



CHARTERED  
ACCOUNTANTS

# SESSION 1:

## Accounting 101 for starting your business

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# Introducing:

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# Session 1 Overview:

Accounting 101 for starting your business including;

- Crunching the numbers: is this new business viable?
- Understanding your statutory and tax obligations
- Basic Accounting Software options and how to choose the best software for your business.
- Choosing the right accountant for your business

# Considerations when starting a business:

What do the numbers tell you?

- Income?
- Expenses? (overhead/fixed and variable costs)
- Who are your customers?
- How much time is involved?
  - Will it be done in addition to your job?
  - Or will it replace your job?
  - Are you buying a job?



# Considerations when starting a business:

## Other considerations?

- What is the demand for your service/product?
- Impact on your family?
- What are the risks? (Is your home securing finance? What if it takes a few months for income to come in?)
- Current market conditions?
- Is this your passion? Do you have skills? Industry knowledge?

# Considerations when starting a business:

Example: Cheryl is a beauty therapist currently being paid a salary of \$50,000 a year. (She works 8 hours, 5 days a week). She is considering opening her own shop and has done some preliminary numbers:

- She could see 5 clients a day (hour session) and each session would be \$100/hour
- The rent on a premises is \$400 week
- Other overheads are \$100 week
- Products are \$100 week
- She has \$20,000 in savings

# Considerations when starting a business:

How do the numbers look?

Estimated income:  $5 \text{ clients/day} \times \$100/\text{hr} \times 5 \text{ days/week} \times 48 \text{ weeks} = \$120,000$

Costs:  $\$400 \text{ (rent)} + \$100 \text{ (overheads)} + \$100 \text{ (products)} \times 52 \text{ weeks} = \$31,200$

Estimated profit:  $\$88,800$

To earn an amount equal to Cheryl's current salary she would need to see 3.38 clients per day  $(\$31,200 + 50,000) / 48 \text{ wk} / 5 \text{ days a week} / \$100/\text{hr}$ .



# Statutory Requirements:

## Structuring your business

- Sole trader, partnership, trust, company or a combination
- What option is best for you will depend on a range of factors (turnover, initial and ongoing costs to maintain structure, tax, complexity, risk, income splitting, etc)
- This topic will be covered in more detail in session 2

# Statutory Requirements:

## ABN registration

- Register on [www.abr.gov.au](http://www.abr.gov.au) (your accountant can assist with this)
- At this stage a business will also have to register for:
  - GST (goods and services tax)
  - PAYGW (Pay as you go withholding) – when employing staff
- As a result of registration a business may have to lodge quarterly/monthly BAS (Business Activity Statements) and/or IAS (Instalment Activity Statements)

To keep things simple Cheryl decides to operate as a sole trader and operate the business in her own name – Cheryl Smith. She sets up an ABN via the ABR website.

# Statutory Requirements:

## GST

- GST is a tax on goods and services
- In Australia the current rate is 10%
- Generally a business must register for GST if the business has a turnover (sales) of \$75,000 or more.
- If the business' turnover is less than the threshold then it is optional to register for GST.
- A GST registered business will need to lodge a monthly/quarterly/annual Business Activity Statement (BAS). Generally most businesses lodge a quarterly BAS.

# Statutory Requirements:

## GST

- Basically how GST works:
  - A business collects GST on their sales. Eg. Cheryl charges \$110 for an hour facial. \$10 is GST and \$100 is her income.
  - A business can claim GST credits on expenses that have GST. Cheryl has an electricity bill of \$900 for the quarter. The GST she can claim is \$81 and the remaining \$819 is an expense. To calculate GST: take the gross amount and divided it by 11.
  - Some expenses and income do not have GST attached to it. E.g. bank charges, interest, water, rates, donations, wages, and superannuation.

This is a complex topic and advice should be sought from an accountant regarding your individual situation.

# Statutory Requirements:

## Employees

- Under all business structures you can employ staff
- Before employing a staff member it would be wise to crunch the numbers and calculate the staffing costs and the additional profit you would expect to receive.

## PAYGW

- A business will need to register for Pay As You Go Withholding (PAYGW).
- PAYGW is wages tax that is withheld from employees' wages.
- This is reported and paid on BAS or IAS (Instalment activity statement)

# Statutory Requirements:

## Employees

### Super

- Generally, if you pay an employee \$450 or more (before tax) in a calendar month, you have to pay super guarantee (SG) on top of their wages.
- Currently the SG rate is 9.5%
- This is paid quarterly
- Register with a superannuation clearing house

**Work cover** – it would be prudent to have adequate work cover in place to protect yourself if employees are injured at work

**Fair work** - it is important you are aware of the award rates and entitlements when employing staff.

# Statutory Requirements:

## Employees

- Forms a new employee will need to complete include a TFN declaration and super choice form. It is also advisable to create an employment contract outlining income, entitlements, expectations etc.
- This is a complex topic and advice should be sought from an accountant regarding your individual situation.

# Statutory Requirements:

## Employees

Eg: Cheryl is considering employing another therapist called Tracey.

Cheryl would pay Tracey \$24/hour wage, \$2.28/hour superannuation (9.5% of \$24), work cover costs \$300 p.a. There would be an additional \$100/week in product costs.

Extra income:  $4 \text{ clients/day} \times \$100/\text{hr} \times 5 \text{ days/week} \times 48 \text{ weeks} = \$96,000$

Extra employment:  $\$26.28/\text{hr} \times 8 \text{ hrs/day} \times 5 \text{ days/wk} \times 52 \text{ weeks} + \$300 \text{ (work cover)} + \$100 \text{ (products)} \times 52 \text{ weeks} = \$60,162.40$

Estimated extra profit: \$35,837.60



# Statutory Requirements:

## Income Tax

- Business profits are taxed according to how the business is structured
- Please note: Everyone wants to reduce their tax liability, but it is important to realise that a business that is paying tax is making money.
- Simply to work out your tax:  
Income less Deductions = taxable profit  
Profit is then taxed at the applicable tax rate

Cheryl earns \$100,000 in sales and has \$30,000 in deductions. Her profit is then \$70,000. This \$70,000 is taxable.

# Statutory Requirements:

## Income Tax

- Income:  
All income made by the business is generally taxable.

**Cheryl's example:** All sales (including her \$100 beauty sessions and the products she sells) is taxable income.

# Statutory Requirements:

## Income Tax

- Deductions

You can only claim expenses that are directly related to earning your assessable income. If you make a purchase that is used for both business and private purchases, you can only claim a deduction for the business portion of the expense.

# Statutory Requirements:

## Income Tax

Types of expenses Cheryl could claim;

- Rent
- Products (creams, lotions etc)
- Electricity
- Phone (if this is her mobile phone, Cheryl may only be able to claim a portion of this cost)
- Water costs
- Postage/freight
- Training
- Bank fees

# Statutory Requirements:

## Income Tax

Types of expenses Cheryl couldn't claim;

- Child care fees (for children in care whilst she works)
- Lunches
- Cheryl's hair and makeup
- Expenses that are specifically non-deductible by legislation such as entertainment, parking fines

# Statutory Requirements:

## Income Tax

### Tricky areas

- Loans – the interest on business loans are generally deductible. However the principal component is not. It would also be important to ensure that the loan has been used solely for business purposes, otherwise the interest isn't fully deductible
- Asset purchases – Generally assets over \$300 can be claimed (depreciated) over a number of years.
- Wages to family – As a sole-trader Cheryl can employ staff, however wages paid to family need to be paid for services rendered and be commercial to be able to claim a deduction. For example she could pay her 16 year old daughter to answer phones and clean at an industry hourly rate

# Statutory Requirements:

## Income Tax

- Travel – Generally travel costs (including motor vehicle costs such as fuel, registration, insurance) are only deductible for travel for business purposes.

# Statutory Requirements:

## Income Tax

- Travel

For example if Cheryl travels from home to work, this is considered private and therefore not claimable. However a trip to buy stock or to do banking would be deductible. Cheryl would need to complete a logbook to track her business use of her car.

Cheryl's yearly car costs is \$10,000 (includes fuel, registration, insurance and repairs). She has kept a logbook for 3 months which shows she has a 50% business use on her car. Therefore she can claim 50% of her business costs being \$5,000.

Alternatively she could claim a cents per kilometre deduction of up to 5000kms. Her claim could be 5000km @ \$0.66/km = \$3,300.



# Statutory Requirements:

## Income Tax

- PAYGI – Pay as you go instalments

Generally a profitable business will have to make PAYGI. Effectively this is partly paying the income tax throughout the year.

E.g. A Cheryl makes the following PAYGI throughout the year:

Sept 2016 \$4000

Dec 2016 \$4000

Mar 2017 \$4000

June 2017 \$4000

At the end of the financial year the accountant determines that Cheryl has \$20,000 in income tax owing to the ATO. As the Cheryl has already paid \$16,000 in PAYGI she only needs to pay an additional \$4,000 to meet the 2017 financial year's tax liability.

# Statutory Requirements:

## Small Business Entities

- Generally small business entities (sole traders, partnerships, trusts and companies) with a turnover of less than \$2million \* have access to small business concessions.
- Small business concessions include:
  - Reduced tax rates (companies are tax at 28.5% and individuals receive an offset)
  - Immediate deduction for prepaid expenses up to 12 months
  - Simplified trading stock rules
  - 2 year amendment period

\* Legislation is currently going through parliament to change this to \$10million.

# Statutory Requirements:

## Small Business Entities

- Small business concessions include:
  - Simplified depreciation rules  
All assets under \$20,000 can be written off in the first year. Any assets over \$20,000 can be added to a general pool and be depreciated at 15% in the first year and 30% thereafter.

Cheryl buys a \$5,000 massage table in March 2017. She can claim the full \$5,000 as a deduction against her income in the 2017 financial year. Cheryl buys a \$25,000 computer and phone system. In the first year she can claim \$3,750 as a deduction in the first year ( $\$25,000 \times 15\%$ ) and \$6,375 in the following year ( $\$25,000 - 3750 \times 30\%$ ).

# Statutory Requirements:

## Primary Producers

- Primary producers are entitled to a number of additional taxation benefits including;
  - Accelerated depreciation benefits;
    - immediately deduct the cost of fencing and water facilities such as dams, tanks, bores, irrigation channels, pumps, water towers and windmills
    - depreciate over three years the cost of fodder and storage assets such as silos and tanks used to store grain and other animal feed
  - Livestock deferrals – farmers who are suffering drought are able to defer declaring their cattle sales for up to 5 years.
  - Income averaging
  - Farm Management Deposits

# Statutory Requirements:

## Personal Services Income (PSI)

- This is very misunderstood piece of legislation and we often hear about wrong advice being given by mates in the crib room
- Basically PSI relates to contractors who set up a company, partnership or trust structure to split income with family members and claim deductions that are otherwise not available to them.
- Generally it captures individuals who produce income from personal skills or efforts as an individual and it is like an employee/employer type relationship

**Example:** rather than Cheryl starting her own business her employer suggests she sets up a company and contracts back to her employer at an agreed \$30/hour. As Cheryl's work is a service as an individual she would fall under the PSI rules.

# Statutory Requirements:

## Personal Services Income (PSI)

- Put simply, if the income derived from a business that has the characteristics of true business income not that of salary, the business is eligible for the usual business deductions and the income is assessed to the entity that earned the income if it is a company partnership or trust.
- If the income is PSI, then all the profit is attributed to the person providing the service and deductions are limited

If you think PSI might apply to your situation we suggest you obtain appropriate accounting advice. We will cover this in more detail in session 5.

# Other factors to consider when starting a business:

## Planning

- Take the time to complete a business plan so you are aware of all the implications of operating a business.
  - Research and understand your customers; what service/product do they want, what are they willing to pay,
  - Who are your competitors? What are their prices?
  - What are your strengths and weaknesses? How can you use your strengths? How can you minimise your weaknesses?
  - What are your goals? Where do you see the business in 3 years? 5 years?
  - What are the risks?

# Other factors to consider when starting a business:

## Planning Example

- Cheryl undertakes some market research before opening her business. She identifies
  - There is 2 beauty therapy businesses in town currently.
  - She plans to use a well known brand that is not used by the other business' in town. She expects to be able to charge a small premium for this product.
  - Her strengths are her experience, skills and qualifications as a therapist. She also has great people skills
  - Her weaknesses are her lack of business experience. To minimise this weakness she has engaged an accountant, downloaded the free ASIC app on her phone about starting a business and reading all the material.
  - Her goal is to build the business up over the next 3 years with staff and earning \$200k p.a.



# Other factors to consider when starting a business:

## Planning Example

- Cheryl undertakes some market research before opening her business. She identifies
  - Risks to her business include:
    - Maintaining staff
    - Competitors
    - Initial set-up risks and costs

# Other factors to consider when starting a business:

## Budgeting /Cashflow

- Prepare a projected cashflow which captures the income coming into the business and the expenses being paid from the business
- Benefits of using a projected cash flow report
  - You can plan for your tax bills
  - You can time asset purchases
  - Track performance
  - Determine minimum sales to break even

# Other factors to consider when starting a business:

## Budgeting /Cashflow

- Benefits of using a projected cash flow report
  - Perform stress tests to see how an abnormal expense could affect cashflow
  - Prepare for months when sales are down (overdraft, savings etc)
  - Determine how much income/wages can be drawn by the business by the owners without impacting on the business's ability to meet its expenses.
- This will be discussed further in session 3

# Other factors to consider when starting a business:

## Cashflow Example:

Cheryl undertakes a cash flow analysis of the first 12 months of trading. She realises that the initial set up will take half of her cash savings and will only leave a \$10,000 buffer initially to cover her whilst she builds up the business.

She expects January to be a slow month whilst people are away on holidays and will require additional funds of \$2,000. However she expects that December will be a bumper month and will cover her shortfall in January.

Cheryl also includes a monthly 'drawings' to cover her personal living costs.

# Other factors to consider when starting a business:

## Finance

How will you fund your initial set up?

- Cash reserves?
- Debt?
- Family?

# Other factors to consider when starting a business:

## Finance example

Cheryl approaches a bank about a business loan/overdraft to provide a financial buffer whilst she is building the business. As she hasn't got 2-3 years worth of financials/past history to show the bank they are unwilling to lend her the money as a business loan.

Cheryl and her husband have a redraw facility on their home and she can access \$25,000.

Cheryl is also considering delaying opening her own business for another 6 months so she can save further funds for the project.

# Other factors to consider when starting a business:

## Insurance

Ensure you have adequate insurances in place

- Work cover
- Public liability
- Business insurance (insurance on premise, equipment, motor vehicles etc)
- Business expense insurance
- Key man insurance

**Insurance example:** Cheryl takes out public liability and business insurance. She will not need work cover until she employs staff.

# Other factors to consider when starting a business:

## Bookkeeping

As part of operating your business, you will need to keep track of your income and expenses. This will help you as the business owner track your success but is also needed by your accountant come tax time.

### Bookkeeping options

- Shoe box full of receipts and invoices (NOT RECOMMENDED)
- Spreadsheet
- Accountant records transactions
- Computer software (eg Xero, Reckon, MYOB)



# Other factors to consider when starting a business:

## Bookkeeping

What software is best for you;

- Cost
- Complexity of your business
- Computer skills
- Internet speeds
- Word of mouth
- Functionality
  - Applications – paypal, payroll, super clearing house
  - Cloud based
  - Bank feeds

# Other factors to consider when starting a business:

## Bookkeeping example

Cheryl does her research and decides to use Reckon One, a low cost bookkeeping system that is cloud based, has the ability to set up bank feeds and it has the ability to add payroll functions in the future. She signed up for the trial program and has a good grasp of its functions.

# Other factors to consider when starting a business:

## Things to consider when looking for an accountant

- Successful business owners
- Qualifications
- Accessible/location
- Costs – flat fee, annual fee, hourly rate
- Word of mouth
- Ethical
- Their team
- Relevant experience

# Other factors to consider when starting a business:

## Things to consider when looking for an accountant

- Proactive about saving you money
- A good accountant will help you grow your business
- Trust

# What are we covering in Session 2?

## Seminar 2: Business Structures

- Factors to consider when structuring your business
- Structure options – what they are, how they work, tax implications;
  - Sole trader
  - Partnership
  - Company
  - Trust

# Questions?



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