mhp CHARTERED ACCOUNTANTS

SESSION 3:

Financial Statements & Employment Obligations

Introducing:

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Tax calculations are based on current tax rates as at 31/3/17.

Session 3 topics:

- Financial Statements 101 – how to read a
  - Profit and Loss,
  - Balance Sheet and
  - Depreciation Schedule.
- How to prepare an effective cash flow report
- What you need to consider when employing staff in your business

Business Reports:

- Generally your accountant will prepare a range of financial reports for your business as part of preparing your tax requirements each year.
  - These include Profit and Loss statements, Balance Sheets, Depreciation Schedule
  - Generally a bank will require these statements when you are applying for finance
  - As a business owner, these statements can be an invaluable tool to assess the performance of your business.
- As a business owner you can also prepare your own reports to assess the performance of your business. These include cash flows and budgets.

Profit and Loss:

- Profit and Loss is a financial statement that summarises the income and expenses incurred during a specific period of time (usually a year)
- Example: Profit and Loss for Cheryl Smith in appendix

Profit and Loss:

Reviewing your Profit and Loss

- Your final figure
- How does this compare to last year?
- How does this compare to your budget?
- Are there any areas you can cut back on?
- Reviewing the sales figure.
- What is the profit margin?
    - Profit margin = Net profit divided by gross sales

Balance Sheet:

- A balance sheet is a financial statement that summarises a business's assets, liabilities and owners equity at a specific point in time.
- Basically it’s a snapshot, representing the state of a business's finances at a moment in time
- Assets – Liabilities = Owners Equity (Net assets)
- Assets
  - A valuable resource of the business.
  - Provides a benefit to the business
  - Current Assets (easily converted to cash)
    - Cash
    - Accounts Receivable/Debtors (money which customers owe the business)
    - Stock

Balance Sheet:

- Non-current Assets (Long-term assets)
  - Fixed Assets such as land, machinery, equipment
  - Long term investments
- Liabilities
  - Liabilities are money that the business owes to outside parties.
  - Current liabilities (liabilities that are due within one year)
    - Accounts payable/creditors (money that the business owes to its suppliers)
    - Tax
  - Long term liabilities
    - Bank loans
- Owner's Equity/Principal/Shareholders funds/Net Assets
  - This is basically the net funds the business owners would walk away with if they sold all their assets and paid out their loans.

Depreciation Schedule:

- Depreciation is a method of allocating the cost of a tangible asset over its useful/effective life.
- The Tax Office have a list of assets and their deemed effective life that businesses can use to depreciate their assets.
- This can get quite complex and there are different depreciation methods that can be used. For simplicity if you have a piece of equipment that has an effective life of 5 years, you can claim the cost of that equipment over 5 years.

Tax Return:

- Partnerships, trusts and companies lodge their own tax returns.
- For a sole trader their profit is included in their individuals tax return
- There is often a difference between a profit/loss that is included in a tax return and a profit/loss that is shown in the financial statements. This is due to the tax office having set rules on the ability to claim certain expenses and declaration of income. Some examples
  - Motor vehicle claims
  - Borrowing costs
  - Fines
  - Private component of business expenses (phone, electricity etc)

Cashflow:

A cashflow statement is a forecasting tool used by businesses to assess whether they have enough cash to run the business.

A cashflow statement is different to a profit and loss.

Cash flows account for all the costs of the business that are not included in profit and loss such as;

- Loan repayments (not just the interest component)
- Owners drawings/wages
- Owner contributions
- Tax payments (GST, income tax etc)
- Asset purchases

Cashflow:

Benefits of a cashflow

- Owners can assess whether they have enough cash or earn enough cash to run their business
- Owners can plan for lean times – i.e. get an overdraft in place, or build up savings to cover periods with lower sales
- Owners can plan for tax payments – BAS, income tax
- Owners can assess expansion opportunities and whether they have the funds to purchase assets, take on new employees, take on projects etc
- Owners can compare forecasts versus actuals to track how the business is performing
- Owners can assess impact of various scenarios that may affect their business by running stress tests on their cashflow such as debtors take an extra 30 days to pay their bills, electricity costs rises by 10%,

How to Prepare a Cashflow:

Step 1: Decide on how you will prepare your cashflow

You can use;

- An excel spreadsheet (such as the one provided at this seminar), or contact your accountant for their template or download a template online
- If you are a business owner your current software may have the capability to prepare cash flows.

If you have never prepared a cashflow before, it is a worthwhile exercise using an excel spreadsheet to create your cashflow. This will give you greater insight into how the numbers work.

How to Prepare a Cashflow:

Step 2: Determine your cash inflows

Prepare in detail all estimated cash sales and inflows to the business

- For existing businesses look at last year's sales figures. Then decide what adjustments you will need to make based on past trends, e.g. Sept, Oct, Nov months are high turnover months, Dec and Jan are slower due to Christmas break etc.
- If you are a new business, start by estimating your income. You may need to work your productive hours by an hourly rate, or your markup on goods.
- Take into consideration the type of customers you sell to, how quickly they will pay you, what the economy is doing, your competitors etc.

How to Prepare a Cashflow:

Step 2: Determine your cash inflows

Sources of cash inflows;

- Sales
- GST refunds
- Government grants
- Owners investing more money into the business

How to Prepare a Cashflow:

Step 3: Determine your cash outflows

Sources of cash outflows

- Fixed costs/overheads – these will costs will generally be easily determined. E.g. rent, wages & Variable costs – e.g. materials, repairs, fuel
  - Purchases (Stock etc)
  - Accountant fees
  - Solicitor fees
  - Advertising & marketing
  - Bank fees and charges
  - Interest paid
  - Credit card fees
  - Utilities (electricity, gas, water)
  - Telephone
  - Lease/loan payments
  - Rent & rates
  - Motor vehicle expenses
  - Repairs & maintenance
  - Stationery and Printing
  - Licensing
  - Membership & affiliation fees
  - Insurance
  - Superannuation
  - Wages (including PAYG)
- Asset purchases
- Loan repayments
- Tax obligations (BAS and Income Tax)
- Payments to owners

How to Prepare a Cashflow:

Step 4: Prepare your cash flow forecast by putting all the gathered information together

- Select which time period you want the forecast to cover (generally a year is helpful).
- You will need an opening bank balance (your actual cash on hand), then add all the cash inflows and deduct the cash outflows for each period, usually by month
- At the end of the month/period you will have a closing cash balance. This then becomes your opening cash balance for the next month.

How to Prepare a Cashflow:

Step 5: Analyse the numbers

- Are there any months with a shortfall? How can you plan to operate during this period? E.g. Increase advertising, apply for finance, reduce costs, etc.
- Are there any periods of surplus? How can you best utilise these funds?
- Are there any areas you can reduce costs?
- Are there any areas you can improve sales?
- Perform stress tests on your cash flow by reducing and increasing your figures to see what your cash balance would be if you had higher costs than expected or lower sales than expected.

How to Prepare a Cashflow:

Step 6: Regularly review your estimated cash flow to actual cash flow

- Review your actual cash flow for the period against your forecast.
- Analyse the numbers to determine why there are variances? E.g. Debtors are taking too long to pay, electricity has gone up more than expected etc
- Use these numbers in your strategic planning for your business.

Employing Staff:

Why employ staff

- Ability to take on more work
- Reduce costs; cheaper to have an apprentice doing menial work
- Increase knowledge base by employing staff with skills, expertise, connections you may not have
- Another person to cover the work whilst you are on holidays, sick etc.
- Build an empire
- Allows the owners to work on their business rather than in it

Negatives of employing staff

- Additional cost of wages, super, tax, training, holidays etc
- Managing/motivating staff
- Less control over quality of service/product

Employing Staff:

Cost/Benefit Analysis

- Will the business return outweigh the costs of employing a staff member?
- Add up the costs of the employee: wages, super, workers compensation
- Add up the return to the business.

Considerations of Employing Staff:

Can you take on an employee? It doesn't matter what structure you operate under (sole trader, partnership, company or trust) you can employee staff.

What kind of employment are you offering?

- Permanent,
- For a set period of time,
- Full time,
- Part time,
- Casual
- Contractor. A note of caution when hiring a contractor, as an employer you may still have superannuation and work cover obligations. This can be a complex area to navigate and we recommend you obtain advice to suit your personal situation.

Considerations of Employing Staff:

- Can your employee legally work in Australia

- Your record keeping requirements
  - Payslips – this will include wages, tax withheld, any super benefits, annual leave hours etc.

Considerations of Employing Staff:

Some of your legal obligations as an employer include:

- paying your employees correct wages
- providing employees with pay slips
- reimbursing your employees for work-related expenses
- ensuring a safe working environment
- ensuring you have workers compensation insurance for each employee
- not acting in a way that may seriously damage an employee's reputation or cause mental distress or humiliation
- not acting in a way that damages the trust and confidence necessary for an employment relationship
- not providing a false or misleading reference
- forwarding PAYG tax withholding to the Australian Taxation Office (ATO)
- making appropriate payment under the Superannuation Guarantee legislation.

Considerations of Employing Staff:

Withholding tax

- Under the Pay as you go (PAYG) withholding rules, you need to withhold tax from your employee payments. This helps your employees meet their end of year tax obligations
- You may need to also withhold PAYGW from contractors and businesses that don't quote their ABN on their invoice.
- To find out how much to withhold you can use:
  - ATO website (Calculator or tax tables)
  - ATO mobile app
- Employees will need to fill in a TFN declaration

Considerations of Employing Staff:

Super Obligations

- As an employer, you must
  - Offer eligible employees a choice of super fund. Temporary residents are not eligible for choice of fund.
  - Pay the minimum amount of super guarantee (SG). This is currently 9.5% of ordinary time earnings.
  - Pay your super obligations for each quarter on these dates – 28 July, 28 October, 28 January and 28 April.
- Which employees are eligible
  - Worker who are paid $450 or more (before tax) in a calendar month
  - 18 year old > 30 hours a week
  - Full time, part time or casual employees
  - You may also need to pay super for some contractors
- Employees will need to complete a super choice form (which details their super fund).
- An employer will need to register with a Superannuation clearing house and each quarter will need to log in and pay their super obligations.

Considerations of Employing Staff:

Workers compensation

- An employer must have insurance to cover workers if they are injured at work or become ill due to their work. Also known as workers compensation insurance.

Employment contract

- An employment contract is an ideal way to outline wages/hourly rate, leave entitlements, expectation etc of the business.
- Fair work have a standard employment agreement that can be tailored for businesses.

What are we covering in Session 4?

Seminar 4: Expanding your business

- Finance strategies
- Restructuring
- Statutory obligations of expanding (such as payroll tax, tax reporting etc)
- Expansion opportunities
    - Purchasing another business
    - Expanding your product/service range

Questions?