Bulletin

mercer & hole
chartered accountants

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Challenging times

To say that the economic climate has got worse since we issued our last Bulletin is something of an understatement.

No one doubts that we are facing probably the worst recession for a generation. As if this wasn't bad enough, many countries, with the UK, the US and parts of Europe among them, are also facing a banking crisis. Many banks and some large public companies now find themselves under government control, with government borrowing in many countries reaching record levels.

So, what of the future?

However difficult the current economic climate is, there are some very early signs that are at least encouraging. No one seems able to agree on when the recession will end, but there does seem to be more activity in the last couple of months in the housing market than there has been for a while. There are substantial investment funds which have to invest money somewhere. However difficult they sometimes make it, the banks are lending money, but the true cost will probably only be revealed as interest rates start to rise again.

However, there are actions that businesses can take and we are already involved with many of our clients to help them in this area. It might be help and advice on cash flow and in particular knowing whether the banks are being fair or not. It might be on helping clients achieve efficiencies, possibly through staff reductions. It might be as simple as making sure that for a business going through a bad patch, any tax payments on account are adjusted accordingly and save on the cash flow or look for ways of the tax system supporting a downturn in the business with some tax advantages. It might be, in extreme circumstances, that clients need help and advice on the insolvency options.

Whatever the issue, we are always delighted to help and we have made sure in this particular issue of the Bulletin that there are some articles focusing particularly on the current economic difficulties. The message as always is, please talk to us; we will do whatever we can to help.

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Small company audit exemption limits...on the up

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A company (group) qualifies as a small or medium-sized company (group) if it meets two out of three criteria relating to turnover, balance sheet gross assets and number of employees in its first financial year, or in the case of a subsequent year, in both the year under review and the preceding year.

New thresholds have been put in place which apply for financial years beginning on or after 6 April 2008, by the Companies Act 2006 (Amendment) (Accounts and Reports) Regulations 2008 (SI 2008/393).

The move follows the Government's general drive to keep small and medium enterprises competitive and alleviate some of the regulatory burden that they face, especially for those smaller, growing entities.

Many clients still decide to have an audit even if the thresholds are not breached, conscious of value added; the need to share financial statements with third parties such as banks; or minorities. However, the existing thresholds and the new thresholds are set out in the table.

	Existing thresholds		No change	New thresholds	
	Turnover (not more than)	Balance sheet total (not more than)	Number of employees (not more than)	Turnover (not more than)	Balance sheet total (not more than)
Small company	£5.6 million	£2.8 million	50	£6.5 million	£3.26 million
Small group	£5.6 million net (or £6.72 million gross)	£2.8 million net (or £3.36 million gross)	50	£6.5 million net (or £7.8 million gross)	£3.26 million net (or £3.9 million gross)

If you require further clarity regarding the audit exemption limits or have a general audit query, please contact Gary Farnes at garyfarnes@mercerhole.co.uk or call 01908 605552.

Also featured in this issue

- Will your bank still lend to your business?
- Responding to the financial crisis
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- Opportunity to secure funds under the Enterprise Finance Guarantee scheme

Will your bank still lend to your business?

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By common consent we are in the midst of one of the worst recessions in living memory. What, in my opinion, makes this recession different from those which have gone before is that it is coupled with a banking crisis. I didn't believe that I would see a run on a bank in my lifetime; I didn't believe that I would see governments in many countries in the world having to give the level of financial support to banks that we have seen; I didn't think that I would see banks effectively stop lending to one another; and I didn't think that 'toxic assets' would ever become a phrase in everyday usage. Compelling as all this may be, what will this mean to your business when you come to renew your overdraft or loan and what will the bank's attitude be if you need to increase your borrowings from them?

In the highly competitive market that existed before the recession, banks in my opinion lent money at margins which were too low. The days of overdraft interest being charged at, for example, 1% (or less) over base rate have for the time being gone. Banks allowed the margins to fall too far and you will now see more realistic rates being applied. Well managed private companies, partnerships and sole traders can expect to find themselves paying somewhere between 2%-3% over base rate on their overdrafts. Among our clients we have seen overdraft interest charged at as much as 5% or 6% over base rate.

Similarly, arrangement fees for new lending or an arrangement fee for merely renewing an overdraft, commonly used to be heavily discounted, or in some instances waived completely. Arrangement fees are now rarely waived or discounted by anything other than very modest amounts.

Clients tend to have emotional reactions to increases in a bank's margin, but in principle I accept that the margins had to go up. There are still some odd decisions that the banks take on margins from time to time which seem difficult to justify, but by and large this is a sensible approach for everybody. My concern, however, is that the true effect of this is at the moment being masked by the interest rates themselves, which are at an unprecedented low level. When they rise again, as they surely will, this will have a much bigger impact on many businesses.

Clients need to be aware that where many banks prior to the recession were selling the idea of being 'your local bank', the recession has ensured that in practice the mechanical process of approving credit within the banks has changed. Different banks have dealt with it in different ways, but essentially an extra layer of credit approval has been installed by most banks. Whatever your views on the need for this, it obviously makes it even more important to support your credit applications with the proper information, including up-to-date accounts and cash flow forecasts.

We have seen banks in the current climate try to move away from linking loan interest to base rate as opposed to LIBOR. We have also seen banks taking a much firmer view on breaches of banking covenants and businesses need to be much more aware of the covenants they have signed up to, when they talk to their banks.

However, in practice probably the change which has produced the largest reaction amongst our clients, is the general move from the banks to increase their level of security and on private companies it is now common for this to take the form of personal guarantees. On private companies, partnerships and sole traders it is also becoming more common for banks to take a charge on personal assets, often the business owner's house. Having spent years getting banks to look at businesses on a standalone basis, in a climate where personal guarantees and security were the exception rather than the rule, this change of approach by some of the banks is hitting clients very hard.

In conclusion, businesses whose facilities which have not come up for renewal in the last six months, will find a very different approach by their bank on their next renewal. My strong advice, as always, would be to make sure that you talk to Mercer & Hole before renewal and seek our help and advice as to what you might expect. These are difficult times, but the banks still have to lend money in order to make money and it is in everybody's interest to have realistic expectations of how to deal with the next 2-3 years. Please do not hesitate to talk to any of us if you feel we can help. You can contact me directly at howardwilkinson@mercerhole.co.uk.

Responding to the financial crisis

For further information contact
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Stock markets may be rallying at the time of writing, but in the real world, business cash flows remain tight, sometimes so. Sales and activity levels remain massively depressed in some sectors and business and consumer confidence indicators are merely showing less pessimism.

The most likely economic outturn for 2009-10 is slowing contraction this year and a low point early next. As many businesses will only then begin to grow, it may well be mid-2010 before you see that growth generating the cash your business really needs to return it to full health and vigour. How will you best get through the next 18 months and what signs should you look out for along the way?

Whatever else you do, concentrate on generating and conserving cash. Cash today is worth much more than profit tomorrow in the current environment. Remember that underlying the financial crisis is a credit crunch and that cash is therefore a scarce resource. It is no longer a commodity but something precious to be cherished and used sparingly.

You might want to look at sales incentives, or at lower prices if they generate cash, especially if you can reduce your working capital investment by lowering stock and work in progress levels. But really put your heart into credit control, both when trying to collect your debts and throughout the customer transaction cycle.

On the payments side, take credit where you can - but beware! If you increase your company's creditors at a time when its liabilities (including contingent and prospective liabilities) exceed the value of the assets or when you are unable to pay the company's creditors as they fall due, and there is no reasonable prospect of avoiding insolvent liquidation, you risk personal liability for your company's debts.

Responding to the financial crisis (...continued)

So what are the warning signs and what should you do if they appear? Firstly, do your liabilities exceed your assets? Particularly when contingencies and prospective claims are included, very many companies are balance sheet insolvent. This isn't necessarily a problem, but it's an early warning sign. More to the point is whether you can avoid insolvent liquidation. You may very well think so, but you may not be best placed to judge. How dispassionate can you be? Aren't you the optimist, the entrepreneur driving business forward?

Ask yourself:

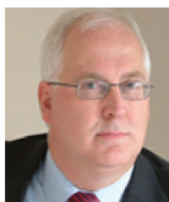
- are you being forced to stretch creditors?
- is your overdraft at or above its limit?
- are you late with PAYE or VAT (and did you know this is the cause of most director disqualifications following insolvency)?
- are your debtor days being stretched?
- are you struggling to get the money in to pay wages and salaries?
- are the directors having to be paid late?

All the above are classic signs of cash flow problems and if any of these things are getting worse, you would do well to take specialist advice. Remember, the economy is likely to get worse, albeit more slowly, for 9-12 months and if you haven't got cash under control now you might have a real problem. Getting help from the bank may not be an option.

What's the solution? Mercer & Hole's Restructuring & Insolvency partners spend much of their time helping clients avoid formal insolvency procedures - or at least use insolvency constructively. The earlier you seek our help, the earlier we can find a remedy and the less pain it will involve. Crisis cash management is a service we can provide to eke out precious funds and there are opportunities for asset or equity funding that can be more attractive than formal insolvency. Alternatively, your being in control of the timing and nature of an insolvency procedure can be advantageous.

We are always happy to have an initial discussion about business difficulties to see what might be done, and many clients find that our situational expertise is a valuable addition to their business knowledge. Even if things have moved quickly and the bank is demanding repayment or judgement creditors are pressing, we can still help - and most clients find us very user friendly! For further advice, please contact Chris Laughton at chrislaughton@mercerhole.co.uk or call 020 7353 1597.

Pensions - simplification it ain't



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Almost anyone who read press coverage of the Budget will be aware that the Chancellor has clamped down on tax relief for pension contributions made by anyone whose income (rather than just their earnings) is more than £150,000 per year, if they make contributions of more than £20,000 to their pension.

The new legislation will come into effect fully from 2011 - until then, we have a different set of transitional rules.

In simple terms though, both aim to reduce the tax relief available on contributions which breach the new levels to the basic rate (ie 20%) rather than the level available prior to the Budget (40%).

Without getting into a political discussion about the rights and wrongs of this move, it is worth making the point that the new measures will potentially affect more people than might originally be expected, as:

- the income limit also applies to the two years prior to the year in which the contributions are paid (for example, a contribution made in June 2009 will be affected if income exceeds £150,000 in any of the three years to 5 April 2010)
- contributions made by employers are also taken into account. Where the limits are breached, employees will be required to report the amount of the excess on their tax returns and to pay tax on it, at 20%
- a salary sacrifice by an employee (for example, an agreement to reduce an employee's salary from £180,000 to £100,000 and to have £80,000 paid into a pension) will be caught, as the amount of the sacrifice will be added back when calculating the person's income for these purposes. In this case, the amount of the salary sacrifice which takes the amended income above £150,000 (ie £30,000 in this example) would be treated in the same way as a 'normal' employer's contribution above.

The transitional rules will not apply where regular contributions in excess of £20,000 were being made prior to their introduction. In this context, regular means at least quarterly - so people who have made annual pension payments once their income is known will find that these do not count. Nor, it seems, will people who have made monthly payments for a number of years be able to treat these as regular if, for example, they missed three or four payments because they were concerned about their job security or future earnings.

HMRC have stated that the legislation in this area will 'evolve' which probably means that new restrictions will be introduced as loopholes are identified and exploited. At the moment, though, the draft rules suggest a number of anomalies, including:

1. someone taking a minimal salary and/or dividends could potentially get his employer to make very large pension contributions, without the new legislation biting. This would be a totally different result from someone whose contract - or earnings history - suggested his income was, say, £200,000 and who gave up most of this in return for a large contribution. On the face of it, they are in an identical position but the new legislation would treat them totally differently

2. the proposal to withdraw personal allowances for people earning just over £100,000 a year could mean that someone earning in the region of £113,000 in 2010/11 and making pension contributions of £13,000 would get tax relief of 60% (so the contributions cost £5,200). Someone earning £130,000 - or £100,000 - and making the same contributions would only get tax relief at 40% so the net cost to them would be £7,800

3. if very large contributions were being made to defined benefit schemes, such as those available to MPs and government ministers, before 22 April 2009 (the date of the Budget) these may continue - provided that any increases are in line with, for example, pay rises

4. the new rules appear to affect contributions to approved pension schemes only. This may make some of the more esoteric offshore schemes more flexible and attractive from a tax perspective, which is presumably not what the legislation is designed to achieve.

The one thing that is certain is that the new rules are a minefield and that everyone committing themselves to making a pension contribution should seek up to date professional advice, first. For further advice, please contact David Mansell at davidmansell@mercerhole.co.uk or call 01604 669330.

Opportunity to secure funds under the Enterprise Finance Guarantee scheme

For further information contact Julian Dobbin
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The Government launched the Enterprise Finance Guarantee (EFG) as part of their measures to assist small medium sized enterprises (SMEs) experiencing cashflow difficulties caused by the credit crunch. The scheme is aimed at businesses who wish to borrow, but their available collateral has been exhausted. It can be utilised by start-ups or existing businesses.

The EFG is in its early days and lenders and advisors alike are only just beginning to understand its rules and limitations. Mercer & Hole has taken some time to dissect the scheme to share its understanding with you and offer assistance with the application process.

What can the EFG be used for?

It is anticipated that the primary use of the EFG will be to secure the provision of 'working capital' for SMEs. However, borrowings may be used for the following purposes:

- property/equipment/other asset purchases
- business expansion
- acquisition of other businesses
- refinance existing overdraft facilities
- start up costs.

The applicant's business plan must be viable and able to meet lenders' standard commercial requirements for a loan.

Potential borrowing and repayment terms

The minimum loan amount is £1,000 and the maximum is £1 million. The minimum term is three months and the maximum is ten years (including any capital repayment holiday). Capital repayment holidays are permitted up to a maximum of three years.

Security

The lender must be satisfied that all personal assets have been pledged before lending under the EFG. It is at the banks' discretion to determine whether:

personal assets should be considered 'available' as security (see below)

- the applicant is personally committed to the venture
- the applicant is using the EFG solely to avoid pledging personal assets.

At Mercer & Hole, we understand that if personally owned assets that would be traditionally offered as security are jointly owned with a spouse/third party, who is not directly connected to the business, any refusal by the third party to charge those assets renders them 'unavailable' for collateral.

If the principal residence is not jointly owned and the applicant refuses to offer this as security, then the EFG scheme can still be used at the discretion of the lender. In these cases, an unsupported personal guarantee would likely be sought.

Applicants will be asked to pledge premises, machinery and other assets used in the business as security for the EFG loan, usually as a fixed or floating charge.

The cost

Businesses will pay a premium to the Department for Business Enterprise and Regulatory Reform (BERR) in return for the guarantee, to the value of 2% per annum on the reducing balance of the loan (reduced to 1.5% for those due and collected in 2009). The premium will be collected centrally by the Government, not the lender.

Who cannot apply

Any applicant's turnover during the previous twelve months must not have exceeded £25 million (including other group companies). There is no restriction on the applicant's number of employees.

There are some sectors which may not be able to apply and these include: banking; property; education; fishing; agriculture; shipping; forestry; performing arts; health and social care and coal and steel. If you are in one of these sectors, then a qualification checklist is available on the BERR website for your information.

Assistance with the application process

Mercer & Hole can provide the following assistance with the applying to the EFG scheme:

- introduction to a bank supportive of the EFG scheme and facilitation of meetings
- help preparing financial projections and review of your business plan
- support identifying an appropriate level of borrowing and viable repayment terms.

Mercer & Hole offers a range of services that are relevant to companies that wish to ensure they are fighting fit when the economy is at its most challenging. If you would like to find out how Mercer & Hole might support you and your business goals, or discuss the EFG scheme please contact Julian Dobbin at juliandobbin@mercerhole.co.uk or call 01908 605552.

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