statements and directors' reports for financial years beginning on/after the date of commencement of the regulations? If not, please state your reasons.

