Introduction

• Why do we prepare Financial Statements
• Different Forms of Financial Information
• Key aspects to Financial Statements
• Accountant vs Bank Profit
• Business Structures
Why do we prepare Financial Statements

- Legislative Requirements
- Taxation Purposes.
- Banking Requirements.
- Monitor Business Performance.
Different Forms of Financial Information

• Cash Basis / Cashflow

• Accrual Based Financial Statements.
Cash Basis / Cashflow

- Transaction is recorded when payment is made.
- Managing Cashflow is critical.
- Simple, easy to understand.
- Does not always reflect true picture.
# Cash Basis / Cashflow

<table>
<thead>
<tr>
<th>CASHFLOW</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Income</td>
</tr>
<tr>
<td>Cash Farm Working Expenses</td>
</tr>
</tbody>
</table>

## TRADING SURPLUS

- Bank Loan Payments (Often include Interest and Principal)
- Rent
- NET CASH SURPLUS
  - Terminal and Provisional Tax Payments
- Capital Expenditure
- Borrowing or Loan Repayments
- Drawings

## CHANGE IN BANK BALANCE

- GST
## Cashflow Report for Sample Dairy

**Date Range:** 01 Jan 11 to 31 May 12

### Income

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Milk Revenue Advance</td>
<td>596,702</td>
<td>54,553</td>
<td>53,975</td>
<td>50,240</td>
<td>53,975</td>
<td>70,840</td>
<td>75,785</td>
<td>70,150</td>
<td>54,316</td>
<td>65,858</td>
<td>65,816</td>
<td>65,169</td>
<td></td>
</tr>
<tr>
<td>Last Season</td>
<td>101,200</td>
<td>17,250</td>
<td>17,250</td>
<td>28,750</td>
<td>37,950</td>
<td>37,950</td>
<td>37,950</td>
<td>37,950</td>
<td>37,950</td>
<td>37,950</td>
<td>37,950</td>
<td>37,950</td>
<td>37,950</td>
</tr>
<tr>
<td>Milk Revenue Total</td>
<td>694,150</td>
<td>54,553</td>
<td>54,553</td>
<td>72,235</td>
<td>74,914</td>
<td>72,735</td>
<td>76,960</td>
<td>73,122</td>
<td>69,622</td>
<td>83,680</td>
<td>65,472</td>
<td>65,056</td>
<td></td>
</tr>
<tr>
<td>Dairy Cows</td>
<td>54,000</td>
<td>4,400</td>
<td>12,370</td>
<td>3,178</td>
<td>7,400</td>
<td>3,636</td>
<td>4,032</td>
<td>12,096</td>
<td>4,184</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Income Total

| Total | 748,150 | 54,553 | 54,553 | 72,235 | 74,914 | 72,735 | 76,960 | 73,122 | 69,622 | 83,680 | 65,472 | 65,056 |

### Net Income

| Total | 748,150 | 54,553 | 54,553 | 72,235 | 74,914 | 72,735 | 76,960 | 73,122 | 69,622 | 83,680 | 65,472 | 65,056 |

### Farm Expenditure

<table>
<thead>
<tr>
<th>Item</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Animal Health</td>
<td>-25,537</td>
</tr>
<tr>
<td>Breeding &amp; Testi</td>
<td>-12,892</td>
</tr>
<tr>
<td>Calf Rearing</td>
<td>-920</td>
</tr>
<tr>
<td>Shed Expenses</td>
<td>-4,289</td>
</tr>
<tr>
<td>Electricity (Farm)</td>
<td>-5,500</td>
</tr>
<tr>
<td>Feed</td>
<td>-20,477</td>
</tr>
<tr>
<td>Pasture Renoval</td>
<td>-4,854</td>
</tr>
<tr>
<td>Fertiliser</td>
<td>-57,954</td>
</tr>
<tr>
<td>Freight</td>
<td>-7,090</td>
</tr>
<tr>
<td>Weed &amp; Pest</td>
<td>-2,360</td>
</tr>
<tr>
<td>Repairs &amp; Maint</td>
<td>-39,233</td>
</tr>
<tr>
<td>Venice Expense</td>
<td>-19,936</td>
</tr>
<tr>
<td>Wages</td>
<td>-83,904</td>
</tr>
<tr>
<td>Administration</td>
<td>-11,392</td>
</tr>
<tr>
<td>Insurance</td>
<td>-8,400</td>
</tr>
<tr>
<td>Rates</td>
<td>-16,733</td>
</tr>
<tr>
<td>Total</td>
<td>-422,298</td>
</tr>
</tbody>
</table>

### Farm Surplus

| Total | 325,897 | 3,876 | 2,540 | 786 | 38,665 | 49,403 | 35,746 | 40,512 | 51,264 | 16,516 | 24,638 | 25,998 |

### Interest & Rent

| Rent | -14,000 | -7,000 |
| Interest | -95,004 | -7,917 |

### Interest & Rent Total

| Total | -109,004 | -7,917 | -7,917 | -7,917 | -7,917 | -7,917 | -7,917 | -7,917 | -7,917 | -7,917 | -7,917 | -7,917 | -7,917 |

### Operating Surplus

| Total | 218,974 | -9,417 | -15,457 | -8,685 | 30,748 | 41,486 | 20,829 | 32,595 | 43,347 | 8,599 | 16,221 | 18,072 | 27,379 |

### Other

| Personal  | -50,746 | -7,334 | -2,708 | -7,334 | -7,583 | -7,583 | -7,583 | -7,583 | -7,897 | -7,897 | -7,897 | -7,897 | -7,897 |
| TAxation  | -49,000 | -10,000 | -10,000 | -10,000 | -10,000 | -10,000 | -10,000 | -10,000 | -10,000 | -10,000 | -10,000 | -10,000 | -10,000 |

### Fin Year Surplus

| GST | 23,976 | -19,600 | -21,832 | -38,186 | 18,098 | 29,786 | -8,021 | 20,845 | 31,597 | -15,151 | 4,875 | 6,026 | 16,598 |

### Fin Year Surplus GST

| Total | 11,690 | 1,661 | 688 | -1,398 | 6,856 | 663 | 5,367 | 7,160 | -4,970 | -12,372 | 4,764 | -3,361 | 6,632 |
| Opening Balance | 25,000 | 25,000 | 7,052 | -14,092 | -53,676 | -27,822 | 2,577 | -977 | 27,028 | 53,655 | 26,132 | 35,771 | 38,436 | 60,616 |
Accrual Basis

Company with a May Balance Date

2010
May-10

2011 Financial Year
Jun-10 Jul-10 Aug-10 Sep-10 Oct-10 Nov-10 Dec-10 Jan-11 Feb-11 Mar-11 Apr-11 May-11

2012
Jun-11

Accrual - When transaction took place

Included in 2011 Financial Year

Cashflow - when payment occurs,

Taken back to 2010 Financial Year
### Cashflow vs Financial Statements

<table>
<thead>
<tr>
<th>CASHFLOW</th>
<th>FINANCIAL STATEMENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Income</td>
<td>Cash Income</td>
</tr>
<tr>
<td>Cash Farm Working Expenses</td>
<td>Accounts Receivable</td>
</tr>
<tr>
<td>TRADING SURPLUS</td>
<td>Change in Stock on Hand</td>
</tr>
<tr>
<td>Bank Loan Payments</td>
<td>Dividends received as shares ie (Ravensdown,</td>
</tr>
<tr>
<td>(Often include Interest and Principal)</td>
<td>Balance)</td>
</tr>
<tr>
<td>Rent</td>
<td>Cash Farm Working Expenses</td>
</tr>
<tr>
<td>NET CASH SURPLUS</td>
<td>Accounts Payable</td>
</tr>
<tr>
<td>Terminal and Provisional Tax Payments</td>
<td>Depreciation</td>
</tr>
<tr>
<td>Capital Expenditure</td>
<td>EARNINGS BEFORE INTEREST AND TAX (EBIT)</td>
</tr>
<tr>
<td>Borrowing or Loan Repayments</td>
<td>Interest Only and Rent</td>
</tr>
<tr>
<td>Drawings</td>
<td>Accounts Payable</td>
</tr>
<tr>
<td>GST</td>
<td>NET TAXABLE INCOME</td>
</tr>
<tr>
<td></td>
<td>Tax Payable on Profit</td>
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<tr>
<td></td>
<td>Surplus After Tax</td>
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<tr>
<td></td>
<td>Change in Fixed Assets</td>
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<tr>
<td></td>
<td>Change in Loan Balances</td>
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<tr>
<td></td>
<td>Change in Current Account</td>
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<tr>
<td></td>
<td>Change in A/c Payable and Receivable</td>
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<td></td>
<td>Change in GST</td>
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<td></td>
<td>Change in Stock</td>
</tr>
<tr>
<td>CHANGE IN BANK BALANCE</td>
<td>EQUITY POSITION</td>
</tr>
</tbody>
</table>

**Statement of Financial Performance**

**Statement of Financial Position**

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SIDE - Understanding Financial Statements
Page 9
<table>
<thead>
<tr>
<th>CASHFLOW</th>
<th>FINANCIAL STATEMENTS</th>
<th>BANK ANALYSIS</th>
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<tr>
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<td>Cash Income</td>
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<td></td>
<td>Accounts Receivable</td>
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<td></td>
<td>Change in Stock on Hand</td>
<td>Change in Stock on Hand</td>
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</tr>
<tr>
<td></td>
<td>Accounts Payable</td>
<td>Accounts Payable</td>
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<tr>
<td></td>
<td>Depreciation</td>
<td>No Depreciation</td>
</tr>
<tr>
<td>TRADING SURPLUS</td>
<td>EARNINGS BEFORE INTEREST AND TAX (EBIT)</td>
<td>Statement of Financial Performance</td>
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<td>CASH RESULT</td>
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<td>BUSINESS RESULTS</td>
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</tbody>
</table>
Interpretation of Financial Statements

• Always check the notes in Financial Statements.
• Focus on all expenditure including:
  - Personal
  - Capital Expenditure
  - Borrowings
• Key ratios
  - Gross Farm Income per kgMS, and per hectare
  - Farm Working Expenses per kgMS
  - Operating Surplus per kgMS and per hectare.
  - Interest and Rent as a % of GFI
  - Debt per kgMS
• Dairy Base produces excellent information for above analysis
Business Structures

- What factors should influence the choice of Business Structure
  - Asset Protection
  - Business Continuity
  - Tax minimisation
  - Funding Options / Market Perception
What are the different Structures

Main Ones

• Sole Trader
• Partnership
• Company
• Trusts

Other Structures

• Limited Partnerships
What Structure

1. Protection of Assets

- Separation of Business from Private Assets
- From creditors / lenders / other business parties
- From family members - e.g. blended families
- Future tax changes - e.g. capital gains tax
What Structure

2. Tax Minimisation

- Income Splitting - Lower marginal tax rates
- Loss Offsets - against profit making entities
- On transfer of ownership
What Structure

3. Business Continuity

• Includes succession planning
• Smooth transition on:
  • death or retirement of business partner
  • Investors exiting or entering the business

4. Funding Options and Market Perceptions

• Structure can impact on investors and banks providing funding, especially for large businesses
Sole Trader

Key Commercial Attributes

- Sole human owner/operator
- No specific laws
- No Registration required apart from IRD
Sole Trader

Key Taxation Attributes

- Subject to individuals’ marginal tax rates
Sole Trader

Advantages

- Sole responsibility
- Instant Start up
- Direct Access to Losses
- Low Administration Costs

Disadvantages

- All income allocated to the owner
- Unlimited liability - private assets at risk
- Altering business structure creates a sale
Partnership
Key Commercial Attributes

- Very common
- Not a separate legal entity
- Partners can be human, company, trust or another partnership
- Governed by Partnership Act 1908
- No registration apart from IRD
- Do not need written agreement
- Joint and several liability
Partnership

Key Taxation Attributes

- Partnership itself not liable for tax
- Individuals taxed on their share of profits
- Individuals claim their share of losses
Partnership

Advantages

• Easy to set up - low administration costs
• Written agreement not required - recommended
• Partners can access losses

Disadvantages

• Unlimited liability
• Liable for actions of other partners
• Not easy for partner to sell interest
• Transfer of ownership creates new partnership
Company

Key Commercial Attributes

A company must have:

- 1 director
- 1 share
- Registered Office
- Address for Service
- 1 shareholder
Company

Key Commercial Attributes

- Is a separate legal entity
- Governed - Companies Act 1993 - Constitution
- Distributions subject to the Solvency Test
- Perpetual Existence
- Complexity / admin - depends on size
- Limited Liability - unpaid portion of shares
Company

Key Taxation Attributes

- Taxed at 28%
- Need to maintain shareholder continuity
- Look through companies allow losses to be distributed
- Dividends distributed by company taxed at 33%
Company

Advantages

- Own legal identity - company owns assets
- Ownership easily transferable
- Limited Liability - can be eroded
- Perpetual Succession
- Wider options for raising capital
- Can have different “classes of owners”
Company

Disadvantages

• High level of regulation
• Strict requirements on directors
• Greater administration costs
• Losses unavailable to shareholders - unless a Look Through Company (LTC)
• Capital Gains tax only assessable on wind up - unless a Qualifying Company (QC)
• Increased tax compliance costs
Trusts

Key Commercial Attributes

- Parties to a Trust are:
  - Settlor
  - Trustees
  - Beneficiaries
- Not a separate legal entity although often thought of as such
- Trust Deed is guiding document
- Assets owned by trustees / manage for beneficiaries
- Legislation - Trustee Act 1956 / Trustee Amendment Act 1988
- Trusts used widely for asset protection
- Have finite life - max of 80 years
Trusts

**Key Taxation Attributes**

- Trustees liable for tax at 33c
- Income allocated / marginal rate of beneficiary
- Provisional / Terminal tax assessed normal way
- Trust losses remain in the trust - can’t allocate
- Previously taxed income - allocated with source deductions
Trusts

Advantages

- No IRD restrictions on allocation of income to beneficiaries
- Preserves assets for future generations
- Provides asset protection against creditors etc
- Mitigate means tested government charges
Trusts

Disadvantages

- Strict duties imposed on Trustees
- Trustees liable for trust debts - can mitigate
- Higher costs to form trust - higher admin costs
- Not able to allocate losses to beneficiaries
- Lose control of assets transferred to trust
- Trading Trusts attract gaze of IRD - tax avoidance
Conclusion

• Understanding Financial Statements important.
• Discuss with Accountant how he prepares Financial Statements.
• Prepare Management information if required to reflect “true” result.
• Dairy Base is a useful tool to assist in this area.
• Understanding reasons for business structure is important
Discussion

• How are you using your financial statements at present?
• How do you work with your professionals to review performance?
• What information should you be collating and using to assess your financial performance?
• Do you know why you decided to use your current business structure.