Crowe

Manufacture

Summer 2019

Audit / Tax / Advisory / Risk

Smart decisions. Lasting value.

Contents

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Foreword

Welcome to our summer edition of Manufacture, Crowe’s quarterly manufacturing newsletter.

Since the age of the industrial revolution the manufacturing industry has been the backbone of the British economy and a key driver for the Country ‘punching above our weight’ relatively, globally. Recent announcements have caused waves of concern across the manufacturing and construction sectors. For example, the collapse of British Steel has highlighted the uncertainty in supplies of steel which has dogged our manufacturing industry for ages. Just a few years ago, a worldwide steel crisis, caused by steel production being ‘bought’ by the far east, only to later flood the market with surplus, created a rollercoaster in prices.

Maintenance of our production will help to prevent such artificial ‘spikes’ adversely affecting UK industry. Aside from the risk to our manufacturing base at a time when it already faces headwinds caused by the likes of the world economic slowdown, Brexit uncertainty and automotive issues, there are many UK infrastructure projects planned, which require heavy steel over the next few years.

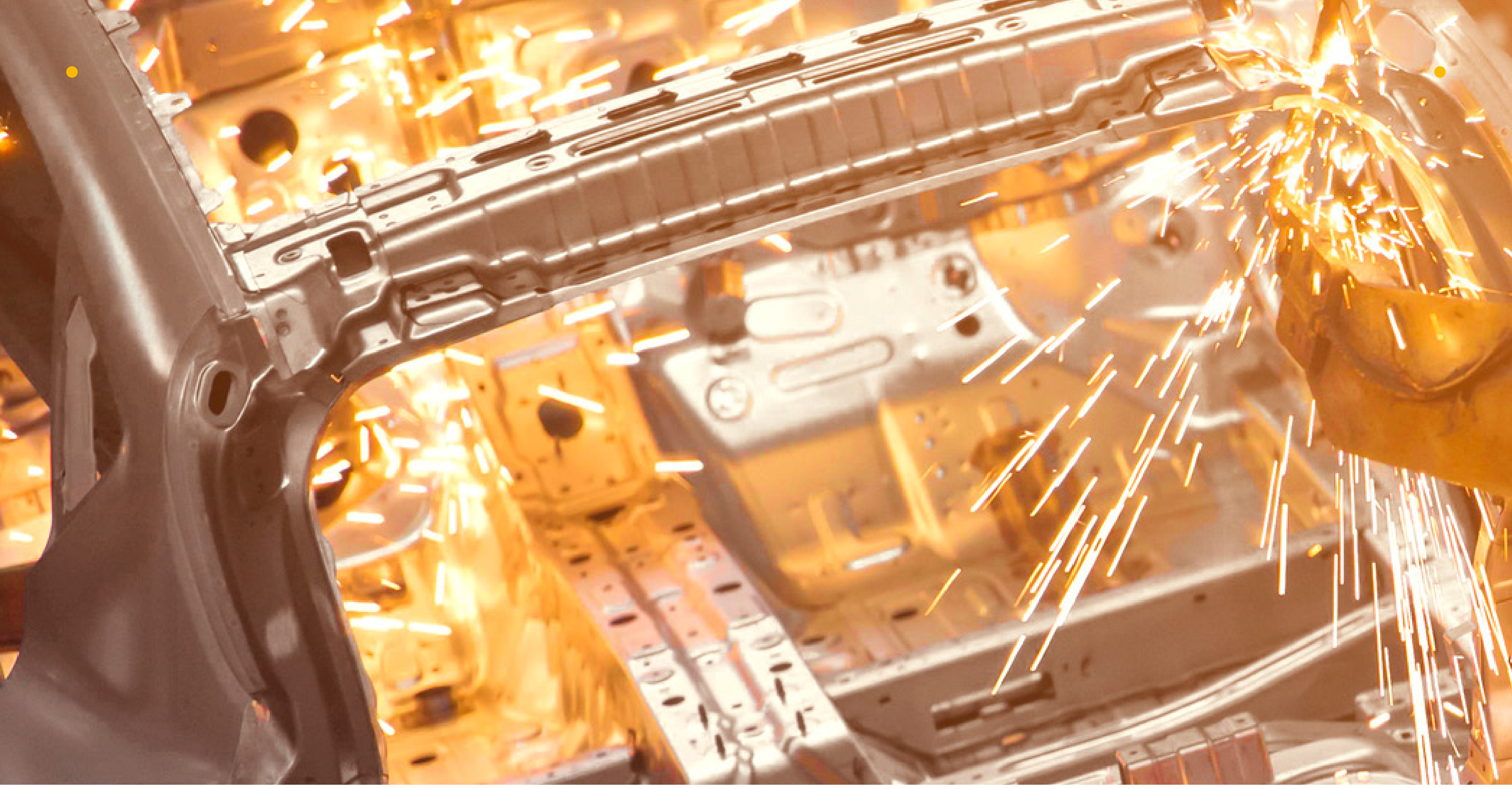
The recent challenges the British motor industry are facing reminds us that this is a critical time for the manufacturing industry with many opportunities ahead, we go into this in further detail in our first article, structural changes in the automotive industry.

We also feature in this issue, articles on growing the UK’s export community, how can you take your business global, we challenge you with the question, ‘What’s next for your business?’, and outline important changes to Accounting for leases.

> We work with our clients to build something valuable, substantial and enduring. Our aim is to become trusted advisors to all the organisations and individuals with whom we work. Close working relationships are at the heart of our effective service delivery.

I hope you enjoy and are inspired by this edition and should any of the topics resonate with you please feel free to contact us for a no obligation meeting consultation with our specialist manufacturing team.

Johnathan Dudley
Head of Manufacturing



Structural changes in the automotive industry

By Jonathan Dudley,
Head of Manufacturing

The recent attempt by Fiat Chrysler to merge with Renault – blocked only by the French Government exercising their 'golden share' – and the rumoured bid for JLR by PSA signals a structural change in the automotive industry that manufacturers in the supply chain and governments need to seriously think through.

It’s so hard to envisage that just 60 years ago, to have access to a car was a rare privilege, the growth of the automotive trade has mirrored the ‘car boom’, motor manufacturers and their supply chain have by and large thrived as a result.

Environmental concerns about petrol drove manufacturers to develop more advanced diesel power plants but these have now been identified as damaging to health.

A move to electric or other renewable power is seen as inevitable. Global climate agreements demand it and the motor industry face a massive challenge with advancements needed quickly, in battery technology, energy harvesting, range, charging availability and speeds all desperately needed as the anecdotal evidence of early adopters gain the ‘oxygen’ of magnified publicity.

Motor manufacturers know that to meet these and other challenges associated with completely changing their manufacturing, engineering and assembly processes whilst continuing to generate profits for their shareholders and cash flow to keep their banks happy is too big a challenge to face alone.

Hence collaboration, merger and rumours of merger abound, it's highly likely that there will be further collaboration with tech giants to deliver mass produced automotive platforms for the likes of Google, Microsoft, Apple and others.

It's logical; a classic example of 'doing what your best at'. Motor oem's have developed processes that assemble in the most efficient way and the tech industry have developed techniques that advance processing powers and innovations that bely the imagination of so many in a way that continues to miniaturise and efficiently use power.

Tesla have been a pioneer but lack the expertise and scale to assemble cars, so far, at least, in a manner that makes their products affordable to the masses and reliable.

They also lack an established brand which therefore presents a 'whiff' of potential unreliability which cannot be covered by a warranty when only backed by a financial structure that has yet to see a profit.

Imagine the combination of an iconic premium motor brand with a similar tech brand... say an Apple Porsche?

So what does all this mean for manufacturers and governments?
Manufacturers will likely have to get used to supplying more generic components which will be common to platform systems that cross many more brands than now. They will need to be able to supply these components globally and in quantities which meet the needs of the oem's whilst having imposed on them even tougher 'cost downs' than ever before. This will require investment, innovation and continuous improvement. It will also remove once and for all, the option for businesses to avoid trading internationally. It will no longer be an option. It will become essential to know how to trade effectively across borders with manufacturing groups that are multinational. The real issues here will not be European bloc based, they will be Global and manufacturers will need to become experts in addressing them.

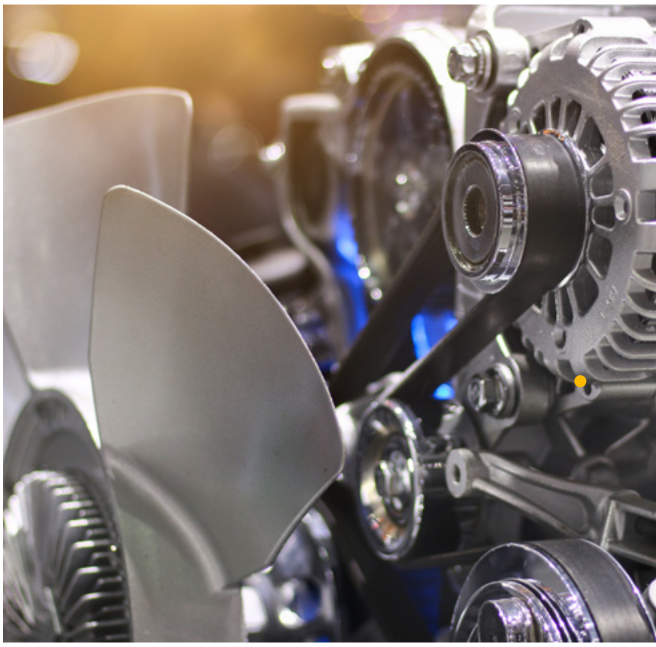
There is of course a huge opportunity to develop the technologies that the industry and its associated industries will need, for example, materials that are lighter than ever before. Power technology will need to be advanced as will the infrastructure to support it. At present our national grid just isn't able to support the electric cars currently on the road, let alone the expected boom as consumers progressively move away from internal combustion power.

Innovation to harvest power from motion, braking and elsewhere will all have key roles to play and of course, necessity is the mother of invention.

The smart governments will inspire support and invest in their manufacturers, scientists and populations to be at the forefront of this technology.

It all seems daunting but it's so easy to forget that we live in the history of a planet which has existed for millions of years. Just over 100 years ago there was no such thing as the motor industry and if you wanted to travel you either boarded a very rickety and slow train, jumped on a horse or walked.

100 years has seen so much progress, the next 30 years will see much much more. Manufacturers need to seriously plan whether they want to thrive over that time or become a casualty consigned to history.



Pashley Cycles: working with WMG's High Value Catapult Programme

By Chris Mould,
Audit and Advisory Partner

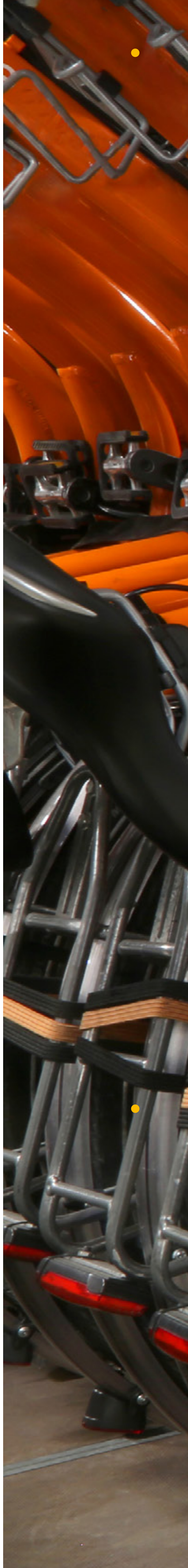
Pashley Cycles was established in 1926 and is Britain's longest established bicycle manufacturer. Based in Stratford-upon-Avon, Pashley makes a diverse range of bicycles and tricycles for consumer use, load carrying and delivery cycles for business use and more recently bicycles for urban bike share fleets.

The company sells to over 40 countries worldwide. It operates in a fiercely competitive market, which has resulted in all but a handful of bicycle makers becoming import traders of bikes built in poor, low wage economies around the world. It survives by keeping its operations lean, providing desirable, quality products and excellent customer service and in particular, being innovative.

In the early 2000s Pashley identified opportunities in urban/campus bike hire market segments and supplied bikes into a small number of schemes.

Then in 2015 an opportunity arose to develop a new bike for the London Cycle Hire (LCH) scheme operated by Serco. This was a totally new design of bicycle which presented many new challenges in terms of components and material selection, all set against a challenging timescale.

Although Pashley is a small SME, it had already approached and worked with Warwick [University] Manufacturing Group (WMG) from time to time in the past and, needing to tap into their resource & facilities on this project approached them under the 'Catapult' programme.



WMG gave Pashley immediate assistance by providing access to its Additive Layer Manufacturing 'ALM' facilities (3D printing) for rapid prototyping/proof of concept work and also market research and appraisal of the sector. This was followed by metrology support / materials testing and component laser scanning in the early CAD modelling stage.

WMG also provided advice – either directly or by recommendation of a possible new supplier – on some of the novel design features implemented using polymers (i.e. for mudguards, covers, etc.) using materials which were new to Pashley. This helped to significantly de-risk and shorten the development process for Pashley.

The outcome was a new bicycle design incorporating lightweight materials and featuring much improved performance and comfort (over the existing bicycle) while offering durability, resistance to on street vandalism, improved handling and safety.

Pashley secured a five-year contract with Transport for London (TfL), with forecast of £4 million increase in revenues which safeguarded/ upskilled existing jobs. The company gained knowledge of new market sector-cycle hire schemes and improved technical knowledge, skills and understanding of manufacturing techniques including the use of new materials such as polymers. The bike was subsequently developed for use in Edinburgh's urban bike share scheme and further projects are underway.

So the term 'Catapult' aptly describes the assistance given to Pashley and Catapult Centres can (and should) be approached by SMEs where they have a need for additional resources, expertise, collaborative partners and facilities to help develop and commercialise a new product.

For further information on Catapult and to discuss how Crowe can help your business seek competitive advantage as Pashley Cycles has done, contact Chris Mould on 01242 234 421, or email **chris.mould@crowe.co.uk**

Changes to Accounting for Leases

By Michael Jayson,
Partner, Manchester

IFRS 16 is to be implemented for all companies who report under FRS 101 or International Financial Reporting Standards for periods commencing on or after 1 January 2019.

To help keep costs low and operations running smoothly, it is quite common across the manufacturing sector for businesses to have operating leases for both items of plant and property. IFRS 16 will change the accounting for these in significant ways if you already report under IFRSs/FRS 101 or plan to do so.

This new accounting standard effectively puts onto the Balance Sheet of lessees an asset and corresponding liability for operating leases which have all previously been off-balance sheet. It is expected that this will result in £2 trillion worth of leasing commitments that are currently off-balance sheet to now be recognised.

In addition, for those businesses involved in 'contract manufacturing', which is common across chemicals manufacturing as well as in the manufacture of 'parts', there may now be a requirement to recognise this as an embedded lease.

As well as the new accounting entries creating a new level of complexity, they will then need to be backed out again for tax purposes, creating yet another layer in reporting.

Whilst this is not in scope at the moment for those UKGAAP preparers who use FRS102, even these companies should have an eye on this standard. There is a strong possibility that it will be brought within the recognition and measurement aspects of FRS 102 in the medium term, most likely when the next 'Triennial review' occurs.

What will I need to do?

IFRS 16 defines a lease as a contract that "conveys the right to control the use of an identified asset for a period of time in exchange for consideration".

The first stage in process will be, for any given contract, to confirm whether there is an 'identified asset'.

Once an asset has been identified, the next stage is to assess whether there is a lease. To do this, a business must next assess whether during the period of the lease it has both:

A the right to obtain substantially all of the economic benefit from the use of the identified asset.

B the right to direct the use of the identified asset.

What is the accounting approach?

At the start of a lease, the lease liability is recognised as is the 'right of use asset'. This is calculated by taking the present value of future lease repayments, discounted at the rate implicit in the lease or if this is not ascertainable, the lessee's incremental borrowing rate.

The lease payments include:

- fixed non-cancellable payments
- the exercise price of a purchase option (providing this is reasonably certain to be exercised)
- variable lease payments that depend on an index
- amounts expected to be payable under a residual value guarantee
- any termination payments if the lease includes an option to terminate earlier

Payments for items such as optional extension periods that aren't reasonably certain or variable payments relating to future profits or sales of the lessee are all excluded from the calculation.

A corresponding right of use asset is also recognised with adjustments made for items such as:

- lease payments made before the commencement date
- lease incentives received
- initial direct costs incurred by the lessee
- an estimate of costs to dismantle, remove or restore the underlying asset.

If I have contract manufacturing agreements, how do I know if I have an embedded lease?

Contract manufacturing can take many different forms but are typically where a Company outsources the manufacturing of a product to a contract manufacturing organisation (CMO) an example might be for a Chemical or Pharmaceutical company to outsource this under a tolling-type agreement or a component manufacturer for the automotive industry.

Contract manufacturing agreements may well contain tangible assets that are specified in the contract such as machinery or production lines. Even where there is not an explicit asset in the contract, a tangible asset might be implicitly specified at the time the asset is made available for use (assuming there are no substitution rights).

If you as the customer/manufacturer have concluded that there is an identified asset, the next consideration is whether you control the use of that asset. Considerations for this may include:

- **the operating decisions** – do you or the customer specify the operating instructions or decisions?
- **right of sale** – do you have the right or ability to sell the product to another customer?
- **frequency and timing of orders –** does this determine whether and when the related machinery or line produces output?

An example of how this might look in the real world

1. A vehicle manufacturer (VM) enters into a 3 year contract manufacturing agreement with a supplier, a CMO, to manufacture a component part.

2. The CMO has a dedicated production line for these components and is contractually unable to use any other for the contract.

3. The components are highly specialised and the purchase orders are very frequent and effectively determine whether, when and how much output is produced.

Analysis

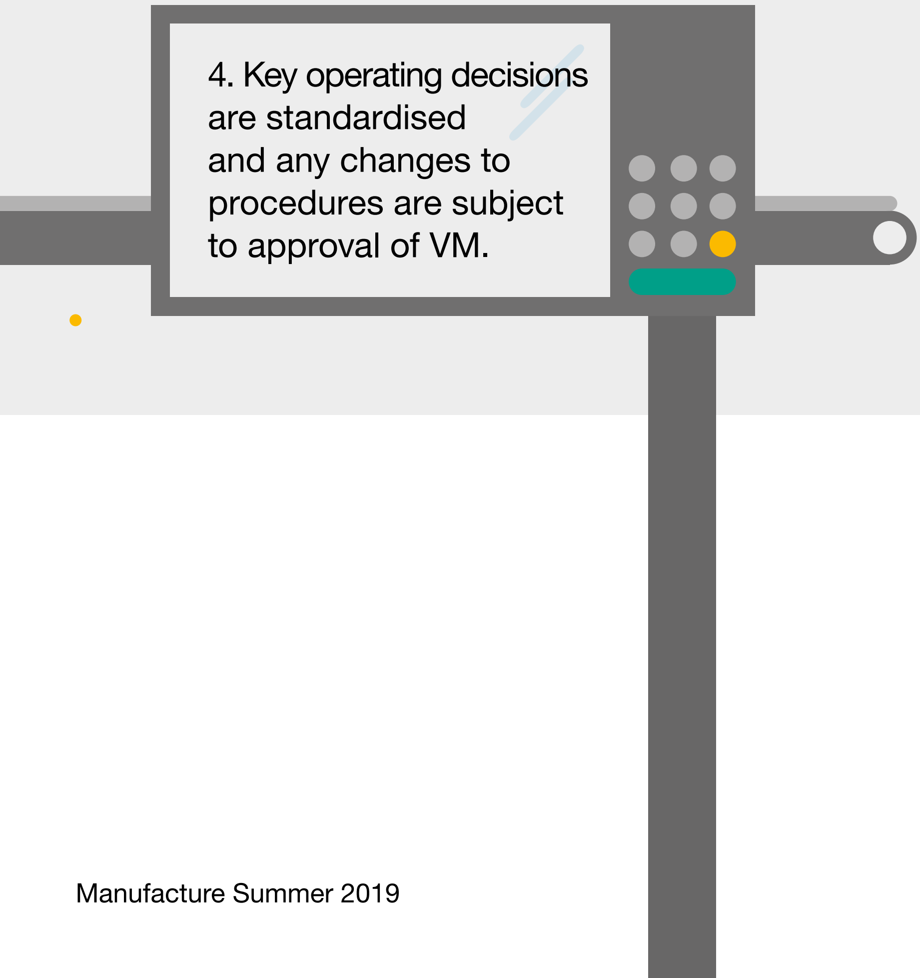
- The production line that has been specified in the contract is an identified asset and there are no substitution rights.
- The VMO appears to effectively control the decision making rights over the use of the production line as the purchase orders effectively determine whether, when and how many components are produced by the dedicated production line.
- The CMO does not have the right to change the operating instructions e.g. types of materials and other production process decisions without prior authorisation of the VM.
- The VM has substantially all of the economic benefits from the use of the production line.
- This arrangement is therefore likely to contain a lease under IFRS 16.

Are there any get-outs?

There are a two key practical expedients allowed.

One is if the lease is short-term i.e. 12 months or less in term.

The other is if it is a low value asset. Whilst the standard does not define a low value asset, the Basis for Conclusions suggests that the standard setters had in mind a value of $5,000 when the asset was new. Laptops, and telephones are therefore likely to be covered by this exemption.



How will this impact my results?

The economic reality of the position of a business will not have changed. There are however, some fundamental changes to the accounting position.

As payments are made over the period of the lease, these will partly reduce the liability held and partly be recognised as an interest cost.

In most circumstances, the right of use asset will be depreciated over the life of the lease and tested for impairment in accordance with IAS 36.

Prior to IFRS 16, operating lease payments will have been included within Admin costs which is clearly a cost to Earnings before interest, tax, depreciation and amortisation (EBITDA). These now switch to interest and depreciation costs – which clearly do not hit this measure. As a result, manufacturers that adopt this standard will see an improved EBITDA. If this is a measure that will be significant to you, e.g. in a debt covenant or transaction, it could be advantageous.

On the negative side, for those business with covenants around the Balance Sheet, there is clearly a new asset and a new liability recognised. There is therefore increase debt on the Balance Sheet and a higher invested capital for the lessee. The return on invested capital (ROIC) will generally be lower as a result.

The new re-measurements required under the standard (which are not covered in this article) may also cause Balance Sheet volatility as changes in estimates and judgements could mean that frequent adjustments need to made to both sides of the Balance Sheet.

IFRS 16 'Leases' represents the first major overhaul of lease accounting in over 30 years. The Standard brings fundamental changes to lease accounting, replacing previous accounting that is no longer considered fit for purpose.

If you would like to discuss any of the points raised, please speak to your usual Crowe contact.

What's next for your business?

By Johnathan Dudley,
Head of Manufacturing

At some point, every business needs to take a step back and decide which route it wants to take in the future. Our Business Lifecycle, represented on our website at www.crowebusinesslifecycle.co.uk addresses the various stages of a business and the challenges it faces along the way.

It's all too often the case where the ownership and or management of the business, especially one in the manufacturing sector, are so busy with the day to day that they lose sight of where they are within the business in the lifecycle and the next steps required to move forward successfully.

Taking a step back and considering what the strategy for the business and its ownership needs to be is greatly beneficial for the future. After all, how can you be successful if you haven't defined what success means for you?

At Crowe, we work with companies and their owners, defining winning strategies for the business to achieve its full potential.

We often start by defining a simple 'one page plan' for the business which benchmarks where the business is now and where it wants to be in the future, we then set out strategies and actions on how it gets there.

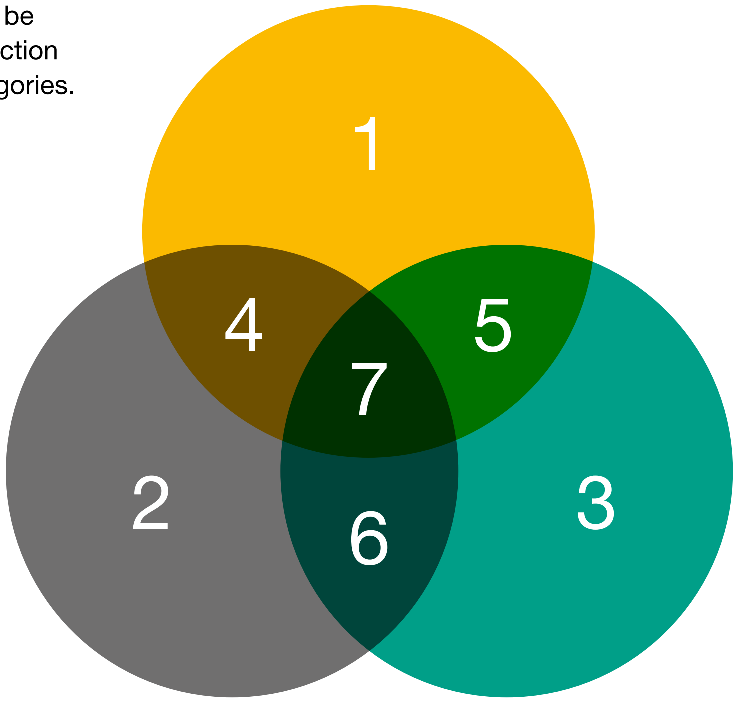
When a company has worked out where it wants to be and the strategies required to get there, it's then often a good idea to map what this means for the stakeholders in the business; the people behind it, the owners, the management and for most SME's the family interests that have to be considered too.

These sometimes conflicting relationships can be ‘mapped out’ as the following. Your strategic action plan needs to consider each of the seven categories.

Family

Ownership

Management



If you plan to grow and perhaps take outside investment to do so, you will need to ask yourself the following:

What will this mean for the family or families that started the business?

If you have some independent management, how will you incentivise them to stay around and help grow the business?

How will you make sure that the management feel as important as family members who work in the business, whether or not they have shares?

How will you know whether the next family generation are up to leading the business into the next phase?

How will you demonstrate to an investor that you have dealt with the above?

The list goes on and there are more questions to be answered in other scenarios too.

The important thing is to anticipate where the challenges are and address them; whether it means creating and adopting a Family Charter, and a Family Council, getting business training and coaching for key people, recruiting and incentivising to fill skills gaps, whether it be the granting of EMI share Options or otherwise.

This is all part of the risk management of your strategy and most importantly, it will help everyone that's important to the business achieve their personal goals too.

Whilst you cannot predict the future, a well planned and implemented winning strategy, makes a business far better prepared whatever the future holds. Our lifecycle depicts a road, we can help businesses and their owners, move down that road and reach success. Contact our business advisory specialists…

Engage the disengaged

By Gareth Jones,
Managing Director, In-Comm Training

Trying to find the answer to industry's 'skills gap' has been a pointless pursuit to date. Gareth Jones, joint Managing Director of In-Comm Training, believes he may have found the answer.

Sometimes I feel like Bill Murray in the excellent 90's film Groundhog Day when asked to debate industry and the 'skills gap'.

It has been one of the most heated discussions for manufacturers for more than a decade, yet thousands of conversations and promises have yet to come up with a consistent solution that delivers what we all want.

So what do we actually want? If you ask management teams at the coalface they'll say a workforce that has the skills to help them grow and be competitive and training courses/apprenticeships that ensure staff deliver a tangible benefit to the bottom line.

Training providers – on the whole – will agree with this, but they'd also echo the need for Government to provide more support for businesses to take training seriously. An interesting melting pot of wants and desires.

Stripping away all the agendas, I see the answer to the million-pound-question as quite simply… an employer-led approach.

Sounds simple? It can be. However, it needs everyone pulling in the same direction and signing up to give their all to finally bridging the 'skills gap'. This means training providers being prepared to listen to companies about what they want and how they want it delivered, this means firms being prepared to invest money and time in the bigger picture and it involves all political parties creating the right environment for training to thrive.

I'm not saying In-Comm Training has nailed it completely yet, but we have adopted this approach and we are seeing some very encouraging results.

The launch of our two Marches Centre of Manufacturing & Technology (MCMT) academies in Bridgnorth and Shrewsbury are great examples. We have teamed up with Classic Motor Cars, Grainger & Worrall and Salop Design and Engineering to create two dedicated learning spaces that are now delivering over 150 trailblazer apprenticeship opportunities for young people in Shropshire.

Every course has been developed in partnership with employers whilst still meeting the national criteria. They get young people that are fully-trained and the engineers of the future get access to £4 million of technology, the best industry experts and a guaranteed job at the end of it.

This is an approach we have taken and applied to our headquarters in Aldridge. Here we have engaged with Hyfore to establish an Academy equipped with £3 million of CNC machinery, fluid power control, metrology, wire EDM and, in partnership with the Elite Centre for Manufacturing Skills (ECMS), a state-of-the-art press and tooling line.

Industry is responding. In a period where apprenticeships have declined by 67%, In-Comm has reported a 40% uptake, whilst our apprentice achievement rates are coming in at 86%, outperforming the national average by nearly 20%.

This positions us in the top 3% of best performing private engineering training providers in the UK.

There has been a lot of conjecture about the Apprenticeship Levy and, whilst we can all admit that it hasn't been a resounding success, it does offer some support if companies understand how to embrace it and make the most of recent subtle changes.

For example, recent reforms have brought the non-levy paying contribution down from 10% to just 5% and employers can use what is 'in the pot' to upskill existing staff and to also look at the increased desire to develop degree apprenticeships.

In fact, the latter has gone from just 30 starts in 2015 to 4500 in 2017/18 and this figure is set to double this year.

Apprenticeship starts at Level 2 and 3 have also increased this year for the first time since 2015, which suggests that employers might finally be getting to grips with the Levy and the standards now available are beginning to meet their requirements.

In-Comm Training, which is rated as ‘Outstanding’ by Ofsted, has masterminded £7 million of investment in its three academies, offering over 75,000 sq ft of dedicated manufacturing training space, including the latest CNC machine tools, automation, robotics, metrology solutions and 3D printing.

This is reinforced by access to industry-experienced trainers and 11 technical partners, who include Blum-Novotest, Ceratizit WNT, Engineering Technology Group, Guhring, Hexagon MI, HK Holding and Hyfore Workholding.

It currently trains over 500 apprentices for 450 companies every year and these are both part and full-time trailblazer courses with a job at a manufacturer guaranteed at the end of it.

The company has ambitious plans to take its Midlands offer national, working with the Engineering Technology Group (ETG) and other industrial partners to establish a number of technical academies across the UK.

We can't have a supply chain without the right skills

The rapid evolution of industry is another factor that the training sector is having to come to terms with.

A lot of providers have failed to get to grips with the change to the Trailblazer apprenticeship standards and this is holding back delivery of the new qualifications and causing unnecessary confusion within industry.

You've also got transitions to quality standards, issues caused by 'diesel gate' and the white elephant in every boardroom across the UK and Europe… the never-ending saga of Brexit.

That little concoction is enough to get any management team looking nervously at its workforce and where it should take its skills training going forward. The clever ones will be making sure their people remain their biggest asset.

We also have a whole raft of new technologies sweeping into engineering and manufacturing. Battery power and vehicle electrification is a major topic in the automotive sector, whilst the use of data and the Internet of Things (IoT) has gone from being buzzwords to being integral parts of the business plan.

Training has to reflect this. We can't lead the world in these new technologies if we don't have the supply chain to support the OEMs and we can't have a supply chain without the right skills at their disposal.

Our role will be to develop courses that reflect what a future engineer and manufacturing specialist will look like and we'll need to tap into the knowledge of employers to make this happen.

In an interesting move to the Apprenticeship Levy, the larger 'paying' companies can now transfer up to 25% of their levy pot for use with companies that supply services and products into them. This is a very worthwhile change of dynamic and shows an eagerness from the very top to build capacity for the challenges/opportunities that lie ahead.

Going back to the original point, we're all in this together and the sooner we share best practice and responsibility, the faster we will bridge the 'skills gap'. We need to engage the disengaged and companies should be actively encouraged to monitor their supply chain and to take up relevant development opportunities.

That's the long-term vision. In the meantime, let's all shout about what a great career engineering and manufacturing can be so we can start changing preconceptions and getting young people excited with industry. There's no time like the present.

VAT pitfalls: prevention better than cure

Robert Marchant,
VAT Partner

As with most things in life, prevention is better than cure. This is particularly so when it comes to effective tax planning, where problems seen in advance can negate their effects later on.

VAT is of course no different, where it is much easier to avoid problems upfront, rather than trying to remedy them after the event. VAT really should not be a cost in the supply chain, however, there are unfortunately many pitfalls.

Property transactions

Property transactions are often high value and complex. Property developers, despite regularly dealing with VAT on land transactions can get it wrong and this risk is even greater for businesses where property transactions are not a core part of their day to day activities. This can lead to some common pitfalls:

Leases granted for nil premium and a peppercorn rent

In such situations, as there is no consideration provided by the purchaser, it is unclear whether there is a supply taking place at all. HMRC has sometimes argued that the vendor is not even 'in business' and so is not entitled to recover VAT on costs relating to the transaction. This could include VAT incurred on the acquisition of the land and on any development works that have taken place.

Barter transactions

Barter transactions are not just specific to property but tend to occur more frequently in land and property deals. Some businesses can lose sight of the fact that, for VAT purposes, there are two supplies taking place and both sides need to consider whether VAT is due on their respective sales. Additionally, there can be questions as to what is the correct value to be applied when there is both monetary and non-monetary consideration paid. Further, there has been some property deals where one of the parties considered that there was an unequal value (for example, the value of the non-monetary consideration provided by 'company A' was, in their view, not the same as that provided by 'company B'), which led to differences in the VAT amounts payable and the potential for unexpected VAT charges.

Option to tax

For commercial property it is possible for businesses to elect to charge VAT. There are often misunderstandings about the process of 'how' an option to tax is made and 'why' they would do so. In a recent property transaction the purchaser was under the misapprehension that they would automatically inherit the vendor's option to tax, which was not the case, and which potentially threatened their recovery of VAT incurred on the property purchase. In addition, a valid option to tax can be one of the key conditions for Transfer of a Going Concern (TOGC) treatment applying where the business assets include land or buildings. An option to tax can help to prevent VAT costs in supply chains where there should be no need for them to arise.

International trade

Evidence of removal from the UK

A key condition for not accounting for standard-rate VAT on sales of goods that are removed from the UK (the sales become zero-rated) is that the supplier holds valid commercial evidence of export. This is a common area for HMRC to review during a VAT inspection and an area where we frequently see assessments being raised for underpaid VAT. Exporters from the UK need to ensure they have robust processes in place and liaise with their freight agents to ensure that the relevant documentation is retained, and within the right time periods. A particular risk area is where the customer collects or arranges for the shipment from the UK as suppliers may not ever be provided with copies of the required shipment evidence.

Import VAT reclaims

VAT paid on the importation of goods into the UK is generally eligible for recovery but a reclaim is only permissible where the business holds the correct evidence, which is a C79 certificate. VAT reclaims using other documentation such as the import entry, freight agent recharges or duty deferment account statements are invalid. Unexpected import VAT costs can arise where a business has not set-up a valid EORI number (effectively an importer ID number) before the shipment arrives. This means that they are unlikely to obtain a C79 certificate and so may not be able to reclaim the VAT. This can particularly be a problem for start-ups and businesses selling into the UK market for the first time.

Other points

Failure to charge VAT on cross-charges between members of the same corporate group

Generally, recharges of costs and supplies of services between UK entities are VATable supplies and the default position is that VAT at 20% is due. Some businesses fail to raise VAT invoices and fail to account for VAT on these cross-charges and this can present easy targets for HMRC during VAT audits. Where the recipient entity is partly exempt or unable to reclaim VAT then a failure to account for VAT by the supplying entity is even more significant as there are anti-avoidance rules that can create annual tax points and an increased risk of unexpected VAT costs arising.

Routine errors in the preparation of VAT returns

It is not uncommon for businesses to have a standard VAT return template that is rolled-forward from return to return. This may have been set-up by someone who is no longer within the organisation. In such instances basic errors can creep in, such as incorrect exchange rate calculations overstating the amount of VAT to be reclaimed and formulae errors where incorrect amounts are summed or cells are missed. There are even transposition errors where the values for inputs were recorded as outputs and vice versa. HMRC estimates there is around £600 million each year of errors when businesses manually enter their VAT return figures into the online portal.

Making Tax Digital for VAT (MTD)

In a bid to reduce the amount of manual transposition errors as well as to ultimately increase the amount of data available to HMRC, MTD was introduced with effect from 1 April 2019 and results in digital record keeping and digital filing requirements. The first VAT returns due for submission under the new rules will be in late May or early June, with MTD really taking effect for many businesses in the summer. However, as with most new major initiatives, there is often confusion; particularly in this case regarding what software solutions are needed in order to comply with the MTD requirements as well as whether businesses' current VAT compliance processes are adequate.

Summary

In most of these situations, the law doesn't intend there to be a VAT cost, but because of the way that the transactions were carried out, one has arisen. VAT is a fact specific tax, so specialist advice should always be sought to prevent costly and unexpected surprises arising. Prevention is better than cure, so it is best that this advice is sought up front and not after the event.

Growing the UK's export community – how to take your business global

Darren Rigden,
Partner

In April HMRC published figures revealing the UK's 'Importer and Exporter Population' for 2018, which shows the number of businesses trading goods abroad. According to the data, 306,000 businesses trade internationally each year, of which 148,000 are exclusively importers, 60,000 are exclusively exporters, while the remainder do both.

While these figures reveal a burgeoning community of international traders, the government is keen to get the UK exporting more. For many, the prospect can be a daunting one, with many considerations needing to be taken into account and opportunities suitably measured against risk.

Exporting carries a number of risks, but also many rewards in opening up new markets. It significantly increases the number of potential clients a business can sell to, but without any prior experience of exporting it can be difficult to know where to begin.

Preparing a strategy

Firstly, it is important to have a clear strategy. This should take the form of a proper business plan, which should include a cash flow forecast. This will need to take account of higher working capital requirements, as exporting will often result in a longer cash flow cycle. The business plan should set out which countries the business wishes to target for its exports and why the product or service will be suitable for that market.

Exporting works particularly well if you have a product that you sell, which can be exported to a country that is unable to make that product internally, or if you can produce the product cheaper in the UK than in the country being exported to. It can also be an avenue to explore if your product is branded or can be sold at a premium as being British-made. Across much of the world, British-made goods are held in high esteem, with the 'British' stamp effectively acting as a revered brand.

At Crowe, we have helped many businesses to produce strategies and forecasts at early stages of export planning. This has helped our clients to avoid unnecessary and additional costs that may be incurred at a later stage.

What to consider?

1

Are there situations or markets that would result in a local demand for your product?

2

Are there any local laws, regulations or religious regions which mean that your product is not suitable for that market?

3

What equivalent local products are available and how does your product compare to these?

4

How are British products seen in the country (in some countries UK-made products are seen as premium and are in high demand)?

5

What is the selling price of your product compared to the local competing products or brands?

6

Have you considered what the additional costs for you in terms of currency, tariffs, taxes and carriage will be?

7

Are there any restrictions on the import of your product to that country which will restrict your market, or prevent you from importing your goods?

8

Are the countries you are targeting subject to any trade or other embargos which could prevent you from dealing with them?*

*Most banks for instance will have a list of countries that they will not allow you to trade with.

Beware of the risks

Foreign exchange
Fluctuating currency rates can easily impact on profit margins if they move against you. Hedging against currency risk can take many forms, some of which are highly complex. Banks, as well as specialist foreign exchange bureaus will be able to provide advice on this. Usually it is better to go for the simplest form of hedging and it is important that you understand the product being offered and its cost. If you are also buying from overseas then the best form of hedging against currency risk is a natural hedge where you buy and sell in the same currency.

Selling strategy
How you will sell is an important consideration and it can be achieved in many ways; direct sales from the UK, use of an agent or representative, using a distributor or commission representative or by setting up a branch or entity overseas. Each route will have its own tax implications, which a qualified accountant will be able to advise on.

The business plan should cover the short medium and long term so that an appropriate structure can be put in place for both commercial and tax planning purposes. However, this should aim to set up the business for the best commercial outcome rather than around a tax structure that does not work commercially. Involving your specialist advisors at an early stage should ensure things are set up properly from the outset, which will potentially save a lot of time and money further down the line.

You should also consult your specialist advisors about VAT and tariffs before agreeing a price with your customer so that you can be sure that all the costs are included and your profit margin will be what you expect.

Invest in the right people
Recruiting and investing in the right people will have a significant impact on how successful the business will be. The most successful businesses often invest in local sales people who not only speak the language but also understand local customs and ways of doing business. They can also be invaluable in understanding local laws and regulations which if not properly considered can cause problems.

Once you are up and running getting your goods to their destination can seem very complicated due to the paperwork required. However, help is on hand from freight forwarders and local chambers of commerce, along with banks and specialist advisors who can help with the paperwork required.

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Hapag-Lloyd
PSA

Receiving payment

Once you have exported you need to ensure you are paid. Receiving the cash is likely to take much longer than if you sell to a UK company due to delivery times and delays at customs. Therefore, you will need to consider how you fund your working capital requirements.

A typical process could include the following before any money is received:

- Generating a pro forma invoice/quote for your customer.
- Receiving a letter of credit from your bank.
- Fulfilling the terms of the letter of credit; a very important stage as a minor discrepancy can hold up payments.
- Manufacturing or collating the product.
- Shipping/insurance arrangements, understanding the INCO* is important as it impacts on your responsibilities and the level of insurance required.
- Packing the goods.
- Arranging for the goods to be transported and delivered to the customer.
- Collecting the shipping documents and ensuring they are properly completed.
- Presenting the shipping documents to your bank.

*The rules which define the responsibilities of sellers and buyers for the delivery of goods under sales contracts.

There is plenty of help available to companies researching overseas markets and information can be obtained from organisations such as the Department for International Trade (DIT), Open to Export along with most banks and of course online research and local guides.

As well as providing information on markets, many organisations will also run trade missions to countries of interest. This is where government officials and business leaders from one country travel to another to promote trade between the two. Trade missions are usually organised by governments or banks and are used to explore potential international business opportunities. They can also help create networks of buyers, agents, suppliers and key government contacts in a specific country or region. Often these may be part funded by the organisation running the mission.

With the right advice exporting is not as daunting as it first seems and will significantly increase your customer base. The key, as with any business, is careful planning and consideration of the above points before you start out.

Dates for your diary

Manufacturing Business Network – Entering new markets

You are invited to join us for our Manufacturing Business Network event on Tuesday 9 July 2019.

Our Head of Manufacturing, Johnathan Dudley will be joined by Karen Poxon, Marketing Director and owner of KDM marketing consultancy. Karen works closely with local manufacturing businesses, she will discuss the opportunities that are available for such companies to enter new markets by developing a straight forward marketing plan – without the jargon!

When
Tuesday 9 July 2019
17:30 Registration
18:00 Discussion
19:00 Dinner and networking

Where
Crowe, Black Country House
Rounds Green Road
Oldbury
B69 2DG

RSVP – nathan.sanghera@crowe.co.uk

Manufacturing Live at Corin Medical with NK Media

Manufacturing Live forum will be held at Corin Group, a world leader in the development, production, and distribution of reconstructive orthopaedic devices worldwide.

Through its investment in research and development, and new manufacturing technologies, Corin is revolutionising orthopaedics aiming to maximise value in healthcare and positively impact lives.

The forum is made up of all types of regional manufacturing directors/ managers finding out more about how others are resolving challenges in the sector and looking to share ideas.

When
Tuesday 2 July 2019

RSVP – joy.hillier@crowe.co.uk

Crowe

A leading national audit, tax, advisory and risk firm with global reach and local expertise. The talent of our people, our size, our structure and our values mean our clients can rely on a depth of specialist knowledge and personal delivery from the professionals they work with.

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>80 Partners

>750 Staff

8th largest firm of auditors on AIM

7 offices

9th largest UK audit firm[1]

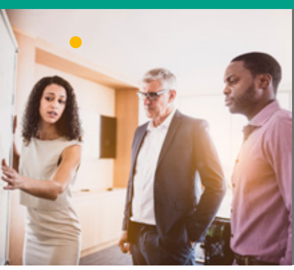
1 FRC Facts and Trends

Crowe Global is the **eighth largest global network** of independent audit and advisory services firms in the world, with 213 member firms and business associates across 130 countries.

130
countries

32,822
partners and staff

>4.3bn
revenue (US$)



782
offices

213
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About Us

Crowe UK is a national audit, tax, advisory and risk firm with global reach and local expertise. We are an independent member of Crowe Global, the eighth largest accounting network in the world. With exceptional knowledge of the business environment, our professionals share one commitment, to deliver excellence.

We are trusted by thousands of clients for our specialist advice, our ability to make smart decisions and our readiness to provide lasting value. Our broad technical expertise and deep market knowledge means we are well placed to offer insight and pragmatic advice to all the organisations and individuals with whom we work. Close working relationships are at the heart of our effective service delivery.

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