PKF FRANCISCLARK

Chartered accountants & business advisers

Corporate services

Summer 2017

supporting you and your business

WELCOME TO OUR SUMMER 2017 CORPORATE SERVICES NEWSLETTER

In our last edition we said 2017 would be an interesting year as the impact of Brexit and the US election result played out. At that time we had not anticipated another UK election, the outcome of which has added to the uncertainty in the political arena. All of these factors are not helpful in creating a stable environment for businesses to plan and invest in the future, but despite the best efforts of our politicians, the economy continues to grow, albeit at a slower rate than in recent years.

The Office for National Statistics (ONS) has recently reported that growth in Q2 2017 was 0.3%, marginally better than the 0.2% seen in Q1. To put that in context growth in 2016 was 2%, and the ONS commented that they had seen a 'notable slowdown' from last year. So the economic disaster forecast by some after the Brexit vote has certainly not materialised but there are without doubt challenging periods ahead.

The labour market continues to perform well in terms of employment rate but wage growth is not keeping pace with inflation as the cost of goods and services increase, impacting many households. Looking after and retaining employees is crucial, as replacing good staff can be difficult, time consuming and disruptive. Benefits and incentive arrangements are a good way of helping here and can often be very cost effective.

One of the more common impacts we are seeing following the Brexit vote is on exchange rates. Clients importing goods are experiencing increased prices. A number of businesses are, in part, dealing with this through sales price increases which are generally being accepted - and indeed often expected - in the market place. Others are also seeing some support from suppliers. These factors have helped reduce the impact on gross margin. Whilst there are opportunities on the export side, creating new channels or ramping up volume can be challenging. We all continue to watch with interest how our domestic and global landscapes develop over the rest of 2017 and beyond.

We have recently held another successful round of Finance Director Seminars (with over 300 acceptances across five locations). There was a technology theme starting with cyber security, which is an issue for us all and something we have to learn to deal with. We can help in various ways, including assessing businesses under the Government's Cyber Essentials scheme. Details of this, along with other topics covered at the seminars, are summarised opposite. We look forward to seeing you at our winter 2017 Finance Director Seminars which are detailed on our website.

Glenn Nicol
Partner and Head of Corporate Services

Cyber

Businesses underestimate the effects of cyber-attacks

Lloyd's of London said in a recent report that businesses underestimate the 'slow-burn' effects of cyber-attacks and need to prepare more fully for a loss of customers, a fall in share price and other potential consequences.

The risk of cyber-attacks is rising and slow-burn effects are additional to short-term costs such as notifying customers, paying ransoms or public relations expenses, the report stated.

"There is a lack of understanding as to what cyber-attacks can mean." Lloyd's chief executive, Inga Beale told Reuters.

Companies face a variety of costs following cyber-attacks, ranging from system repair, customer compensation, legal costs and PR spending, to lost revenue and reputational damage.

In addition, companies operating in Europe are dramatically underestimating the impact of the new data protection regulation that comes into force in May 2018 and are failing to prepare adequately for it.

The EU's General Data Protection Regulation (GDPR) will require many companies to adopt much stricter processes in dealing with customer data. Its implementation follows serious data breaches at TalkTalk in the UK, Yahoo, and other companies, and the recent ransomware attack, WannaCry, which affected organisations in 150 countries.

The maximum fine for failing to comply with the regulation is 4% of the previous year's annual global turnover, or €20m, whichever is the higher.

Cyber threats can be mitigated by adopting the Cyber Essentials scheme which has been created by the Government for UK businesses, so that they know where to start and what to do. The net result is to reduce the risk of becoming a victim of internet fraud and cyber-attack, and to become a more robust and confident business in the complicated and fast moving world of commerce.

You don't have to trade online to take advantage of the scheme; just about any business that uses internet banking for instance has an asset that the cyber criminals would value stealing. Much too often it is the small business, or the organisation that does not think it has anything worth stealing that is most susceptible to attack. They typically have less resources and more priorities, making them an easy target for a cyber criminal.

PKF Francis Clark has become a Certification Body on behalf of the IASME Consortium. IASME (Information Assurance for Small and Medium sized Enterprises) is one of the five accreditation bodies set up by the UK Government to roll out the Cyber Essentials Scheme which provides a set of five controls that organisations can implement to achieve a baseline of cyber security - boundary firewalls and internet gateways, secure configuration, access control, malware protection and patch management.

The IASME Governance Standard, based on international best practice, is risk-based and includes aspects such as physical security, staff awareness, and data backup. The IASME Standard was recently recognised as the best cyber security standard for small companies by the UK Government.

The IASME governance self-assessment includes the Cyber Essentials assessment but goes further in helping with GDPR compliance by adding assessment of business risks, staff training, dealing with incidents and handling operational issues.

Any businesses or organisations that need help and guidance with Cyber Essentials or want more information about IASME accreditation, should email cyber@pkf-francisclark.co.uk.

Financial reporting

Web-based reporting - a new challenge

The last 18 months has seen the development of a new reporting trend for businesses - web-based reporting of business information. While the statutory requirements are typically targeted at large businesses (although the precise definitions vary), commercial and societal pressures are already starting to push smaller businesses towards compliance as well.

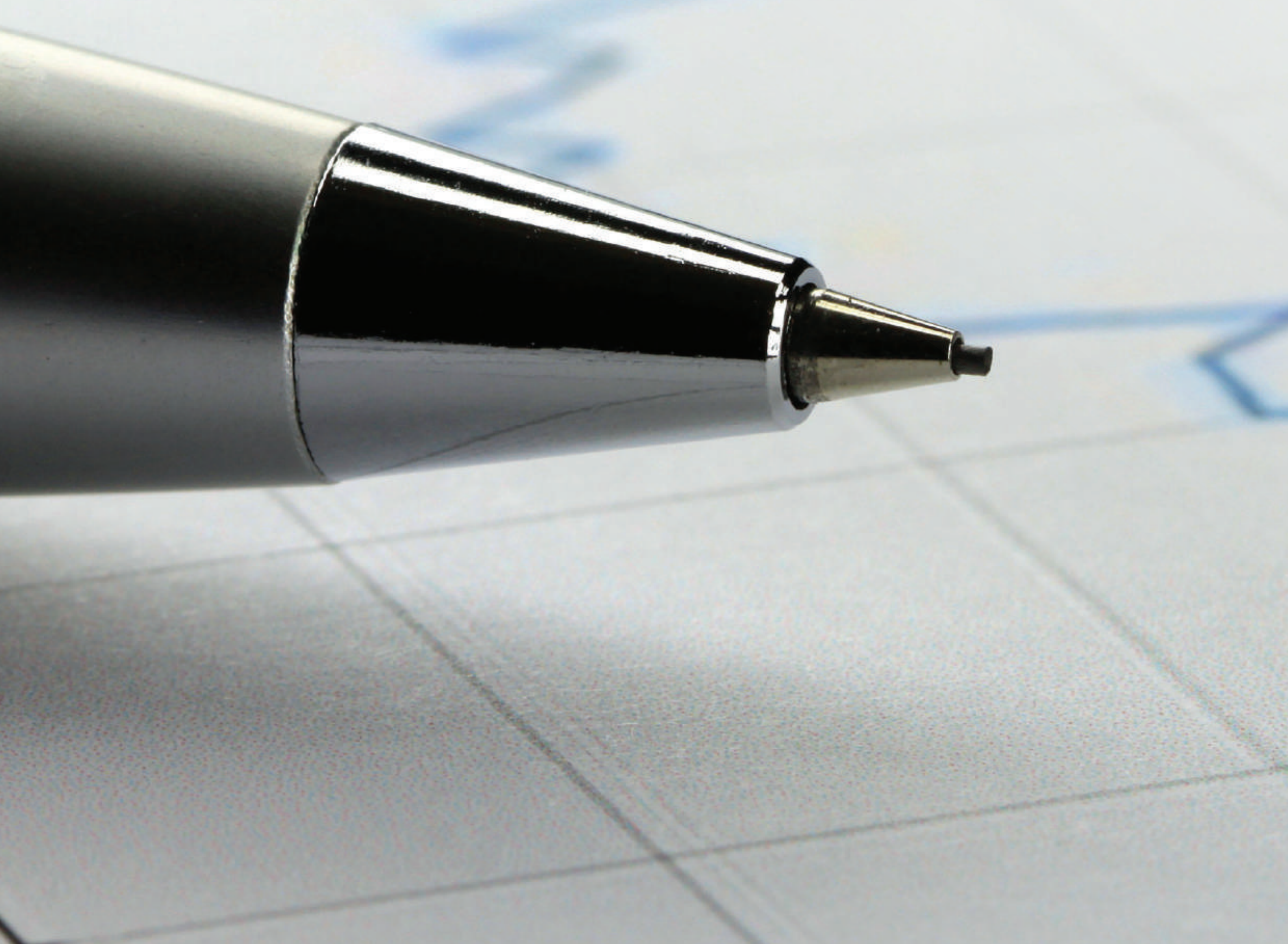
The new reporting requirements go beyond the usual information presented in company accounts to cover areas that are more concerned with business behaviours and practices than with finance. Some of them are responses to perceived abuses or to public pressure.

So, where is web-based reporting required, when and by whom?

The three areas where web-based reporting has been introduced are:

- Modern Slavery and Human Trafficking - this requires the publication of a statement describing the steps the business has taken during the financial year to ensure that slavery and human trafficking is not taking place in its operations or supply chain or that it has taken no such steps;
- Gender pay - requires the collection and publication of data on the difference between average male and female earnings as a percentage of male earnings (the gender pay gap); and
- Payment practices and performance - requires the publication of information about the entity's payment practices with its suppliers and performance against them during the financial year.

The table opposite summarises the key reporting requirements. Note that the affected entities are different in relation to each report and so you may find you are only caught by one or two of the requirements.



Report required	Affected entities	Application date	Timescale for reporting	Where to report
Slavery and human trafficking statement	Companies and partnerships, carrying on commercial operations in the UK, having a global turnover over £36m	Financial years **ending** on or after 31 March 2016	As soon as reasonably practicable after the year end	On the company website with a link in a prominent place on the home page
Gender pay gap data	Private and voluntary sector employers in Great Britain having more than 250 relevant employees on 5 April	Headcount and pay data as at 5 April 2017	Within 12 months of the year end on the gender pay gap as at 5 April each year (the 'snapshot' date)	On the employer's searchable website which must be accessible to employees and the public and on the designated government website. Data must be retained for three years
Payment practices, policies and performance statement	Large UK companies and LLPs Two out of three of: turnover > 36m total assets > £18m 250+ employees	Financial years **beginning** on or after 6 April 2017	Report six monthly within 30 days	Web-based service provided by government

So, the first step is to establish which of the requirements, if any, you are caught by. Secondly, note that the application dates and timescales for reporting are different, so if you are affected by more than one web-based reporting requirement you will need to think about when and how often each report is required.

Bear in mind that there are detailed regulations behind each report and you may need some legal support to interpret and apply the rules to your circumstances.

Finally, you will need to establish appropriate policies and procedures and develop systems to capture the relevant data. That may require collaboration, for example between the finance and HR functions for gender pay gap data.

Only then can you get to work on producing the report itself.

SMEs should bear in mind that while they may not be directly affected by the new rules, they may be required to provide equivalent information as part of tender applications or to maintain relationships with existing large customers.

VAT Topical VAT issues

We explored two issues relating to international VAT in our recent Finance Director Seminars. First, HMRC has been looking closely at the zero rating for export of goods sent out of the EU. In particular, it has been taking issue where sufficient official or commercial proof is not held to evidence that goods have left the EU within the time limits. A particular point to note here is where official commercial proof is held by the carrier rather than by the taxpayer itself: HMRC's view is that the taxpayer must hold the proof on its own systems rather than on the carrier's. It is understood that a case is being taken to tribunal on this matter. Second, we looked at the Registered Exporters System (REX). This is a new self-certification system for which there is a phased introduction from 1 January 2017. REX replaces the current procedures under the Generalised System of Preference (GSP) which allow preferential rates of customs duty on the import of certain goods from beneficiary countries. It is advisable to speak to your suppliers if you import goods from GSP countries such as India and Vietnam. In addition, there will be a requirement for UK traders to register for REX in the UK where they export goods to a GSP beneficiary country for incorporation in products and return back to the UK or where goods imported under REX are sent on to other member states.

Another area to be wary of is cross company charges and issues relating to VAT groups. The message on cross company charges is not to forget VAT when charges are made between companies that are under common control or group companies that are not in a VAT group. With regard to VAT groups, there are advantages and disadvantages to group registration.

Where there are charges between two associated businesses, say for staff and support services and the recipient business is exempt or partially exempt (and thus unable to reclaim the VAT that would otherwise would have been charged by the associate), the inclusion within the VAT group of both entities takes the charge outside the scope of VAT and that VAT is 'saved'.

However group registration could be disadvantageous. Consider the inclusion within a VAT group of two companies - one that constructs new residential care homes and makes a supply of such services to the second, which then makes the onward supply to residents as an operator. Ordinarily, outside the VAT group, the constructor would be able to zero-rate its supply to the operator (subject to certification) and reclaim the VAT that it had incurred on sub-contractors, professional and materials charges. Within the VAT group there is no supply by the constructor and as the operator's charges are exempt, the VAT group is unable to reclaim the VAT incurred by third party supplies as these are now deemed to directly relate to that onward exempt supply.

Finally, property and pension schemes are areas where VAT complications can often occur. Issues arise where the current owner of the property has made an option to tax or where the property is less than three years old and the freehold interest will be purchased by the pension scheme. There are also issues relating to compliance and VAT registration for the pension scheme. As always, we would stress that consideration should be given to VAT issues prior to the transaction taking place rather than afterwards.

FCFP Ever changing pension rules

The lifetime allowance (LA) reduced from £1.25 million to £1 million from April 2016; however, there are some protections available that could help to alleviate a tax charge.

The spring 2017 Budget also announced a reduction in the annual contribution allowance for those who have already drawn income from their pensions, from £10,000 to £4,000. The implementation of this measure was delayed by the General Election but is now confirmed and will be back-dated to 6 April 2017.

You might think that once your pension fund has been tested against the LA on initial withdrawal, that was it; unfortunately, this is not so. At age 75 it is re-tested by taking the figure at age 75 less the original amount at the point of withdrawal and testing the growth again against the limit.

Pensions dashboard

Not sure what pension plans you have? What they are worth? How much income they might provide and when? Well from 2019 this information will be made available via an online portal. An excellent use of technology that should enable better forward planning and enable old forgotten pension plans to be found.

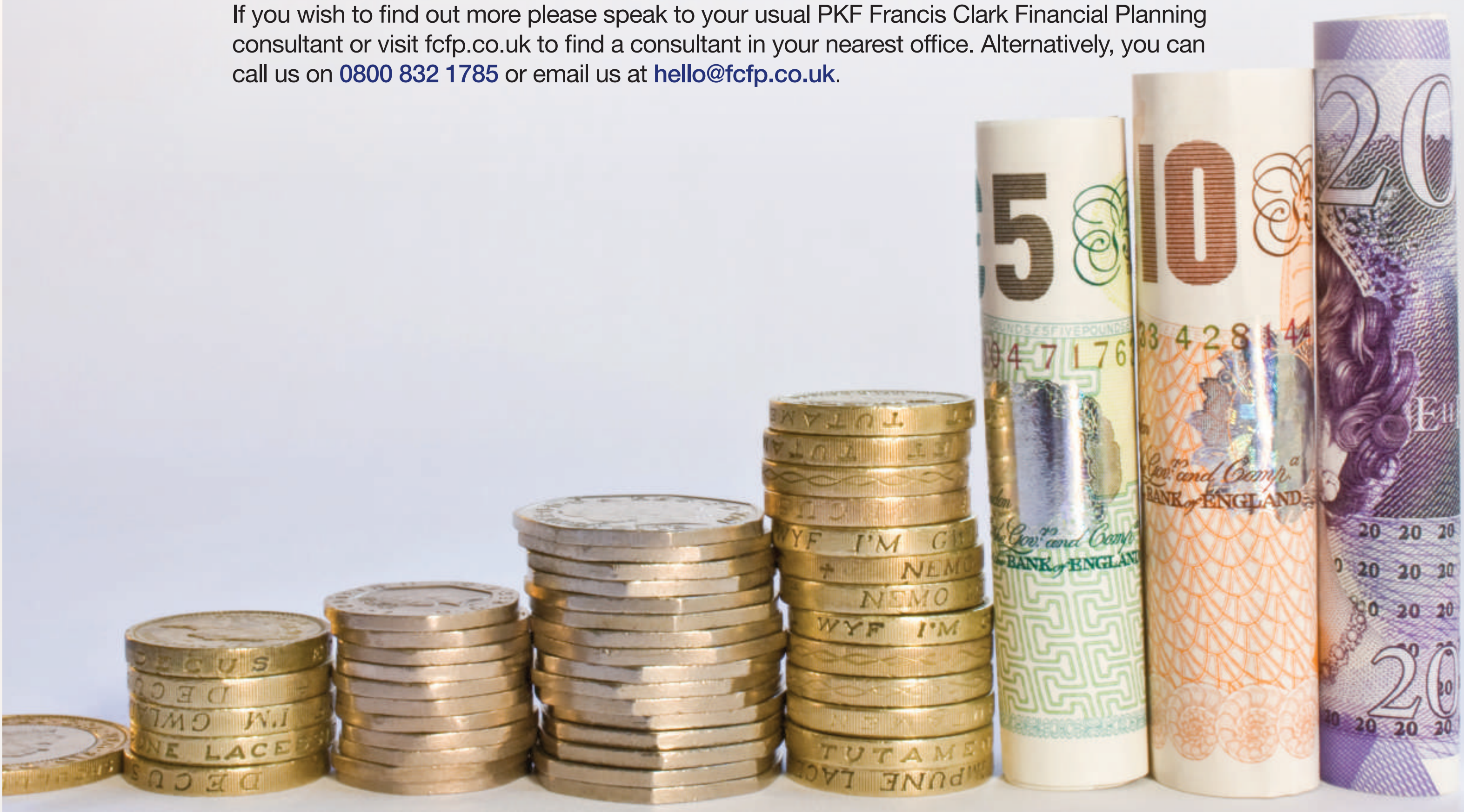
Pension flexibility

Rule changes brought about in 2015 are now benefitting huge numbers of people by introducing flexibility as to how they can access their pension funds. Drawing down funds gradually using tax free lump sums and utilising annual personal tax allowances can be very useful when bridging the gap maybe between finishing work and the start of the State Pension.

Flexible death benefits and the fact that pension assets are generally outside of the estate for inheritance tax purposes can play an important role in tax planning for families.

The flexible opportunities and favourable tax treatment of pensions makes them a key planning vehicle for the majority of people. However, the rules and array of options can be confusing; the rewards though are compelling.

If you wish to find out more please speak to your usual PKF Francis Clark Financial Planning consultant or visit fcfp.co.uk to find a consultant in your nearest office. Alternatively, you can call us on 0800 832 1785 or email us at hello@fcfp.co.uk.

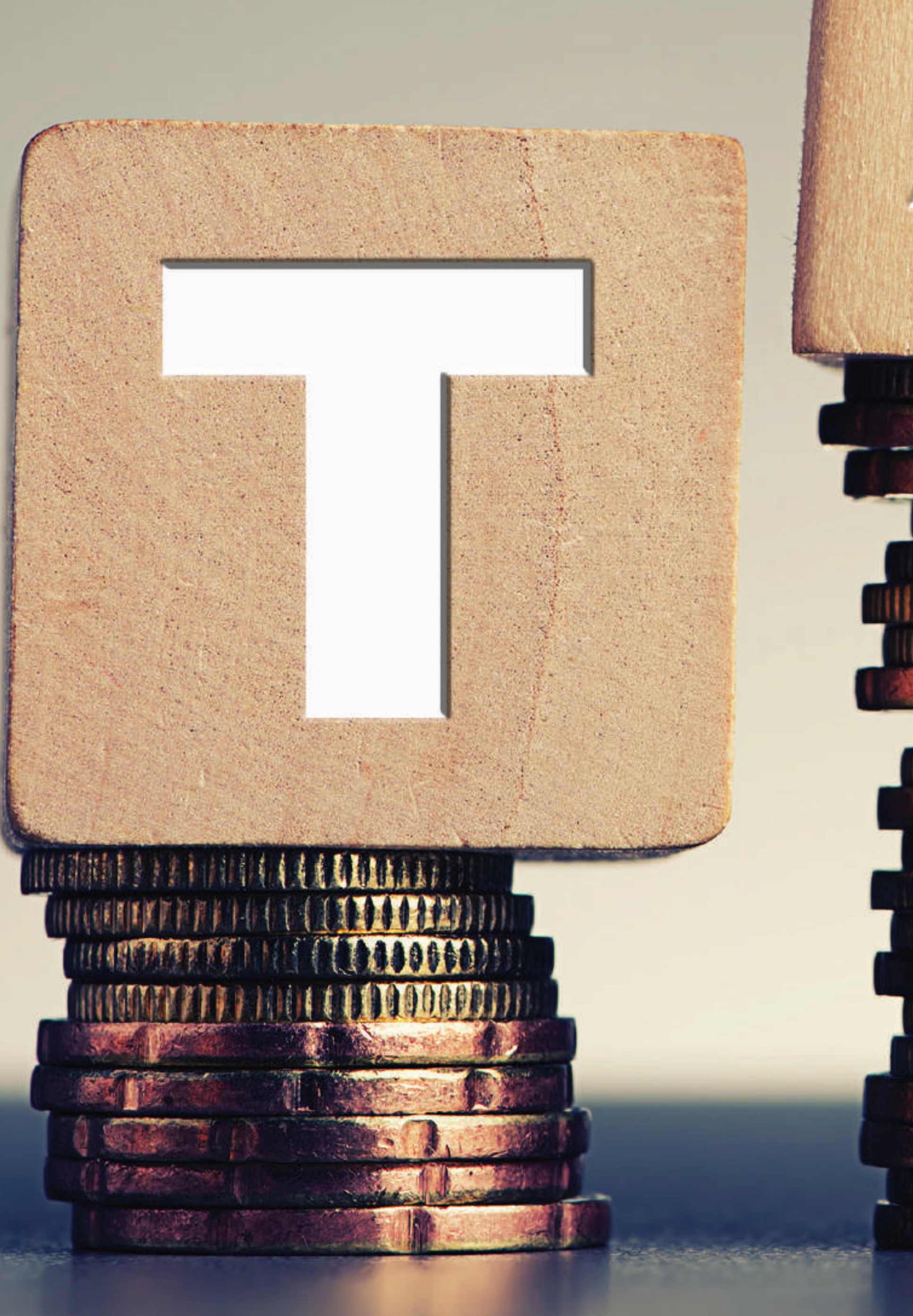


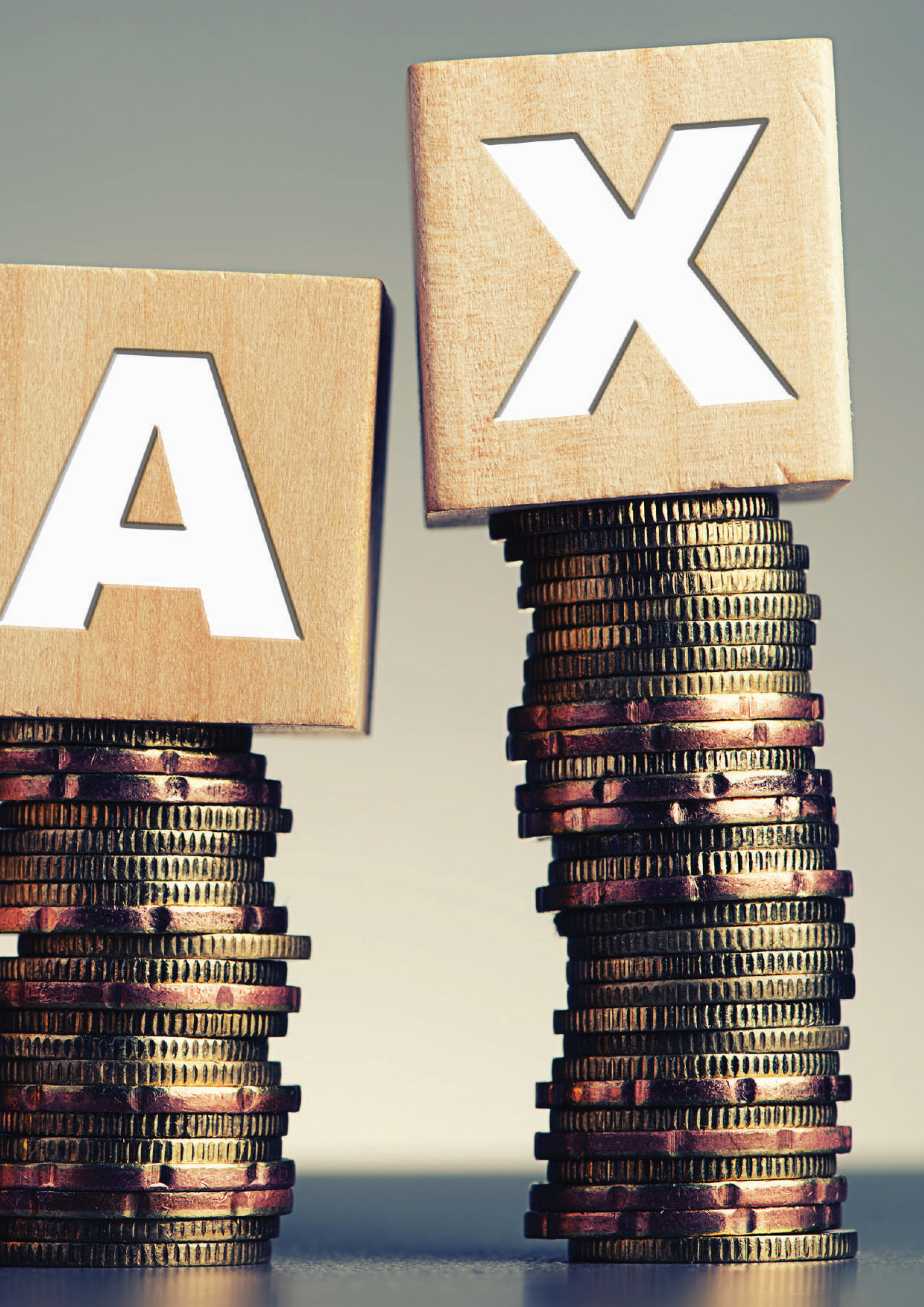
Tax

Jeremy Corbyn has certainly been getting popular support with his calls for more tax on corporates and the Labour manifesto suggested that the corporation tax rate should be increased to 26%. Currently, the corporation tax rate is 19% and is due to fall to 17% in April 2020, a change that has already been legislated. Even if the corporation tax rate does remain on its downward trajectory, it is possible that a future government will look to restrict tax reliefs.

The new restriction on interest relief for highly geared companies is a case in point. This is being introduced in the current Finance Bill so it is not yet on the statute book but is effective from April 2017. If the Government had a large majority then the niceties of Parliamentary process wouldn't matter very much but in the current circumstances, the view of the opposition is much more relevant.

The interest restriction is being introduced as a result of a coordinated attempt to clamp down on tax planning by multinationals by the OECD through the BEPS project. The UK is an early introducer of such measures as David Cameron championed the changes. In the UK, corporate groups are restricted to only being able to claim an interest deduction for tax up to 30% of their EBITDA, but with a de-minimis of £2 million. This means that the rules do not apply to the vast majority of groups but £2 million is starting to look very generous by international standards and may not increase as and when interest rates go back up. Another area of focus is likely to be taxes paid by self-employed workers. Philip Hammond got into trouble on this in his March Budget but it is unlikely that his views have changed despite the Government u-turn. The Matthew Taylor review of employment practices and the Labour party focus on workers in the gig economy mean that differences in tax rates between employees and self-employed workers are going to remain in the spotlight with a potential impact of increased business input costs. Businesses should be risk-reviewing their exposure to any such cost increases in order that this is taken into account in commercial negotiations, pricing and business investment decisions.

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Corporate finance

Due diligence and data analytics

Whilst few businesses are regularly subjected to due diligence, it is key to ensure that there is awareness of what it involves and how it has changed over time so that you can be adequately prepared, as most businesses will go through it at some point.

Historically, when a potential purchaser or an investor/funder looked to investigate a business, a team of accountants and tax experts would descend on-site and spend several weeks asking questions and reviewing files to understand the business and identify potential issues. This tended to focus on a few specific areas as time and resources were limited.

Today most information is provided electronically via a ‘dataroom’ or electronic access is provided to the accounting systems. With the use of modern techniques such as data analytics, due diligence can take on a whole new approach - and at the extreme, *all* data can be reviewed.

This can mean that there are no hiding places, *all* transactions and relationships can be investigated, from the smallest such as the individual items on every director or employee expense claim, through to a full analysis of stock provisions and their smoothing effect and impact on the tax charge.

As a buyer or investor, this can provide a great insight to the business and how it operates - the good, the bad and the ugly. From the company’s perspective, it often needs significantly more fore-thought and preparation, as well as ensuring that adequate explanations of trends and analyses are ready and ideally presented in advance.

Corporate finance

Mini-bonds and alternative finance

The effects of the current ‘wall of money’ looking for a home, the ‘hunt for yield’ in a low interest environment and global interconnectivity via the internet, have combined to create significant alternative financial offerings compared to traditional lenders and investors.

Alternative finance in the UK had lent £7 billion by January 2017 and has now exceeded £10 billion (and globally more than £100 billion) with the exponential growth rates expected to continue.

With all the publicity and headline-grabbing stories (Hotel Chocolate, BrewDog etc), it could be considered that this type of funding is ‘mainstream’. However, most of it is only suitable for higher risk lending and investing, and short term needs - key requirements that are not well served by traditional funding sources. If you are considering raising money via these sources, have a well prepared and presented business plan **and ensure that traditional sources have been fully utilised first of all** - the total costs of alternative finance and sources such as mini-bonds include far more than the initial headline rate. Often there will be draw-down fees, exit fees, legal fees and professional costs as well as significant management time required for documents and bond issues.

Whilst some alternative headline borrowing rates may be in the region of 4%-5%, unless you have a well-established brand that people are backing, the total costs can rapidly become 10%-15%, which might make more time spent with the Bank Manager worthwhile after all!

Alternative finance definitely has a place in the funding market and is here to stay. It is especially well suited when funds are required rapidly and traditional sources and their credit-worthiness assessment process is too slow for your needs. The higher interest costs therefore reflect the higher risk, and for longer term borrowing, **as soon as you have a little more time and the perceived risk is reduced, the alternative finance should be replaced with traditional sources** as soon as possible.

Corporate finance

Models misbehaving

Virtually everybody in today's business world relies on the output of financial models for making business decisions. It is therefore surprising that they are generally treated in such a relaxed way and not kept in check, as so often **an incorrect model can result in the wrong business decision.**

For example, recent examples of errors we have seen:

- a business making the wrong capital investment programme decision costing them circa £300k as the utilisation assumption was a variable but had been hard-coded into one cell of the spreadsheet;
- the use of a rounding function in Excel being incorrectly applied reducing the projected EBITDA by £250k, resulting in an adverse reaction from the funder;
- a subtotal being included in total revenue which incorrectly increased turnover by some 30%; and
- the summary table pulled information from the wrong part of a secondary tab resulting in people numbers being used instead of their wage cost!

Simple modelling techniques of using an input page, having a model fit for purpose (rather than adapting an old one), and including check functions will reduce many errors. However, despite significant effort on the detail **it is critical to allow sufficient time to stand back and review the output for reasonableness** - all the error examples above were identified during an overview by somebody who didn't even have detailed knowledge of the businesses involved.

The simple rule of not sending a financial model (or the output from it) after 5pm would save many a late night error from a cold review in daylight in the recipients' hands.

Our financial modelling team can assist you with the full range of services from preparing the whole model and ensuring that the functionality is suitable (including sensitivities, covenants, headroom calculations etc. and graphical representations), through to sample model checks or just a simple reasonableness review. During due diligence on projections we normally spot material errors within a morning, and often within an hour!

Make sure that your model isn't misbehaving and you present the right information for Board decisions, funders or potential acquirers.

We have offices in:

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