



Your business

News for growing companies

Welcome to the February 2017 edition of Your Business - our regular round-up of news, views and advice specifically for growing companies, their owners, directors and shareholders.

Get in touch with any of our team members if you have any questions.

Unbundling the new IFRS 15 revenue recognition rules

The new revenue recognition International Financial Reporting Standard (IFRS 15 - Revenue from Contracts with Customers) comes into force from 1 January 2018. Whilst that might seem a long way off, businesses should not underestimate the amount of preparatory work that may need to be undertaken and ought to keep in mind that the 2017 financial statements may need to be restated or adjusted as the comparative period. In addition, there already exists a requirement for entities that adopt IFRS to consider and disclose the impact of yet to be implemented new accounting standards on future financial statements, and that applies to financial statements to 31 December 2016. So what should you start thinking about over the next few months?

What is IFRS 15 – a recap

IFRS 15 introduces a five step revenue recognition approach that requires businesses to:

- Identify the contract(s) with the customer
- Identify the separate performance obligations
- Determine the transaction price
- Allocate the transaction price to the performance obligations
- Recognise revenue when the performance obligations are satisfied

It's worth spending some time now working through the steps to make sure you're correctly recognising revenue when you should and that you're capturing the reasoning. The relevant documentation you'll need is not just for your own reporting requirements but also to help support the year-end audit.

Businesses with a single non-complex product (or service) with a transparent pricing structure should find working through these steps relatively straightforward. However, many businesses that provide bundled products and services (such as those, for example, incorporating deferred payment options, warranties, licences, 'software as a service' and incentive schemes) will need to unbundle the underlying product and service components, and may find certain elements of a contract being dealt with by different accounting standards.

The challenges of unbundling – what do you need to look out for?

When unbundling, it's important that the less obvious components are identified and accounted for appropriately. For example, if incentives such as deferred payment options are offered, then part of the customer contract may be regarded as financing.

Warranty and incentive schemes that lock-in customers or encourage repeat business also need to be identified and evaluated.

Once unbundled, a value will need to be attributed to each of the performance obligations. Where there are observable prices for similar discrete products and services, this should not be too onerous. Where prices are less observable, the task is harder and will undoubtedly require the exercise (and disclosure) of judgement.

It's worth noting that IFRS 15 recognises that in certain circumstances the delivery of the product and service are inextricably linked to such an extent that there is a single performance obligation – such as the delivery of a piece of software that needs to be integrated into existing operational applications before it can be used – each case will need to be looked at on its own merits.

The need to look at each contract might appear daunting - and it may well be if each customer contract is bespoke. However, IFRS 15 takes a pragmatic view by allowing a portfolio approach to be adopted if you have a large number of similar customer agreements – for example, where standard licence, support and maintenance agreements are issued in respect of a standard product suite.

The comparative year – two options

You will need to apply the new standard not just in the year it comes into effect, but also for the comparative period. The good news is that businesses have two options. You can either opt to fully restate all of the comparative figures for open contracts for each prior period presented. Alternatively, you could leave the comparative figures unaltered but show the financial impact of the change under IFRS 15 as a current period adjustment to the opening brought forward retained earnings

Managing the impact – should you tell your stakeholders?

It's worth investing time as early as possible to quantify the likely financial impact of the new standard. Even where only additional disclosures arise from the adoption of IFRS 15, time will still need to be taken to ensure all of the underlying details are known and available for reporting. It is also important to start managing the expectations of key interested parties such as:

- Analysts and the investment community - if your revenue and earnings forecasts are going to change materially;
- Funding providers - where you have financial covenants linked to profitability; and/or
- Employees - where you have an employee incentivisation scheme also linked to profit.

Is there a tax implication?

A business's tax base will typically be affected in cases where amendments to revenue recognition policies alter the business's profit. In the first period of implementation, adjustments to prior period profits will also be brought into charge.

However, such changes may be overridden by existing legislation that prescribes specific treatment that is not affected by accounting practice (for example, in respect of leases) or by any legislative changes introduced by the Government in light of the changes to IFRS 15. As things stand, no such changes have been identified, but this will be monitored as we approach implementation.

IFRS 15 is coming, and now is the time to begin your preparations. While undertaking this exercise, check that your finance team and accounting systems will be able to capture and maintain this information on a regular basis to ease the interim and financial reporting obligations.

To discuss how your business can respond to the new IFRS 15 standard, please contact [Rhodri Whitlock](mailto:rwhitlock@pkf-littlejohn.com) on +44 (0)20 7516 2433 or rwhitlock@pkf-littlejohn.com.

Data protection – are you protected?

Both the risks and the likely penalties for suffering a data loss are increasing. The Information Commissioner (ICO) stated recently that organisations need to rethink their approach to data protection and is backing up this warning with decisive action. In total, 36 organisations were collectively fined £2 million in 2016, up from nine fines totalling £668,500 two years earlier. The difficulty for many SMEs is that they typically have limited financial resources and relevant expertise, and their focus is almost certainly on the provision of services. But none of that will count as mitigating factors if you suffer a data breach or use personal information inappropriately.

How are the rules changing?

All personal data held by any organisation for any purpose is governed by the Data Protection Act 1998 (DPA) and the Privacy and Electronic Communications (EC Directive) Regulations 2003 (PECR). However, there is a new EU Directive, the General Data Protection Regulation (GDPR), which is due to come into force on 25 May 2018. The GDPR increases the size of the fines that can be levied in the event of a data breach or non-compliance with the Directive to as much as 4% of the annual worldwide turnover of an organisation or €20 million (whichever is the greater). This is enough to put most SMEs out of business.

What can you do?

There are a number of steps you can take to minimise the risk of your business suffering a data loss or using information inappropriately:

- Security and confidentiality of data must be at the heart of your IT decision-making, not just an afterthought
- Ensure you have explicit consent for storing and using any personal information for the specific process you wish to use it for
- Encrypt confidential data. The ICO has said categorically that it will not accept any excuse for a data breach if the data were not encrypted, regardless of any other measures in place
- Make sure you know what data you're capturing, where it is stored and how it is protected. Take particular care before entering into agreements with third-parties for data storage and processing, such as specialist emailing services or outsourced data centres. Remember that you are responsible for your data at all times, regardless of where it is located or who is processing it
- Ensure you have well-defined policies and procedures that are communicated regularly to all relevant personnel regarding both the security and use of personal information
- Commit to an independent review of your measures and policies on at least an annual basis to identify issues and gaps
- As a general rule, don't do anything with data unless you are certain that it is appropriate and secure to do so.

If you have any concerns about data protection or require advice, please contact [Ian Singer](mailto:isinger@pkf-littlejohn.com) on +44 (0)20 7516 2236 or isinger@pkf-littlejohn.com.

What do you know about domain name fraud?

The answer matters because of several new scams that are currently being targeted at businesses unfamiliar with the domain name registration process.

The Intellectual Property Office (IPO), in an article published earlier this month, explains two recent scams. In the first, fraudsters send an invoice to a business for payment for the renewal of an existing website domain. They will data-mine 'who is' domain registration databases to find domains that will soon be up for renewal; they can actually find out the exact renewal date. They then send an official-looking invoice to the domain's billing contact. The fraudster hopes that the recipient won't notice that the invoice isn't from their preferred domain registrar and will blindly pay it. The fine print often notes that, by paying the invoice, the SME is agreeing to transfer the domain from their preferred legitimate registrar to the fraudster. So not only is the business out of pocket, but it may have also contractually locked itself into paying the fraudster's registrar for future renewals.

A second domain name scam highlighted by the ICO involves the victim being contacted by phone from someone claiming to be from the 'Trade Marks Intellectual Property Office'. Their aim is to panic businesses into buying unnecessary domain names at grossly inflated prices.

Trademark protection is extremely important to SMEs, so why wouldn't you try to protect your brand in the best way you can? The law in many countries informs brand owners they need to register a domain name, or the business may lose the right to protect it in the future. Fraudsters play on this, by suggesting that someone is trying to register a domain with the SME's name and then use high pressure sales tactics to make the victim purchase overpriced domain names that are not needed.

Consider a fictional business 'Westferry Watches' to demonstrate what happens. Being UK-based, the main domain the SME may have chosen could be westferrywatches.co.uk and to protect the brand, it may have pre-emptively registered westferrywatches.net and westferrywatches.com. After the fraudster has done some research, Westferry Watches would be told that an organisation with a similar name was trying to register a domain name in, say, China and would be offered a package of Asian domain names that would include westferrywatches.cn, westferrywatches.net.cn and other such Asian addresses. The fraudsters exploit your unfamiliarity with that country's laws in order to get you to register the name via their registrar at overinflated rates.

If you would like advice about how to properly protect your business against fraud, please contact [James Earp](#) on +44 (0)20 7516 2479 or jearp@pkf-littlejohn.com or [Martin Moore](#) on +44 (0)20 7516 2320 or mmoore@pkf-littlejohn.com.

Changes to the minimum wage – don't get caught out

The national minimum wage in the UK is rising from April 2017. Many SMEs will be affected and you need to ensure that everything is lined up for payroll to be properly processed. The new rates are set out below:

25 AND OVER	21 TO 24	18 TO 20	UNDER 18	APPRENTICE
£7.50	£7.05	£5.60	£4.05	£3.50

Earlier this month, the Government 'named and shamed' hundreds of businesses that have failed to pay the National Minimum Wage, which resulted in more than 15,500 workers receiving back pay of nearly £1 million. Make sure that you aren't caught out! For more information, please contact [Tim Herbert](#) on +44 (0)20 7516 2249 or therbert@pkf-littlejohn.com.

We hope you've found this issue useful. If people within your business would like to receive future issues, please send their details to Ruby Crowley (rcrowley@pkf-littlejohn.com).

Our specialist team is here to help. If you would like advice on any of the issues discussed in this newsletter, please contact one of our Growing Business specialist partners.



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