

# Understanding Financial Statements and Business Structures

## South Island Dairy Event

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# 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
  - Companies Act and Financial Reporting Act.
- 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

<b>CASHFLOW</b>
Cash Income
Cash Farm Working Expenses
<b>TRADING SURPLUS</b>
Bank Loan Payments (Often include Interest and Principal) Rent
<b>NET CASH SURPLUS</b>
Terminal and Provisional Tax Payments
Capital Expenditure
Borrowing or Loan Repayments
Drawings
GST
<b>CHANGE IN BANK BALANCE</b>

# Cashflow Report - Cash Manager Rural



## Cashflow Report for Sample Dairy

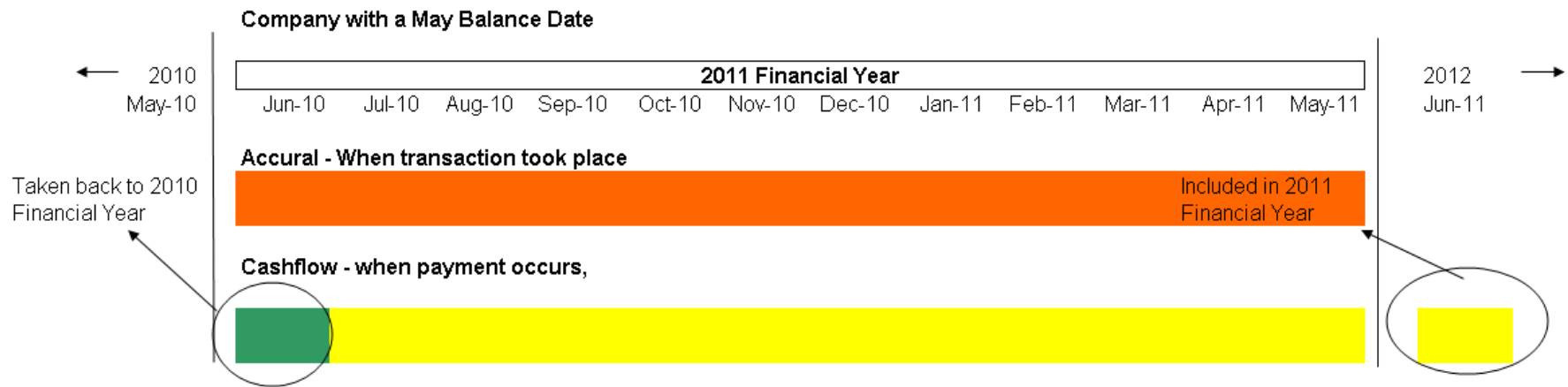
Cashflow: Revised (Main - 29/02/2012)

Date Range: 01 Jun 11 to 31 May 12

GST Exclusive

	Total	Jun-11	Jul-11	Aug-11	Sep-11	Oct-11	Nov-11	Dec-11	Jan-12	Feb-12	Mar-12	Apr-12	May-12
		Act	Act	Act	Act	Act	Act	Act	Act	Act	Bud	Bud	Bud
<b>Income</b>													
Milk Revenue													
Advance	596,702	54,553			20,240	53,975	70,840	75,785	70,150	54,316	65,858	65,816	65,169
Last Season	101,200		17,250	17,250	28,750	37,950							
Dairy NZ Levy	-3,746				-214	-372	-455	-663	-528	-656	-386	-359	-113
Milk Revenue To Dairy Cows	694,156	54,553	17,250	17,250	48,776	91,553	70,385	75,122	69,622	53,660	65,472	65,457	65,056
	54,009			4,400	12,370		3,176		7,400	6,351	4,032	12,096	4,184
<b>Income Total</b>	<b>748,165</b>	<b>54,553</b>	<b>17,250</b>	<b>21,650</b>	<b>61,146</b>	<b>91,553</b>	<b>73,561</b>	<b>75,122</b>	<b>77,022</b>	<b>60,011</b>	<b>69,504</b>	<b>77,553</b>	<b>69,240</b>
<b>Net Income</b>	<b>748,165</b>	<b>54,553</b>	<b>17,250</b>	<b>21,650</b>	<b>61,146</b>	<b>91,553</b>	<b>73,561</b>	<b>75,122</b>	<b>77,022</b>	<b>60,011</b>	<b>69,504</b>	<b>77,553</b>	<b>69,240</b>
<b>Farm Expenditure</b>													
Animal Health	-25,537	-323		-3,525	-3,874	-5,396	-3,581	-1,341	-1,580	-1,077	-1,058	-1,967	-1,815
Breeding & Testi	-12,892			-463			-8,213	-1,324	-946	-946	-1,000		
Calf Rearing	-490				-490								
Shed Expenses	-4,289		-47	-1,081	-986	-60	-163			-952		-1,000	
Electricity (Farm)	-6,500	-337		-337	-675	-675	-675	-675	-675	-675	-710	-710	-356
Feed	-89,477	-2,038	-2,038	-2,038	-2,038	-14,667	-13,886	-19,215	-2,038	-25,081	-2,146	-2,146	-2,146
Pasture Renovat	-4,854										-1,000	-2,854	-1,000
Fertiliser	-87,954	-32,283		-2,446	-2,446	-2,446				-1,468	-20,085	-24,720	-2,060
Freight	-7,088					-1,588			-2,500				-3,000
Weed & Pest	-2,369	-611	-203	-204	-203	-105		-243					-800
Repairs & Maint	-36,233	-6,114	-3,970	-2,853	-1,998	-1,091	-1,826	-1,855	-4,500	-3,026	-3,000	-3,000	-3,000
Vehicle Expense	-19,536	-1,254	-1,254	-1,254	-1,254	-1,254	-1,254	-1,655	-1,254	-2,053	-2,350	-2,350	-2,350
Wages	-83,004	-6,917	-6,917	-6,917	-6,917	-6,917	-6,917	-6,917	-6,917	-6,917	-6,917	-6,917	-6,917
Administration	-11,392		-410	-600	-900	-3,000	-600	-685	-397	-600	-200	-1,200	-2,800
Insurance	-8,400	-700	-700	-700	-700	-700	-700	-700	-700	-700	-700	-700	-700
Rates	-16,753		-4,251			-4,251			-4,251			-4,000	
Acc	-5,500										-5,500		
<b>Farm Expenditun</b>	<b>-422,268</b>	<b>-50,577</b>	<b>-19,790</b>	<b>-22,418</b>	<b>-22,481</b>	<b>-42,150</b>	<b>-37,815</b>	<b>-34,610</b>	<b>-25,758</b>	<b>-43,495</b>	<b>-44,666</b>	<b>-51,564</b>	<b>-26,944</b>
<b>Farm Surplus</b>	<b>325,897</b>	<b>3,976</b>	<b>-2,540</b>	<b>-768</b>	<b>38,665</b>	<b>49,403</b>	<b>35,746</b>	<b>40,512</b>	<b>51,264</b>	<b>16,516</b>	<b>24,838</b>	<b>25,989</b>	<b>42,296</b>
<b>Interest &amp; Rent</b>													
Rent	-14,000						-7,000						-7,000
Interest	-95,004	-7,917	-7,917	-7,917	-7,917	-7,917	-7,917	-7,917	-7,917	-7,917	-7,917	-7,917	-7,917
<b>Interest &amp; Rent T</b>	<b>-109,004</b>	<b>-7,917</b>	<b>-7,917</b>	<b>-7,917</b>	<b>-7,917</b>	<b>-7,917</b>	<b>-14,917</b>	<b>-7,917</b>	<b>-7,917</b>	<b>-7,917</b>	<b>-7,917</b>	<b>-7,917</b>	<b>-14,917</b>
<b>Operating Surplu</b>	<b>216,893</b>	<b>-3,941</b>	<b>-10,457</b>	<b>-8,685</b>	<b>30,748</b>	<b>41,486</b>	<b>20,829</b>	<b>32,595</b>	<b>43,347</b>	<b>8,599</b>	<b>16,921</b>	<b>18,072</b>	<b>27,379</b>
<b>Other</b>													
Principal	-54,171	-8,334	-4,167	-4,167	-4,167	-4,167	-4,167	-4,167	-4,167	-4,167	-4,167	-4,167	-4,167
Personal	-90,746	-7,334	-7,208	-7,334	-7,583	-7,583	-7,583	-7,583	-7,583	-7,879	-7,879	-7,879	-7,614
Taxation	-48,000			-18,000			-18,000			-12,000			
<b>Other Total</b>	<b>-192,917</b>	<b>-15,668</b>	<b>-11,375</b>	<b>-29,501</b>	<b>-11,750</b>	<b>-11,750</b>	<b>-29,750</b>	<b>-11,750</b>	<b>-11,750</b>	<b>-23,750</b>	<b>-12,046</b>	<b>-12,046</b>	<b>-11,781</b>
<b>Fin Year Surplus</b>	<b>23,976</b>	<b>-19,609</b>	<b>-21,832</b>	<b>-38,186</b>	<b>18,998</b>	<b>29,736</b>	<b>-8,921</b>	<b>20,845</b>	<b>31,597</b>	<b>-15,151</b>	<b>4,875</b>	<b>6,026</b>	<b>15,598</b>
<b>Gst</b>													
Gst	11,690	1,661	688	-1,398	6,856	663	5,367	7,160	-4,970	-12,372	4,764	-3,361	6,632
<b>Gst Total</b>	<b>11,690</b>	<b>1,661</b>	<b>688</b>	<b>-1,398</b>	<b>6,856</b>	<b>663</b>	<b>5,367</b>	<b>7,160</b>	<b>-4,970</b>	<b>-12,372</b>	<b>4,764</b>	<b>-3,361</b>	<b>6,632</b>
<b>Opening Balance</b>	<b>25,000</b>	<b>25,000</b>	<b>7,052</b>	<b>-14,092</b>	<b>-53,676</b>	<b>-27,822</b>	<b>2,577</b>	<b>-977</b>	<b>27,028</b>	<b>53,655</b>	<b>26,132</b>	<b>35,771</b>	<b>38,436</b>
<b>Closing Balance</b>	<b>60,666</b>	<b>7,052</b>	<b>-14,092</b>	<b>-53,676</b>	<b>-27,822</b>	<b>2,577</b>	<b>-977</b>	<b>27,028</b>	<b>53,655</b>	<b>26,132</b>	<b>35,771</b>	<b>38,436</b>	<b>60,666</b>

# Accrual Basis





# Cashflow vs Financial Statements

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

### CASHFLOW

Cash Income
Cash Farm Working Expenses
<b>TRADING SURPLUS</b>
Bank Loan Payments (Often include Interest and Principal) Rent
<b>NET CASH SURPLUS</b>
Terminal and Provisional Tax Payments
Capital Expenditure
Borrowing or Loan Repayments
Drawings
GST
<b>CHANGE IN BANK BALANCE</b>

### FINANCIAL STATEMENTS

Cash Income
Accounts Receivable
Change in Stock on Hand
Dividends received as shares ie (Ravensdown, Balance)
Cash Farm Working Expenses
Accounts Payable
Depreciaton
<b>EARNINGS BEFORE INTEREST AND TAX (EBIT)</b>
Interest Only and Rent
Accounts Payable
<b>NET TAXABLE INCOME</b>
Tax Payable on Profit
<b>Surplus After Tax</b>
Change in Fixed Assets
Change in Loan Balances
Change in Current Account
Change In A/c Payable and Receivable
Change in GST
Change in Stock
<b>EQUITY POSTION</b>

### BANK ANALYSIS

Cash Income
Accounts Receivable
Change in Stock on Hand Moved to later in Analysis
Dividends received as shares ie (Ravensdown, Balance)
Cash Farm Working Expenses
Accounts Payable
No Depreciation
<b>TRADING SURPLUS</b>
Interest Only and Rent
Accounts Payable
<b>NET SURPLUS</b>
Terminal and Provisional Tax Payments
Capital Expenditure
Drawings
<b>CASH RESULT</b>
Change in Livestock at market values
<b>BUSINESS RESULTS</b>

Statement of Financial Performance

Statement of Financial Postion



# 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.