United Kingdom: Key Performance Indicators: Their Impact on the Tax Adviser

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Has the tax adviser thought at length how involved they will have to be with the introduction of KPIs?

"Key Performance Indicators" (KPIs) are factors that measure effectively the development, performance or position of the business of the company, (s234ZZB (5) CA85). This definition is rather vague and leaves it open to directors to set such KPIs' as they see fit. KPIs should complement a business' overall targets and relate to its core activities. As a result, they will differ depending on the business. They are quantifiable measurements of the improvements in performing an activity that is critical to the success of a business. KPIs, as their name suggests, need only be indicators of success/failure – they are not necessarily the same thing as success or failure. The DTI guidance says that it is for the directors to decide exactly what information to include about their particular company provided that the information is relevant to an understanding of the business. Alun Michael, Minister for Industry and the Regions said: "Our aim has always been to encourage meaningful strategic, forward looking information to assist shareholder engagement while avoiding disproportionate burdens on business, in line with our better regulation agenda". In the absence of a requirement to use the same KPIs on a year-by-year basis it leaves scope for abuse, such as selectively using those KPIs that show the company's performance in a favourable light. All companies that now have to produce a Business Review will be exempted from disclosing information that is seriously prejudicial to the company's interests. This exemption was previously only provided for companies that had to produce an Operating and Financial Review.

The Companies Act 1985 (Operating and Financial Review and Directors' Report etc) Regulations 2005, SI 2005/1011 has introduced new and more extensive requirements for a business review in the directors' report. However, there will not be any statutory reporting standards for the Business Review and for those companies which comply with small company status this regulation does not apply.

The original requirement for quoted companies to produce an operating and financial review, OFR, was removed by the Companies Act 1985 (Operating and Financial Review) (Repeal) Regulations 2005, SI 2005/3442, which came into force on January 12, 2006. The requirements of the Business Review, and the other reporting requirements of the directors' report, cover some of the same ground as the OFR.

The requirement for all companies, other than those meeting the small company criteria, to include a business review in their Directors' Reports is now set out in section 234ZZB of the 1985 Act and is effective for financial years which begin on or after April 1, 2005. Thus, accounts for years ending March 31, 2006 onwards must contain:

- A fair review of the business and company; and
- A description of the principal risks and uncertainties facing the company.

Failure to comply with the Directors' Report requirements may lead to civil and/or penalties being applied. The Financial Reporting Review Panel, part of the Financial Reporting Council, has the legal authority to review companies' Directors' Reports, from April 1, 2006 and, if necessary, may go to court to compel a company to revise its report.

In summary, the business review must be:

- a balanced and comprehensive analysis of the development and performance of the company during the financial year, and the position of the company at the end of the year;
- consistent with the size and complexity of the business;
- Include analysis using financial key performance indicators, to the extent necessary for an understanding of the development, performance or position of the company.
- Where appropriate, include analysis using other key performance indicators, including information relating to environmental and employee matters; and
- Where appropriate, include references to, and additional explanations of, amounts included in the annual accounts of the company.

The auditors must state in their report whether in their opinion the information given in the directors' report for the financial year for which the accounts are prepared is consistent with those accounts.

A welcome change is that although auditors must continue to report on the consistency of the directors' report with the annual accounts, they will no longer have to check for other inconsistencies that they may come across in performing their

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role as auditor. This was seen to be an expensive burden under the OFR.

One of the problems of giving any view on financial (tax) matters, is that it can be used against the provider. So what company tax angles are likely to impact from April 1, 2006 (for accounting periods on, or after April 1, 2005)? This will of course extend from corporation tax to VAT, PAYE and Employee Benefit schemes.

Key factors that immediately come to mind are:

- Any registered tax planning schemes;
- Tax risks and uncertainties;
- Ongoing tax enquiries;
- Areas of the company's activity that might be risk assessed as capable of giving rise to a tax enquiry.
- Associated companies;
- Close investment – holding companies (CIHC) – letting to connected persons;
- EMI options – corporation tax relief for share cost;
- Employers' contributions to registered pension schemes;
- Corporate gift aid;
- Film tax relief;
- Research and development tax relief;
- IBA – stock holding trade;
- Business premises renovation allowances;
- Purchase of own shares;
- Shadow directors;
- Ascertained share valuations;
- Qualifying loan not wholly for the purpose of company trade.

One clear key fact that arises from a review of the KPI legislation and guidance is that reporting accountants will have to liaise with tax advisers to ensure that disclosure is complete and understood.

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