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Selling your business

Peter Hemington tells entrepreneurs how to get the best deal

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Building bridges with the IS department

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Feedback

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Season's greetings

THE FACULTY WISHES SEASONAL GREETINGS TO ALL MEMBERS

December 2000 Issue 70

Lecture plans for 2001

During 2001, the Faculty of Finance and Management is planning a series of conferences around the UK in conjunction with several of the country's leading business schools.

The first of these regional events is planned for April at Manchester Business School. This conference will look at the ways that organisations are becoming more adaptable in the fast-moving business world and the impact this has on traditional budgeting procedures.

Plans are also under way to hold conferences at Cranfield School of Management in Bedfordshire, Leeds Business School in West Yorkshire, and Aston Business School in Birmingham later in 2001.

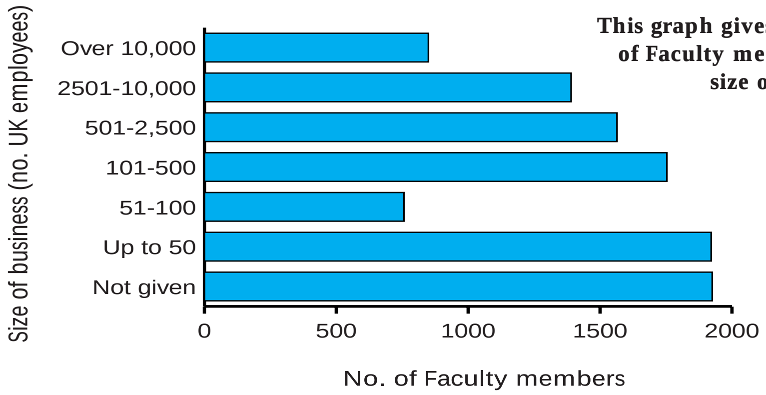
In addition, the Faculty will hold its annual conference in June 2001 in central London and is currently exploring possible subjects for this event such as 'The Impact of E-Commerce on Finance', 'Shareholder Value' and 'The Future of the Finance Director'.

Four evening lectures will also be held in central London throughout 2001.

The first of these will take place on 20 February, 'Competing in the New Economy' and the second will be on 13 March on the subject of 'Dynamic Strategy – Creating Shareholder Value through Stakeholder Management'.

Details of all these events will be set out in future issues of *Finance and Management*.

Analysis of Faculty membership



This graph gives an analysis of Faculty membership by size of employer's business.

PLEASE NOTE THAT ALL CHANGES OF ADDRESS AND OTHER NEW DETAILS OF FACULTY MEMBERS SHOULD BE NOTIFIED TO THE INSTITUTE'S MEMBERS' REGISTRATION DEPARTMENT (TEL: 01908 248250 OR EMAIL: finmreg@icaew.co.uk).

Grooming your business for sale

With the right preparation, entrepreneurs can make a substantial difference to the value of their business. **Peter Hemington**, head of mergers and acquisitions at BDO Stoy Hayward, explains how.

Many entrepreneurs may be currently looking to capitalise on today's strong private company market where prices are close to record levels. This is because of high liquidity in the market, together with an influx of venture capital funds and a strong economic outlook.

Indeed, the BDO Stoy Hayward/ Acquisitions Monthly Private Company Price Index*, based on every private company sale reported within the UK, shows that the average private company achieves a p/e ratio of more than 14 on sale.

Arguably, for many companies this figure is distorted by the fantastic prices which have been paid this year for some new economy businesses. But the strength of the index illustrates the underlying buoyancy of the market.

Yet, selling your business is an extremely complex process. Get it wrong and many years of hard work could be wasted. If you are considering the sale of your business in the next few years, you may also be able to enhance its value by preparing the business for sale now.

** Private Company Price Index, June 2000. P/e multiple quoted is average of exit price realised stated in relation to historic post-tax earnings.*

Targeting real operational change

The objective here is not just cosmetic enhancement but real operational change. This can require substantial effort and discipline and, as a result, may not be something that can be completed easily in the six-month run up to a sale.

There are three key areas to consider:

- your people;
- the financial issues; and
- the legal requirements.

Not all private companies require grooming across every single area. You should look to maximise the impact of what you can realistically achieve in relation to the amount of time and effort available.

People

If a vendor is actively involved in the day-to-day running of the business, perhaps winning and retaining new customers, the purchaser will probably be keen to retain their services for a handover period after the sale. This is a requirement which many entrepreneurs will want to avoid.

Businesses where the entrepreneur has developed a sound second tier management team are always going to do better on sale than others. This is because if the owner is not critical to the business the buyer's investment risk is clearly much reduced.

It also usually makes sense to incentivise the management team to assist the sale process by offering performance related completion bonuses, which are payable on confirmation of a successful sale. A good adviser will be able to ensure an appropriate structure, which takes into account any tax implications, is put in place.

Financial issues

Easy solutions in this area are rare and should be viewed with caution. Although it makes sense to do what you can to increase sales and margins and control overheads before entering into a transaction, it is likely that you are already doing all you can to achieve this. However, areas particularly worth considering are:

- accounting policies – a careful look at your accounting policies, compared with those normally adopted in the industry, can yield unexpected benefits. You may find your accounting policies result in conservative profit recognition compared with, say, a quoted company whose policies are usually earnings (and share price) driven with the aim of maximising reported profit. Quoted buyers are unlikely to argue with a restatement of your policies so that they are more in line with theirs, even if it means that ultimately they may pay more;
- non-recurring expenditure – identifying non-recurring expenditure is a valuable exercise. This expenditure may include exceptional owner's expenses and remuneration, and one-off expenditure, such as the costs of re-location or other unusual disruption to normal business. Highlighting these adjustments and focusing the buyer on the underlying earnings of the business should be a prime concern. Again, even if it means that they have to pay more, buyers are happy to accept adjustments to reported profits if the changes are robust, justifiable and give them useful information about future profitability;
- capital expenditure – it is particularly difficult deciding whether to incur significant capital expenditure in the run up to a sale. However, if a business has been run purely for cash and there has been underinvestment in capital and operational resources, a sensible purchaser will focus on the remedial investment required and factor this in to the assessment of value. Generally, it is sensible to continue to invest in the business as if you intend to own it in the future; and
- business forecasts – most buyers will want to understand the forecasts for the business in the next few years. In this area, credible budgets and longer-range forecasts can enhance value enormously. They should be underpinned by reasoned assumptions, perhaps by customer and product, and be prepared on a bottom up basis with the full involvement of the management team.

'... deciding whether to incur significant capital expenditure in the run-up to a sale... '

Another word of caution – a buyer's due diligence will almost certainly discover any quick fixes and the process particularly scrutinises the sustainability of sales and profits. There is no advantage in presenting a fine-looking company, which on detailed investigation does not have the operating base to sustain the business.

A 'grooming' checklist

- **Establish sound first and second tier management teams. Reduce the investment risk to buyers by demonstrating that you are not critical to the business;**
- **consider performance related completion bonuses with staff – and the resulting tax implications;**
- **review accounting polices carefully. Are they tax driven to recognise conservative profit or do they seek to maximise reported profit? ;**
- **highlight non-recurring expenditure. Focus the buyer on the underlying earnings of the business;**
- **establish credible budgets and longer range forecasts. Both of these can enhance value enormously. They should be underpinned by reasoned assumptions and prepared with the full involvement of the management team; and**
- **address intellectual property and asset ownership issues. Ensure contracts or documentation exist where reasonable.**

Legal issues

The final area to consider concerns the legal process. Your buyer's lawyer will conduct extensive legal due diligence, including a review of all material contracts and title to assets. An issue often revealed by this process, especially for entrepreneurially managed businesses, is the absence of contracts or other documentation which might reasonably be expected to exist.

Sale and purchase contracts contain extensive warranties and indemnities, which sellers must provide. Having a good understanding of the state of the company and its tax, financial, environmental, customer and supplier relationships and other legal affairs is, therefore, imperative.

This issue can become acute if the documents relate to a key employee, customer or supplier, intellectual property or asset ownership. Where practical, you should ensure this is addressed before sale.

Entrepreneurs are sometimes very emotionally involved in their business. As a result, they often find themselves embroiled in litigation more for personal than for commercial reasons.

If a sale of the company is on the horizon then it often makes sense to settle outstanding issues earlier rather than later.

Conclusion

Although pinning down all or some of these three areas can bring surprising rewards, no two companies are the same and the priorities for each business vary accordingly. Most entrepreneurs find the sale of their business far more emotionally demanding, time-consuming and stressful than they had anticipated at the outset.

Any step you can take to make the process more rewarding should be considered and raised with a professional adviser. See your advisers, ask your lawyer, speak to your bank manager and profit from someone who has been through the hoops before.

Peter Hemington is head of mergers and acquisitions at BDO Stoy Hayward Corporate Finance, which advises companies on raising finance for growth, acquisitions and realisations.
Tel: 020 7893 2344.

BDO Stoy Hayward has launched a new 'Grooming your business' programme designed to help vendors maximise the value of their business ahead of sale or flotation. For further details, contact Caroline O'Connor on 020 7893 2740.

BOOK REVIEW

Plain talking about marketing

Alan Mitchell (*below*) reviews 'Marketing and the Bottom Line: the new metrics of corporate wealth' by Tim Ambler (*Financial Times/Prentice Hall*, £19.99)

How to measure the financial effect of marketing efforts remains something of a mystery to many finance directors. But in a new book managing director turned marketing professor Tim Ambler provides clear thinking hard-nosed advice on the problem.

Finance and marketing directors rarely see eye-to-eye and Ambler doesn't mince his words in addressing that issue. Accountants seem to imagine that a pile of money will grow if you only count it enough, declares this former joint managing director of International Distillers and Vintners turned London Business School marketing professor, on the first page.

However, his isn't a tome of childish invective. It contains hard-nosed advice from a clear thinker with the mind of a practitioner, based on the results of a 30 month research project.

Marketing metrics matter

Ambler focuses on three core conclusions. First, marketing metrics matter. Traditional management accounts do an excellent job at measuring flows of cash in and out of the company but pay little attention to how healthy the source of these cash flows is: ie the company's brand equity or standing with customers, distribution channels, employees, and so on. But this brand equity is the storehouse of future profits, says Ambler. In future, no professionally managed business will measure short-term profits without also measuring shifts in brand equity.

(That's not the same as valuing brands. Brand equity is the asset itself and cannot be reduced to a single measure just as we cannot judge our own health by a single measure such as pulse or temperature. As Ambler demonstrates, most pure brand valuation methodologies are suspect).

Proxy measures

Measuring brand equity isn't easy, however. As an asset that lives in people's heads, it cannot be measured directly. Instead – conclusion number two – we need proxy measures including: inputs such as share of voice in terms of advertising spend; intermediate measures such as customer satisfaction or perceived quality; and behaviour such as market share or conversion of trial to repeat purchase.

No best set of measurements

This, in turn, leads to Ambler's third main conclusion: there is no single, uniform best set of measures. Each company has its own unique goals and strategies. So each company must develop its own suite of measures to calibrate progress towards these goals.

And as Ambler points out, the joint marketing/accounting quest to discover and agree on these measures will probably do more to create a common language than anything else.

Alan Mitchell writes extensively on marketing and finance, and is a former editor of Marketing magazine.

Marketing vs information systems – a blurring of the battlelines!

Marketing and IS departments have traditionally not been obvious candidates for smooth collaboration. But needs must, in the drive to build an impressive web presence. Faculty member **Liz Eyles** oversees just such a collaborative effort at Perpetual, and outlines her top tips for a happy working relationship – and a good result.

In the past, the supposed enormity of the differences between the two sexes, could equally well be applied to the relationship between IS and marketing departments in many companies. Neither understood why, how or with whom the other worked – and, in most cases, gave up trying a long way back. But all that is changing in the new world as the two departments are being forced to come together to build a web presence for their companies.

Companies will structure responsibility for web development in different ways: sometimes as part of the IS department, sometimes as part of marketing and sometimes as a totally separate department. The best method will depend on the nature of the business, the skills and experience of those involved and the existing relationships between the different areas. One thing that is always needed, however, is a very close working relationship between all those involved. It's a cliché, but true, that traditional boundaries no longer apply when dealing with the web.

Pointers to working together in the brave new world include:

● Plan the project together properly

This means the dreaded project plan. To marketing, Microsoft Project is a bit of an anathema – we find it very hard to make sense of all those lines and tasks, and please don't even mention gantt charts. IS can't understand what our problem is – of course it all makes perfect logical sense! The solution is to make sure that a high level version of the plan is available – and for the project manager to make sure that, however painful, those responsible do sit down and go through it line by line and take ownership of it. There's a fine balance to be struck here between the desire from marketing for flexibility in order to react to the market, and the desire from IS to 'stick to what's been agreed'. There is no easy answer other than to talk and negotiate.

● Work as a team

More than with any other project, IS, marketing and those responsible for whatever business processes are being adapted for the web, need to work very closely together – and if you don't have the right team, with the right leadership and chemistry it won't work. Encourage the team to spend time together and understand where each of their strengths lie. You may need to give them more free rein than you'd normally expect at the start of the project. The potential downside to close teamwork is that it's easy for team members to try to do one another's job – so regularly review who is doing what.

● Understand each other

There's little point in designing a spectacular web site, if it is virtually unprogrammable. On the other hand, it's not very helpful to let IS concentrate solely on what can be added to a site from a technical perspective, and not let them know what should be added from a marketing perspective. An initial meeting to set overall guidelines of what can, can't and should be done, together with regular progress meetings to check that everyone is keeping within these guidelines is a good idea.

● Learn the technical side

Never underestimate the credibility that you'll gain as a marketing person when you're able to discuss things such as the hardware infrastructure with a reasonable show of intelligence – it works wonders for team morale and getting things fixed when you need them fixed urgently. Sit in on the occasional meeting where it's being discussed and show interest.

● Consider using third parties

If necessary, why not use outside experts to help you with development? For example, a good design agency can help fill in gaps in IS knowledge of what is possible with the tools that are being used for development. But be careful how you manage suppliers! From marketing's perspective, we're used to working with our own agencies – beware, it's different when you're working with a techie agency! You may also find that IS are less used to managing suppliers to tight deadlines. Make sure that the project team is happy with the agency and gives it a tight brief and budget.

Keep others updated

It's important to keep the rest of the organisation on board with developments. You may find that your knowledge races ahead of others' and you'll need to think about how to keep everyone (from key decision makers to those that will be responsible for answering basic web queries) up to speed both with what you are doing and with technological developments and their impact.

Watch your language!

Always make sure that you understand what IS are talking about. Don't be afraid to ask what something means and keep asking until you fully understand. Also make sure that IS know what you are talking about when you indulge in 'design speak'.

Make your content manageable

It should be easy for whoever is responsible for the content to amend it. For example, if there is an urgent news story to put onto your site, how can it be done quickly and without too many hoops to jump through?

Share your designs

This is potentially the biggest minefield, as almost everyone is a frustrated designer at heart! Agreeing and developing design will test your negotiation skills to the limit, and there are no hard and fast rules as to how to get through it. Marketing will need to accept that the skills needed for web design are very different from those needed for print design, whilst IS may need convincing that it really does matter what a site looks like. The best solution is to work it out together – you'll soon discover that your IS department is able to offer invaluable advice about download times and general internet practices, which will hugely influence the way your site is constructed.

Involve the whole team in talking to the users

It's an obvious role for the marketing team to make sure that they find out what the users of the site want, but don't forget to get IS involved in the process. They'll be delighted to be 'let loose' on customers and it will add to their understanding of what the business needs. What's more, they should be able to help answer some of the more technical queries.

Be patient!

This is going to be a new way of working for many of the people involved. You'll also have to learn a lot about each other's jobs, and keep this new knowledge in mind whenever you make any decisions. Obviously, this is not going to happen overnight and there are bound to be teething problems. But if you persevere, it will happen eventually.

Web site development is frantic but fun – there's a whole new aspect to how an organisation can trade and communicate to be discovered and put to use. If you can make it work, you will find that you have a team of individuals who have negotiated a steep learning curve to become a real asset to the company – and who are highly motivated and enjoy their jobs.

Liz Eyles leads the marketing team responsible for developing Perpetual's web presence (www.perpetual.co.uk).

ABSTRACTS FROM LIBCAT

Battersby J – Hit for six
Taxation, Vol.146. No.3780, 26 October 2000, p85-87 (3 pages)
The tax treatment of overseas operations of close and non-close companies has been a serious anomaly for some time. The author discusses the recent increased tax charges for private companies with international operations.

D'Souza S – For what it's worth
Financial World, September 2000, p38-40 (3 pages)
Bank customers have always received a monthly statement and an annual statement of unit trusts and endowment policies, but nowhere has this come together to allow consumers to take a unified view of their financial status. However, advances in bank technology and the attractive front end provided by the internet have created an opportunity to change this. The author outlines ways financial institutions can evaluate the net worth of individuals effectively.

Courtnage S – Doing your homework
Finance Director's Review, Vol.9, No.2, July 2000, p14 (1 page)
The rewards of a successful homeworking strategy are not so much the office overheads you save, as staff motivation, performance and satisfaction. This is the conclusion of a new research paper from the Institute of Employment Studies, 'An evaluation of homeworking in ACAS', commissioned by the Advisory, Conciliation and Arbitration Service (ACAS). The article summarises the main findings of the report.

Arundel R – From bricks to clicks
Money Management, July 2000, p66-67 (2 pages)
Three new services from the eXchange, AssureWeb and BMC Programmes, provide a template service so that independent financial advisers (IFAs) can go on-line, add their unique content and create an instant web site. However, the author suggests that there is more to successful marketing on the web than simply building an instant site.

MacDonald S – Rough guide to work
CA (ICAS), Vol. 104, No.1129, August 2000, p28-32 (4 pages)
Looking for a change of scene? Spending a couple of years overseas using your skills as a chartered accountant may well prove the ideal solution. The author reports on careers abroad.

http://www.icaew.co.uk/library.htm

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Risk share – the benefits and the potential pitfalls

Faculty member **Mark Collis**, draws on first hand experience to explain the upside and downside of risk sharing, and provides a useful set of guidelines for risk managers.

Understanding and managing risk is a key part of being an accountant. Risk plays a central role of so many parts of accountancy that it is impossible to avoid. For example:

- auditors talk about the "risk of forming an incorrect opinion";
- stock exchanges price stocks based on analysis of risk and return; and
- most, if not all, investment appraisal techniques evaluate projects after taking into account risk.

The purpose of this article is to look at how the taking on of risks can be a key differentiator to a company's service.

Strategy

A key strategy for most businesses will be to maximise profits. In finance, profit maximisation is always gauged on how much financial effort is required to achieve the level of profit. The measurement between capital employed and profit is, of course, return on investment (ROI).

Our company, Ventiv Health Limited, provides outsourced sales and marketing to pharmaceutical companies. In this context our client will wish us to achieve the maximum increase in sales for its products, with minimum expenditure. However, problems arise when the client does not believe that its sales are being maximised. This is where risk share contracts become attractive.

What is risk share?

Risk share is a generic term that can be defined as a means by which an element of business risk can be transferred to another third party involved in the transaction.

How can a company use risk share?

If the product or service sold has an element of performance within it, then the level of performance achieved can govern the final price paid by the client.

The whole principle of risk share is founded on the sharing of risk. In the promotion business this means putting your money where your mouth is.

What are the potential upsides?

Clearly for the client there is much upside:

- if performance is not achieved, the amounts paid will be less than under a standard contract; and
- if performance is achieved above a mutually agreed level, the client will benefit from abnormal profit. However, a portion of this profit is due to the company provider taking on an increased level of risk;

For the company the benefits are not necessarily as clear. Effectively you are adding risk into a contractual arrangement, which would normally be fairly risk free. However upsides do exist:

- the opportunity to achieve much higher revenue stream. In addition, depending on how the risk share deal is structured – it may be possible to benefit from the client's upside for longer. For example, in the case of the pharmaceutical industry, clients may allow you to continue to take a share in increased sales for several years after your promotional activity ceases;
- the client doesn't have to believe fully in your ability to provide a top-rate service, because if you don't, it will not have to pay you;
- risk share deals often allow pricing to be more competitive as the client may be paying less than it normally would. By the same token, it may also pay more, but in a correctly structured deal this will be funded out of increased contribution; and
- risk share deals also allow a level of flexibility that may otherwise not be achievable. For example a client may not have any budget to promote one of its products, but, with a correctly structured deal, the promotion could be self-funded.

What are the potential downsides?

In respect of the client, these have to be viewed relative to a standard contract for service:

- if the mutually agreed levels of performance are achieved, the client will have to share some of the associated profits; and
- if the mutually agreed levels of performance are not achieved, then, although in absolute terms that is not ideal, relatively speaking there is only an upside as the client will be asked to pay a much lower fee.

For the company, clearly a downside

does exist; it might not even cover the cost of providing the service if it was not successful. For this reason, due diligence is most important.

What factors should be considered when entering into such a deal?

The following two major factors should be considered:

- how risky is the deal; and
- can we afford to take the risk?

How risky is the deal?

The bottom line is that without a thorough due diligence process you won't know until it's too late.

The best approach is to involve as many relevant people within and outside your company. This will mean an accountant, an operations person, and a business developer/marketeer.

Typical questions that need to be answered would include:

- can we really make a difference to the product? (eg is the product sensitive to our service? In the pharmaceutical industry we need to be able to ensure that we can raise the level of sales and increase market share.)

This question inherently raises numerous other questions:-

- has the product previously demonstrated responsiveness to promotion;
- what base level of promotion is currently being provided and will this base level continue;
- are we truly adding an extra resource; and
- what will our client's competitors be doing in reaction?

In many instances it is necessary to employ an independent consultant as facilitator to ensure the deal reached is acceptable to both parties. Other important questions for the company to ask itself are:

1. can we measure our input into the performance of the product; and
2. how much risk does the client expect us to take?

The answer to the first will necessarily involve such issues as the impact of other areas of the marketing mix (ie advertising, the client's own internal promotion, pricing, etc) and also the level and accuracy of sales data.

As for the client's expectations on the level of risk to be taken by the company, this all depends on the product, the client's attitude, and its own financial position. Clearly the structure of profit/risk share has to be agreeable to both parties. However, while we and our clients agree on the principles, the sticking points invariably arise in the detail.

Can we afford to take the risk?

This is largely a financial decision and again a number of factors need to be considered.

Depending on how the deal is structured the company may find it will incur losses in the early stage of the contract. Assuming these losses flow through into net cash outflows then additional funds will often be required. It may be possible to separate the performance level from the payment of funds for services. For example, the client may be willing to provide an up front cash payment.

Losses will also upset shareholders and stock market analysts. Therefore it is imperative that the nature of the contract, its risks and likely upsides are all communicated to the various stakeholders in the company. If the deal is a good one, then ultimately one can expect the stock price to rise.

Accounting issues also come in to play. For example from a prudence perspective, set up fees would normally be written off in year one. However from a matching perspective one could argue that the whole cost of the contract should be matched against its future revenues. The accounting treatment will be governed by the riskiness of the deal. SSAP 9 Stock and Long-term Contracts will not allow matching if profitability is too uncertain.

What's happening in the market now?

In the UK and European market in which Ventiv operates we are seeing a lot of interest in the principles. Clients see that we are able to offer something that has distinct benefits to them.

In the US, risk share has already taken off in a serious way; five-year risk share contracts have already been signed. It is fair to say that assuming that the product subject to the promotion is right for a risk share deal, then within the next few years, risk shares will become the standard.

Conclusion

If the right deal is struck, the risk and return is fairly allocated between both company and client. This ends up as the elusive win-win situation.

However in a badly structured deal a company could sustain severe losses. This will inherently create bad feeling between client and company to the extent that the relationship that exists could be irrevocably damaged.

Mark Collis is finance director of Ventiv Health Limited. He can be contacted on tel: 01256 307572; fax: 01256 307012; email:Mark.Collis@ventiv.co.uk

Treasury matters

Chris Mansell reviews the growth of internet services

Treasury on the web

Internet banking for business customers is prompting another sea-change in the fundamentals of banking. Although most of the elements of banking services on offer through the net have been available via tied-line on-line banking for some time, both the flexibility of the internet and the pricing which is being seen are quite new. The latter is reflected in the stock market's caution on the impact on banks' profits of internet banking.

There are four main advantages of banking on the web:

(a) accessibility to on-line banking irrespective of size. Costs and complexity have discouraged smaller businesses up to now;
(b) better returns on surplus funds and opportunities for more efficient cash management;
(c) availability of the service from anywhere as well as at any time; and
(d) very cheap transaction processing.

There have been well-publicised horror stories affecting, for example, early users on the Barclays system. Other clearers, notably Lloyds TSB and HSBC, are being very cautious on the timing of their introductions. The offerings will surely arrive before too long: it's just a determination to ensure that the security is as robust as possible and to avoid the PR banana-skins.

Although the prospects are exciting the picture is not entirely clear from the business customers' viewpoint. With payments input by a single individual, as opposed to a dual signatory cheque for example, internal approval procedures and segregation of duties becomes an important issue for the smaller business. E-Banking offers a reliable audit trail, but the network of passwords, limits and authorisations needs to be fully thought through if the advantages of web banking are to be taken securely.

Inevitably there will be question marks over the future quality of business banking services as yet further cost is taken out of the banking overhead. Surveys of what customers look for from their bankers tend to point up the importance of banking personnel 'knowing the customer's business'. This is knowledge and 'feel', which takes time to acquire – a luxury that few can afford outside the major corporate account directors. Stability – seeing the same familiar faces – is also a thing of the past as banks reorganise and business centres become more remote. There will be drawbacks if not pitfalls if internet banking takes hold.

LETTER FROM BRUSSELS

by
Martin Manuzi

Managing the EU's finances: reform efforts continue

Two years ago, the word 'accountancy' was rarely heard in Brussels: the concept of financial management (or some would say management *tout court*) was widely regarded as irrelevant to the building of Europe. These days, however, there is hardly a speech given by a senior European Union official which is not littered with an array of other jargon hitherto the exclusive property of the accounting fraternity. Accountancy and auditing are now at the centre of the EU – a fact which received further confirmation earlier this month.

The European Commission has published further details of its reform of financial management – amid continuing disputes over whether the organisation is respecting its timetable for its much-needed administrative overhaul. Meanwhile it is bracing itself for the publication of the European Court of Auditors' report on the 1999 budget – which is likely to confirm the persistently high level of mismanagement of EU funds. Some estimates put this at around €1 billion annually.

The Commission remains, therefore, under considerable pressure to demonstrate real change. This is the rationale behind three communications which seek to demonstrate that the Commission's new Internal Audit Services will operate on a par with that of comparable international organisations such as the World Bank and the IMF. Neil Kinnock, who is responsible for the reforms, appears particularly anxious not only to put an efficient new structure in place but to ensure that it remains topped up with appropriate expertise. An external expert is to be appointed to the Audit Progress Committee which will oversee the functioning of the entire internal audit organisation. Furthermore, internal audit training for all Commission auditors will be offered from next year – a veritable revolution for the organisation.

The Court of Auditors' report on the 1999 budget will cover the last months of the Santer Commission: consequently, there are likely to be many serious criticisms. However, there is a strong recognition within the Brussels cognoscenti that the EU cannot afford a second implosion. This sentiment is particularly evident in the European Parliament which triggered Santer's downfall.

There is considerable support for the Court of Auditors to focus as much on EU member states as on the Commission. After all, the member states are responsible for around 80% of the EU budget – and some MEPs would like to see the court 'name and shame' states which are failing to stamp out irregularities and fraud.

FORTHCOMING FACULTY EVENTS

- 20 February 2001
LECTURE
LONDON
(Chartered Accountants' Hall)

'COMPETING IN THE NEW ECONOMY' – PROFESSOR DAVID ASCH, MSC, FCA, FRSA, OPEN UNIVERSITY BUSINESS SCHOOL.

This lecture is designed to highlight some of the key issues confronting organisations with the rapid development and deployment of information and communications technologies (ICTs). The session will start by considering some fundamental aspects of customer choice and the nature of buying decisions. Data on the development of ICTs will then be presented followed by the implications for both retailers and producers. The session will conclude by considering the business opportunities available to firms. Registration & coffee 6.00pm; lecture 6.30pm and buffet 7.30pm.

***David Asch** is professor of management at the Open University Business School. He was dean of the school from 1993 to 1999 and has written eight books and over 35 articles on strategy, competition and change, including the bestseller 'Managing Strategy'. His latest book, 'New Economy – New Competition' is due to be published in 2001. His next book, 'Strategy & Capability', should be completed early in 2001. He is currently working on an industry-funded research project examining the drivers for competition and globalisation across a range of industries including domestic appliances, electrical products, professional service firms and telecoms. David has worked with the senior teams of a range of firms including Cornhill, Ernst & Young, Fujitsu/ICL, 3M, Marconi, Siemens Computer Systems, and Sun Microsystems. In addition, he has been an adviser to the Office of Fair Trading on competition policy and is currently an adviser to the government of Ethiopia. He is also an advisor to the World Bank on designing technology-based distance learning in developing countries. Prior to his academic career David worked for a merchant bank and a firm of management consultants.*

- 13 March 2001
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'DYNAMIC STRATEGY – CREATING SHAREHOLDER VALUE THROUGH STAKEHOLDER MANAGEMENT' – MARK THOMAS OF PA CONSULTING.

The lecture aims to illustrate how companies that adopt this approach can create spectacularly superior returns for their shareholders over the long term. It will show how companies can develop strategies by understanding the way complex interactions between stakeholders can alter the strategic battleground and how strategies – often, ones that are counterintuitive – can be formulated to exploit these dynamics. Registration and coffee 6.00pm; lecture 6.30pm and buffet 7.30pm.

***Mark Thomas** is a member of PA's management group. He works within PA's strategy and marketing practice, helping major organisations to resolve fundamental issues of corporate or business unit strategy and to align their management processes with the creation of long-term shareholder value. Mark has advised businesses across Europe and in the US in a range of industries. Before joining PA, Mark was director of corporate development for UniChem. Mark has an MA in mathematics from Cambridge University and is an associate fellow of the Institute of Mathematics and its Applications.*

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RECORDINGS OF FACULTY LECTURES

Recordings of the London lectures are available, in both audio and video format . To obtain a recording, please tick ***EITHER*** the audio ***OR*** the video box on the response form opposite (please note that we cannot offer both recordings to any one member). There is **no charge** for these recordings. However, please note that the recording shown here is available **for one month only**.

If you have any queries, please call Jacquie Lee on 020 7920 8486.

UPDATE

Financial reporting

Continuing *Finance & Management*'s series of regular columns updating members on developments in relevant areas, Moore Stephens' technical partner **David Chopping** looks at changes in financial reporting. His first column brings readers up-to-date, outlining the changes that have taken place in the last few months. Future articles will deal with changes as and when they occur.

David Chopping is a regular author and lecturer, and a member of the technical and practical auditing committee of ICAEW's Audit and Assurance Faculty. Tel: 020 7334 9191; email: david.chopping@moorestephens.com

Since June there have been no new accounting standards (although some are due soon) but the Urgent Issues Task Force (UITF) has produced two new abstracts and revised another.

UITF 24 – accounting for start-up costs

UITF 24 is mandatory for accounting periods ending on or after 23 July 2000. It addresses whether an entity may treat costs in a start-up period differently from similar costs incurred as part of its ongoing activities.

In simple terms, the answer is 'no': start-up costs should be accounted for on a basis consistent with the accounting treatment of similar costs incurred in ongoing activities; and, where there are no similar costs, start-up costs that do not qualify for recognition as assets under a relevant Financial Reporting Standard (FRS) or Statement of Standard Accounting Practice (SSAP), eg FRS 10 or 15 or SSAP 13, should be treated as an expense.

UITF 25 – National Insurance contributions on share option gains

UITF 25 is effective for accounting periods ending on or after 22 September 2000. The NI charge on share options applies to gains under non-approved schemes on options granted after 5 April 1999. The gain subject to NI is the difference between the share price at the date the options are exercised and the exercise price. It applies to any schemes where the shares are readily convertible assets.

The question is whether the employer should accrue for any estimated liability and then how any of this should be calculated. The UITF requires that companies make provision for NI on outstanding share options that are expected to be exercised. This is calculated by applying the NI rate to the difference between the market value of the shares at the balance sheet date and the exercise price. Where there is a performance period, the amount should be spread over that period; where none, it should be fully adjusted. The charge should be taken to the profit and loss account as staff costs, unless they can be capitalised.

In addition, employers and employees may agree the NI charge will be payable by the employee. There are two ways to achieve this:

1. there is an agreement that the employee will assume the liability. In this case the company should account for a separate asset and liability. Prudence may not allow the recognition of such an asset; or
2. there is a joint election that the employee will assume the liability, so there is no cost to the company, and no charge or provision will appear in the financial statements.

UITF 17 – Employee share schemes (revised)

The UITF has revised its abstract on employee share schemes, with effect from 22 November 2000. The principle remains the same, although there is some clarification of the scope of the exemption from the main requirements in respect of SAYE schemes.

It is made clear that the exemption:

- applies only to Inland Revenue approved SAYE schemes and overseas equivalents;
- does not apply to approved profit-sharing schemes under ICTA 1988, nor to new schemes such as all-employee share plans; and
- does not apply where employees are given the opportunity to subscribe for shares at a discount when a company obtains a listing.

Where the exemption is taken companies now need to state this fact, but are not required to quantify the impact.

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