TRADIES
Business Advisory

Understanding your Financial Reports

A handy guide for the business owner who wants to know more about what is going in their accounts

The Pure Bookkeeping System

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Introduction

For too many small business owners, bookkeeping is a necessary evil good only for keeping up to date with IRS filings and other compliance requirements. Many business owners don't realize that the expertise of an appropriately qualified and experienced bookkeeper is a powerful resource that can change their destiny!

Big call? Over the top??

Not at all. The regular review of a firm's financial reports can reveal emerging trends that may ultimately lead to the demise of the business and allow early corrective action to be taken long before crisis management becomes the last tool available to stave off disaster. When reviewed regularly, a firm's financial reports may reveal opportunities to increase revenues, decrease costs and increase profitability. Increased profitability provides more opportunities - for growth - or to bring one closer to the day one chooses to retire. Simply put, more opportunities mean more choices to shape the future.

To be of any value, of course, the bookkeeping and reporting must be up to date. It's somewhat "long after the horse has bolted" to wait until your tax accountant prepares your tax return (which can be months after the end of the financial year) to find out "how you went" for the year and what you should have done about it.

In recent years there has been a revolution in small business accounting options. Today's online "cloud" accounting systems make it even easier to keep your business accounting up to date and to get real time advice, on demand, with everyone on the same page.

This guide has been produced to provide the business owner with a basic understanding of what the financial reports from the systems they use for their day-to-day accounting can tell them. They can then engage in more meaningful, and value adding conversations with their tax accountant and other business advisors and gain the best advice available.

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This publication has been based on the booklet Understanding Your Financial Reports produced by Pure Bookkeeping Pty Ltd.

Bookkeeping vs Accounting

Bookkeeping is a transactional and administrative role that handles the day-to-day task of recording financial transactions, including purchases, receipts, sales, and payments. Tax accounting is more subjective, providing business owners with financial insights based on information taken from their bookkeeping data.

What does a bookkeeper do?

Bookkeeping, in the traditional sense, has been around as long as there has been commerce – since around 2600 B.C. A bookkeeper's job is to maintain complete records of all money that has come in and gone out of the business. Bookkeepers record daily transactions in a consistent, easy-to-read way, and their records enable the accountants to do their jobs.

These are some typical bookkeeping tasks:

- Recording financial transactions
- Posting debits and credits
- Producing invoices
- Managing payroll
- Maintaining and balancing ledgers, accounts, and subsidiaries

The bookkeeping industry has transformed over the past 10 years. No longer are bookkeepers considered the "poor cousin" of tax accountants. They are certified in the accounting software, such as QuickBooks Online or Xero, members of professional associations and have professional indemnity insurance. They have a deep understanding of how the numbers work and many have now expanded their service offerings into advisory. Going well beyond "just bookkeeping", they are providing their clients with accurate and reliable information and advice so that clients make informed decisions for growth and profitability.

There are two things that bookkeepers are not trained, or qualified to do:

1. Offer tax advice.
2. Offer financial advice.

Tax advice is the job of the Tax accountant and financial advice is the job of a Financial Planner.

What does a Tax accountant do?

A Tax accountant's primary role is to give the business owner tax advice and file tax returns. They can also analyse the financial data, prepared by the bookkeeper, to provides business owners with important business insights based on that information.

These are some typical tax accountancy tasks:

- Verifying and analysing data
- Generating reports, performing audits, and preparing financial reporting records like tax returns, income statements, and balance sheets
- Providing information for forecasts, business trends and opportunities for growth
- Helping the business owner understand the impact of financial decisions

A proactive Tax accountant may also offer insights into the overall financial health of your business, offer tax saving advice, and help you make strategic decisions based on industry benchmarks and forecasting.

The Three Financial Reports Overview

A firm's financial statements are a window into its financial health. No wonder studying them is an integral part of fundamental analysis. While analysts dig deeper into financial statements and try to unearth the not-so-obvious aspects of a firm's financials, business owners are often bamboozled by the numbers and what they mean.

The following information is written to help business owners understand the basics and demystify the financial statements.

There are three major financial statements: the Balance Sheet, Profit and Loss Statement and Cash-Flow Statement. The Balance Sheet tells you about the Assets and Liabilities of a business and overall

profitability as of a specific date. The Profit and Loss Statement tells you about a firm's profitability in a given year (or any period of time within that year). And the Cash-Flow statement is about the flow of cash into and out of a business.

In Summary:

1. Balance Sheet

The Balance Sheet displays the firm's Assets, Liabilities, and Owner's Equity. Assets are what you own, and Liabilities are what you owe. Owner's Equity represents what would be paid to the Shareholder if the business was sold, the assets liquidated, and the debts were paid.

Key feature:

Shows the financial position of a business as a "snapshot" or financial picture at a specified point in time usually the end of a month or financial year (but can be any chosen date).

2. Profit and Loss Statement (P&L)

Often, the first place an investor or analyst will look is the Profit and Loss (or Income Statement). The P&L shows the performance of the business throughout each period, displaying sales revenue at the very top. The statement then deducts the Cost of Goods Sold (COGS) to find Gross Profit. From there, the gross profit is affected by other operating expenses and income, depending on the nature of the business, to reach net income at the bottom – "the bottom line" for the business.

Key feature:

Shows the revenues and expenses of a business expressed over a period of time (ex: 1 year, 1 quarter, Year-to-Date, etc.)

3. Cash Flow Statement

The Cash Flow Statement show the change in cash per period as well as the beginning balance and ending balance of cash.

Key feature:

Cash is the lifeblood of a business. The Cash Flow statement shows the movement of cash in and out of the business.

The Balance Sheet

A Balance Sheet, also known as a Statement of Financial Position, is a snapshot of a firm's financial condition at a specific moment in time, usually at the close of an accounting period. A Balance Sheet comprises Assets, Liabilities, and Owners' or Shareholders' equity. Assets and Liabilities are divided into short and long-term obligations including cash accounts such as bank, money market, or stock securities and bonds.

It's called a Balance Sheet because the two sides balance out. This makes sense: a firm has to pay for all the things it has (Assets) by either borrowing money (Liabilities) or getting it from shareholders (Shareholders' Equity).

The Purpose of the Balance Sheet

A Balance Sheet enables you to:

- Quickly see the financial strengths and capabilities of your business
- Review the level of assets, debt and working capital of your business
- Compare the increase or decrease in value of your business over time
- See the relative liquidity of your business

- Analyse your ability to pay all short-term and long-term debts as they come due

A Balance Sheet helps business owners quickly get a handle on the financial strength and capabilities of the business and answer questions such as:

- Is the business in a position to expand?
- Can the business easily handle the normal financial ebbs and flows of revenues and expenses?
- Does the business need to take immediate steps to boost cash reserves?

Why is the Balance Sheet important?

Without the Balance Sheet, you are running your business wearing a blindfold.

Concentrating solely on the Profit and Loss is a mistake which can contribute to a business failing. It also leaves open too many questions. One of the most common is – I made a profit this month so why don't I have any cash in the bank?

Cash flow can be a huge problem for growing businesses. By examining the Balance Sheet, you will be able to see how "healthy" the business is. It answers the question "where has my money gone?" and it shows if the business is adequately funded.

It can tell you if you owe more money than what you currently have, the current value of your assets and the overall value of your business.

More importantly the Balance Sheet can provide warning signs so you can solve any problems before they destroy your business.

The Balance Sheet is a vital financial statement you should be reviewing regularly, as it changes with every transaction.

Balance Sheet Terminology

1. Assets

An asset is defined as anything that is owned by a business and holds inherent, quantifiable value. A business could, if necessary, convert an Asset into cash through a process known as liquidation. Assets are typically tallied as positives (+) in a Balance Sheet and broken down into two further categories: Current Assets and Non-Current Assets.

Note: For illustration purposes, we will be using a Xero Demo file, however the principles of accounting apply to all accounting software globally.

Balance Sheet

Demo Company (AU)
As at 31 March 2021

	31 MAR 2021
Assets	
Bank	15,081.23
Current Assets	10,749.50
Fixed Assets	198,385.00
Total Assets	**224,215.73**
Liabilities	
Current Liabilities	53,167.50
Non-current Liabilities	215,000.00
Total Liabilities	**268,167.50**
Net Assets	**(43,951.77)**
Equity	
Current Year Earnings	(36,039.77)
Retained Earnings	(7,912.00)
Total Equity	**(43,951.77)**

Current Assets

Current assets are any assets that can be easily converted into cash within one year. This typically includes check or money market accounts and Accounts Receivable that are due within one year's time.

- **Bank Accounts and Cash** - Money available immediately, such as check accounts, is the most liquid of all short-term assets.
- **Accounts Receivable** - This is money owed to the business for purchases made by customers
- **Current loans** – amount of money lent to another party, with repayment date not exceeding one year, are also considered a Current Asset.

Assets	
Bank	
Business Savings Account	15,081.23
Total Bank	**15,081.23**
Current Assets	
Accounts Receivable	10,749.50
Total Current Assets	**10,749.50**

Fixed Assets/Long-term Assets

Typically include long-term investments that aren't expected to be converted into cash in the short term. Also referred to as Non-Current Assets.

- **Land** - is real estate that is exclusive of any buildings or other assets situated on the property. It is the only asset that is not depreciated for financial reporting or tax purposes.
- **Buildings** - is a Fixed Asset that contains the carrying amount of the buildings owned by an entity. The carrying amount is the original purchase price, plus later capitalized additions, if any. This is depreciated over time.
- **Computer Equipment** - Can include a broad array of computer equipment, such as routers, servers, and backup power generators.
- **Motor Vehicles** - This would include cost of any vehicles used in your business.
- **Office Equipment** - This includes equipment such as copiers, fax machines, printers, and computers used in your business.
- **Plant & Equipment** - This figure represents machines and equipment used in your business to produce your product. Examples of machinery might include lathes, conveyor belts or a printing press.
- **Accumulated Depreciation** - is the total amount of the depreciation expenditure allocated to a particular asset since the asset was used. It is a negative Asset Account that offsets the balance in the Asset Account with which it is usually linked.

Whenever a business records depreciation expenses, the same amount is also credited to the respective Accumulated Depreciation Account, enabling the firm to show both the cost of the asset and the total depreciation of the asset. This also shows the net book value of the asset on the Balance Sheet.

Assets	
Bank	15,081.23
Current Assets	10,749.50
Fixed Assets	
Computer Equipment	3,264.00
Less Accumulated Depreciation on Computer Equipment	(254.00)
Office Equipment	750.00
Less Accumulated Depreciation on Office Equipment	(825.00)
Motor Vehicle	200,450.00
Less Accumulated Depreciation on Motor Vehicle	(5,000.00)
Total Fixed Assets	**198,385.00**

2. Liabilities

A Liability is the opposite of an Asset. While an asset is something a firm owns, a liability is something it owes. Liabilities are financial and legal obligations to pay an amount of money to a creditor.

Just as assets are categorised as Current or Non-Current, liabilities are categorised as Current Liabilities or Non-Current Liabilities.

Current Liabilities

This includes all debts and obligations owed by the business to outside creditors, vendors or banks that are payable within one year.

- **Accounts Payable** - This are amounts due to vendors for goods or services received that have not yet been paid for.
- **GST Liabilities** - This includes the GST Collected and GST Paid, PAYG Instalment and can include an ATO Payment Arrangement.
- **Payroll Liabilities** - This includes PAYG Withholding and SGC Liabilities that are owed for employees but have not yet been paid.
- **Loans** - This represents money owed on a short-term collection cycle of one year or less. It may include Commercial Bills, mortgage obligations, and HP liabilities and can include Provisions for annual or long service leave.

Liabilities

Current Liabilities	
Accounts Payable	3,234.06
Accrued Liabilities	869.00
GST	1,448.88
Historical Adjustment	19,212.21
PAYG Withholdings Payable	6,028.00
Rounding	(0.09)
Superannuation Payable	1,273.00
Wages Payable - Payroll	13,400.00
Business Bank Account	7,702.44
Total Current Liabilities	**53,167.50**

Noncurrent Liabilities

These are any debts or obligations owed by the business that are due more than one year out from the current date. Typically referred to as Long-term Liabilities.

- **Loans** - This is the balance of a mortgage or other loan that extends out beyond the current year. For example, you may have paid off three years of a fifteen-year loan, of which the remaining eleven years, not counting the current year, are considered long-term.

Non-current Liabilities	
Bank Loan	200,000.00
Loans - Director	15,000.00
Total Non-current Liabilities	**215,000.00**

3. Equity

Equity is made up of the initial and ongoing investment in the business as well as any retained earnings that are reinvested in the business.

- **Owner's Equity** - In the case of a Sole Trader this is the Owner's Capital (i.e., any money you have put into the business) and Owner's Drawings (any money you have taken out of the business).
- **Net Income** - If you look at your Profit and Loss for the same period ending as your Balance Sheet, you will notice that Net Profit on that report is shown as Current Year Earnings on the Balance Sheet.
- **Retained Earnings** - This is an accumulated figure of previous year's earnings.

Equity	
Current Year Earnings	(36,039.77)
Retained Earnings	(7,912.00)
Total Equity	**(43,951.77)**

The Profit & Loss Report

The Profit and Loss Report (also known as a Statement of Financial Performance or an Income Statement) shows how much revenue and expenses a firm has generated over a certain period. The Profit and Loss Report is the most commonly used, but also the most commonly misunderstood financial report.

The Profit and Loss Report is a summary of the financial performance of a business over a period of time (typically monthly, quarterly or annually.) It reflects the past performance of the business and is the report most often used by small business owners to track how well their business is doing.

As the name indicates the Profit and Loss Report measures the profit or loss of a business over a specified period. A profit and loss statement summarises the income for a period and subtracts the expenses incurred for the same period to calculate the profit, or loss, for the business.

The Purpose of the Profit & Loss Report

Producing a Profit and Loss Report at least monthly (but more frequently if required) will enable you to:

- Answer the question, "How much money am I making, if any?"
- Compare your projected performance with actual performance
- Compare your performance against industry benchmarks
- Use past performance trends to form reasonable forecasts for the future
- Show your business progress (good or bad) and financial health over time
- Detect any problems regarding sales, margins, and expenses within a reasonable time so adjustments may be made to recoup losses or decrease expenses

- Provide proof of income if you need a loan or mortgage; and
- Calculate your income and expenses when completing and submitting your tax return

To make sense of a Profit and Loss Report you will need to know the basis on which it has been prepared. This could be either Cash Basis or Accruals Basis.

Cash Basis - as the name suggests, cash accounting tracks the cash that comes in and out of your business. For example, if you receive a bill, it doesn’t appear on the Profit and Loss until you have paid it. Similarly, when you send an invoice to a customer, the sale doesn’t appear on the Profit and Loss until the customer has paid it. In other words, cash accounting doesn’t include Accounts Receivable and Accounts Payable.

Accruals Basis - records bills and sales invoices when the purchase or sale takes place, instead of when they are paid. For example, if you send an invoice to a customer for payment, the sale is included in the Profit and Loss, even though you haven't received payment yet. When you report on an accruals basis, the Profit and Loss will show the outstanding bills and sales (not the ones that have been paid). In other words, accrual accounting includes Accounts Receivable and Accounts Payable.

Most computerised accounting packages produce a Profit and Loss Report using the Accruals Basis as the default but provide the option to switch to Cash Basis. Accruals Basis accounting is required by Australian and International Accounting Standards and is the preferred method as it provides a better understanding of the relationship between income and the costs associated with generating that income.

Components of Profit and Loss Report

- **Revenue/Income/Sales** - The amount of money a business takes in
- **Costs of goods sold (COGS)** - The cost of what it takes to make whatever a business sells
- **Gross profit** - Total revenue less COGS
- **Operating Expenses** - The amount of money a business spends
- **Net Profit** – The amount of profit a firm has left over after paying off all its expenses

These “buckets” may be further divided into individual line items, depending on a firm’s policy and the granularity of its income statement. For example, revenue is often split out by product line or division, while expenses may be broken down into administrative expenses, professional fees, wages, rent, and interest paid on debt.

Profit and Loss

Demo Company (AU)
For the month ended 31 March 2021

	MAR 2021
Trading Income	
Sales	17,245.00
Total Trading Income	**17,245.00**
Cost of Sales	
Cost of Goods Sold	16,886.00
Total Cost of Sales	**16,886.00**
Gross Profit	**359.00**
Operating Expenses	
Advertising	1,818.18
Bank Fees	10.50
Cleaning	155.00
Consulting & Accounting	2,549.00
Depreciation	3,450.00
Entertainment	1,475.00
General Expenses	852.00
Light, Power, Heating	444.00
Motor Vehicle Expenses	450.00
Office Expenses	178.54
Printing & Stationery	118.09
Rent	1,500.00
Superannuation	1,273.00
Telephone & Internet	32.50
Travel - International	4,025.00
Travel - National	1,645.00
Wages and Salaries	13,400.00
Total Operating Expenses	**33,375.81**
Net Profit	**(33,016.81)**

The Importance of Profit and Loss Report

The Profit and Loss enables business owners to make crucial decisions regarding the firm's operations, the management's efficiency, their performance compared to other industry players, and the possible danger areas wherein profit may diminish. It reports the business's overall profitability, and thus, it is just as important as the firm's growth or loss for an extended period.

The Profit and Loss can also provide you with information that will help make decisions to reduce expenses or create strategies to increase Gross Profit which will improve the overall financial position of the business.

The Profit and Loss Report may be produced in a variety of forms to best suit the needs of the user.

- Profit and Loss for the month showing Year to Date figures

A Profit and Loss Report in this simple form will show you the income and expenses for the month. The Year to Date (YTD) column added to this report in the accounting software will show income and expenses for the financial year to date. This report should be produced and analysed, with the help of a professional bookkeeper or accountant, at least monthly.

- Profit and Loss showing three months side by side

The Profit and Loss Report showing three months side by side is a useful report because it will enable you to compare one month's trading to the next. This format is useful because you can see how the business has performed month by month over a select period and includes a total for the period (and optionally, YTD). It is also handy for spotting things that might have been missed or duplicated like a rent payment for example. Significant variations between each month that can't be quickly explained probably call for further investigation. This report is commonly produced and analysed quarterly, with the help of a professional bookkeeper or accountant.

- Profit and Loss for 9 months of the year

Producing a report for the 9 months of the financial year is very important. This is the best time to meet with your accountant to prepare for end of year and get tax planning advice. This report, along with the Balance Sheet, will provide your accountant with enough information to suggest strategies you can implement over the coming three months to help minimise your tax, or improve profits, before end of year.

- Profit and Loss Actuals vs Budget

A budget is an important tool for projecting what your business will be doing in the future and for keeping you on track with your business plan. A budget is a summary of expected income and expenses for the period. Regular reviews of your budget against actual results will reveal whether your business is on track to achieve the goals you have set.

For business owners who are keen to develop their understanding of the Profit and Loss, feel free to contact us and we will arrange a no obligation, free financial health check of your accounting software and an analysis of your Profit and Loss.

The Cash Flow Statement

The Cash Flow Statement is one of the most important tools in managing your finances. It tracks all the money flowing in and out of your business and can reveal payment cycles or seasonal trends that require additional cash to cover payments. This cycle or pattern can help you plan ahead and make sure you always have money to cover your payments.

It is the Cash Flow Statement which answers the perennial question – If I am making a profit, WHY do I not have any money in the bank? The Cash Flow Statement is an essential financial statement for the business person who really wants to understand what is going on.

A Cash Flow Statement is divided into three categories:

- **Cash flow from Operating Activities** - cash inflows and outflows resulting from day-to-day business operations, including the collection of cash from sales and payment of expenses.

- **Cash flow from Investing Activities** - result from the purchase or sale of the business's non-current assets, that is, assets owned for longer than 12 months.

- **Cash flow from Financing Activities** - any financing activity that changes the size and composition of the business' long-term financing structure. This includes repayments of the principal on the business mortgage or capital contributions the business owner has made to the business.

A cash flow statement is a valuable measure of strength, profitability, and the long-term future outlook for a firm. The CFS can help determine whether a firm has enough liquidity or cash to pay its expenses. A firm can use a cash flow statement to predict future cash flow, which helps with matters of budgeting.

Hopefully you now have a better understanding of your financial reports. In the next section, we will explain why it’s important to keep business records.

Why Keep Business Records?

Economics 101: We live in a world where our wants are unlimited but the resources to meet them are scarce. Good record keeping is an essential tool to help best manage this eternal conflict. For the business owner, this conflict is expressed in the form of how do we maximise profits with the limited capital, property, and human resources that we have available?

For too many small business owners bookkeeping is a necessary evil, required only to keep up with compliance requirements. This mindset tragically blinds those who believe it, to a wide world of opportunities. The business owner who takes a proactive approach realises that good business record keeping is an essential resource to enable informed decision making involving a whole range of matters, including, of course, keeping on top of compliance.

Keeping good business records is about much, much more than just managing your tax obligations. Yet it is an inability to manage these matters that leads to most business failures. Not only is it best practice to keep business records, it is actually an ATO requirement which stipulates:

Keeping good records helps you and your tax adviser:

- *to provide written evidence of your income and expenses*
- *prepare your tax return*
- *to ensure you are able to claim all your entitlements*
- *prove the information you provided in your tax return (in case we ask you)*
- *reduce the risk of tax audits and adjustments*
- *improve communication with us*
- *resolve issues that relate to a dispute of your assessments or adjustments*
- *avoid exposure to penalties.*

Good record keeping

There are a number of reasons why you should keep good records of your business transactions. Good record keeping:

- makes it easier for you to meet your tax obligations
- makes it easier for you to understand how your business is doing
- helps you make good business decisions.

Record keeping is a legal requirement. By law you must keep business records for at least five years from the date you lodged the tax return, either on paper or electronically. They must be in English or in a form that can easily be converted.

If you don't keep the right tax records, you can incur penalties. Poor record keeping is also one of the main reasons why some small businesses fail.

Often, when you are busy running your business, the bookkeeping is the last thing on your list. It’s not your expertise and the risk of getting it wrong can be costly. Perhaps you have considered outsourcing, but don’t know who to trust. Call us. We will be happy to speak with you to discuss your needs and provide a quote.

Business records you need to keep should include the following:

- **Income tax records** - You must keep records of all your sales (income) and expenses to prepare your Business Activity Statements (BAS) and annual income tax return, and to meet other tax obligations.

- **Income and sales records** - Records of all sales transactions for example, invoices, receipt books, cash register tapes and records of cash sales.

- **Expense or purchase records** - Records of all business expenses, including cash purchases. Records could include receipts, invoices including tax invoices, cheque book receipts, credit card vouchers and diaries to record small cash expenses. Records showing how you worked out any private use of something you purchased. **you need a tax invoice to claim GST credits**. You must keep any other document that records any adjustments, a decision or a calculation made for GST purposes.

- **Payroll records** – These include all payments made to employees, super contributions made for employees or contractors, Single Touch Payroll reports, Payment Summaries/Income Statements, Tax Fil Number Declaration forms.

- **Year-end records** - These include lists of creditors (who you owe money to) or debtors (who owe you money), and worksheets to calculate the decreasing value of your assets, also called 'depreciating assets', stocktake sheets and capital gains tax records.

- **Bank records** - Documents you receive from the bank such as bank statements, loan documents and bank deposit books.

Record keeping evaluation tool

There may be other records in addition to those listed above that you will need to keep when you are running a business. To help you work out the record keeping needs for your business, you can use the ATO Record Keeping Evaluation Tool.

TIP: You can claim any costs associated with keeping good records including accounting software and bookkeeping and accounting services.

Common bookkeeping mistakes to watch out for

Is your bookkeeper really looking after you?

It is surprising how many business owners opt for price over quality when engaging people to look after the heart and soul of their business. Accountants report they spend up to 30% of their time (read 30% of their fees) fixing bookkeeping mistakes. When you engage with unqualified and inexperienced people, you will likely end up paying more in the long run after someone else has come in to fix up the mess left behind.

Most businesses would not know where to begin when reviewing their bookkeeping or their bookkeepers' work so here's a few things to look out for.

1. Ineffective reconciling

Bank accounts not reconciled for long periods of time or old, unreconciled transactions left for someone else to deal with. The effect of this can be costly for business owners because these transactions may affect the GST being claimed, tax return being lodged, or incorrect payroll records provided to staff.

2. Duplication of transactions

Duplication of supplier of bills which results in double payments! In a similar vein, a list of credits owed to the business that hasn't been applied. Bookkeepers should at least, monthly, reconcile back to supplier statements. These mistakes should not happen if they follow this process.

3. Not reconciling Accounts Payable or Accounts Receivable

Reconciling AP and AR at least monthly is often neglected by bookkeepers. They don't review the invoices and bills to ensure they are "real" i.e., they are actually outstanding. It's not uncommon for customers to pay their invoice by cash (which sometimes isn't deposited into the bank) therefore, the payment is not recorded against the invoice. A similar thing can happen with bills. The business owner pays a bill with cash or from their personal account and the payment is not recorded.

4. Unmonitored Cashflow

Some bookkeepers fail to regularly update bank and credit card reconciliations, payment processing, and more importantly, invoicing of customers. When done regularly, this will update the business owner with their current position and allow plans for contingencies and further business development.

5. Incorrect Payroll setup

Many bookkeepers don't know how to set up the superannuation and entitlement calculations accurately in the accounting software, thus resulting in staff being paid much more than the statutory rate on their ordinary times earnings. As a result, they incorrectly assign accruing annual, personal and long-service leave entitlements – a very expensive mistake!

6. Not separating personal transactions from business transactions

Although it is common for business owners to use the business account to pay for personal expenses, it increases the amount of bookkeeping required and therefore should be discouraged because it adds unnecessary costs.

7. Failing to account for GST correctly

This applies especially when dealing with GST on imports, insurance and motor vehicle registration that have both GST and GST-free components. We have seen bookkeepers post these transactions incorrectly in the accounting software and then claim incorrect GST credits on the Business Activity Statement (BAS) lodged with the ATO.

8. Incorrectly categorising income and expenses

Bookkeepers should review the Profit and Loss Report showing the previous two months so they can check to see if any expected income or expenses are missing. An example would be the monthly rent. If you rent your premises and pay monthly, they should check if there is a transaction missing when it should appear in every month.

9. Not a Registered BAS Agent

There are many bookkeepers who provide a BAS service (as defined by the Tax Practitioners Board) without being a Registered BAS Agent or working under direction of a BAS or Tax Agent. This not only includes preparing and lodging IAS and BAS to the ATO but simply setting up a Xero or QBO file and allocating the Tax Code in the Chart of Accounts. It is illegal for bookkeepers to provide a BAS service if they are not a BAS Agent.

10. Not caring about the source documents

We have already explained how important it is to keep accurate records. Because it is not the responsibility of bookkeepers to ensure source documents are saved in a way that they can be made available to the ATO in the case of an audit, many bookkeepers overlook this important function.

We consider it an important service for our clients, and we have systems in place to electronically retrieve and store all source documents so you don't have to worry about it.

How you can improve Cash Flow

As any small business owner knows, maintaining smooth cash flow requires juggling nearly every facet of a business, from staying on top of Accounts Receivable, to extending lines of credit, to managing inventory. The essence of successful cash flow management is regulating the money flowing in and out of your business. Increasing your cash flow reduces the amount of fixed capital that you need to support the given level of your business. An increased, consistent cash flow also creates a predictable business pattern, making it easier to plan and budget for future growth. Here are ten things you can do to improve your cash flow:

1. **Review your Cash Flow reports and forecasts regularly** so that you know where your cash is going and so you can plan ahead for periods when cash might be a bit tight. A cash flow forecast is the primary tool you need to use. By forecasting your inflows and outflows of cash, and the surplus or deficits you'll have left over, you'll be better equipped to adjust course and stay on track later when you can compare the actual figures with your forecasts. Contact us if you need help preparing a Cash Flow Forecast.

2. **Invoice immediately.** Any steps you can take to shorten your receivables will boost your cash flow. For instance, send out invoices immediately after the delivery of goods or services. Don't wait until the end of the week or the end of the month.

3. **Review your payment terms.** For example, reduce your terms from 60 days to 30 days. Offer a small discount to customers who pay their bills early and charge a penalty to those who pay late. Monitor your receivables on a weekly or bi-weekly basis and follow-up with late payers immediately when appropriate. Set up the expectation that once you have delivered the goods or service, you expect to be paid promptly as agreed. Make sure that your invoices clearly state your payment terms (make it even clearer by showing a due date) and follow up immediately if you haven't been paid on time.

4. **Stretch out your payables.** Note the date due and arrange payment for then. Your suppliers' terms are an interest-free line of credit, and you could be earning interest on that money in the meantime.

5. **Take advantage of early payment discount**s. If the effective return provided by the discount exceeds what you could earn elsewhere then it makes sense to pay early and keep the change.

6. **Balance your client base.** Many service and professional companies, such as advertising or PR agencies, accountants, lawyers, real estate management firms, etc., work with certain clients on a project-by-project basis. Look for ways to convert some of these clients to a retainer relationship, where they pay you a set amount of money per month for a certain number of services. You might want to offer them some kind of incentive e.g., value-added services or a discount to encourage them to shift to a retainer. This might reduce your profit margin, but it will help make your cash flow more predictable.

7. **Check your pricing.** Have your prices kept up with your rising costs? Many small businesses hesitate to increase their rates because they're afraid they'll lose customers. However, customers actually expect their suppliers to institute small, regular price hikes. Also, be sure to check out your competition on a consistent basis. If they're charging higher prices, you should too.

8. **Spread the love around**. You can save money by splitting your business between suppliers. Closely examine where you need to pay for added service, and where you can save money by paying commodity prices. For example, you might want to buy your computer hardware from a value-added reseller who can help you choose the right system to meet your business needs, while you can purchase other items e.g., printer cartridges, cables, or off-the-shelf software, from a discount wholesaler.

9. **Renegotiate your insurance and supplier contacts.** Are you getting the best possible deal on insurance, phone service and other regular business expenses? Review each of your insurance policies annually and get three quotes for each to ensure you're getting the most for your money. Keep a close eye on price sensitive services such as your long-distance phone service or your internet access service. Regularly examine these bills and call around to make sure you're getting the lowest available rate.

10. **Review your inventory.** Overstocking inventory can tie up significant amounts of cash. Regularly assess your inventory turns to make sure they are within industry norms and customer expectations. You can do this by calculating your inventory turnover ratio (cost of goods sold divided by the average value of your inventory). Avoid buying more than you know you need when suppliers lure you with big discounts as this can tie up cash. Periodically check your inventory for old or outdated stock, and either defer upcoming orders to use that stock or sell it at cost to improve your liquidity.

11. **Put your spare cash to work.** Chances are your business cheque account pays you little or no interest whereas a high-interest savings or cash management account for business allows you to earn a competitive rate of interest on your cash on hand, but the funds are accessible whenever you need them. You earn interest every day on every dollar saved and you can withdraw the money whenever you need to. It makes no sense (cents?) to have any more than you need for day-to-day management, sitting in your lazy cheque account.

Cash Flow Forecasting

The above-mentioned financial reports all have one weakness in common. They are all historical, that is they provide information about what has happened in the past. A significantly more valuable resource is a tool which can assist in predicting what is coming ahead. You have probably heard the expression, "Cash is King".

Maintaining a Cash Flow Forecast is a valuable resource for the business owner who wants to be informed and remain in control of how cash is flowing in the business. It can warn of the possibility of upcoming cash shortages so that preventative action can be taken in good time or conversely a cash flow forecast can alert the owner to possible surpluses that can be used for investment or to pay off debt.

	This week	Next Month	Following Month
Cash Open Bal	15000	22900	17000
Expected Income	25000	22000	19500
Less			
Suppliers	9500	16000	13500
Wages	2500	5000	5000
Overheads	1800	2300	2300
Car payment	350	350	350
BAS payment	1500	1500	1500
One Off	1450	2750	1900
Cash Closing Balance	22900	17000	11950

In the above example of a simplified Cash Flow Forecast, we can see that, based on current expectations, cash reserves will fall to around half current levels in two months. With this knowledge in advance the business owner can consider how they might be able to increase revenues or reduce costs ahead of time.

Contact us if you need assistance in developing and maintaining a Cash Flow Forecast.

Key Performance Indicators (KPIs)

Key performance indicators (KPIs) refer to a set of quantifiable measurements used to gauge a firm’s overall long-term performance. KPIs specifically help determine a firm's strategic, financial, and operational achievements, especially compared to those of other businesses within the same sector.

KPIs distil the information provided by financial and operational reports, as well as from other sources, into single numbers which are understandable at a glance. Using KPIs can give you better business insight and keep you on track towards achieving your goals.

Effective key performance indicators could be organised into groups such as:

- Efficiency – reducing waste, return on inputs including staff
- Growth - Sales or equity
- Health - Debt to equity, forward cash flow
- Resilience - Risk management

The important thing about KPI reporting is that the KPI’s you select are relevant to how your business operates and the goals you are wanting to achieve. For example, in accommodation rental, daily overnight occupancy would be a useful KPI which at a glance states how effective marketing has been (or not).

Modern accounting software can be used to track some of these KPI groups. And if that software is cloud-based, you can keep an eye on your KPIs from anywhere and at any time.

You also have to consider that KPIs do not necessarily have to be solely tied to financial data. While profits and debt levels are indeed important key financial indicators, a firm’s relationships with both its customers and its employees are no less important to establishing its general health. Common non-financial KPIs include measures of foot traffic, employee turnover rates, the number of repeat customers versus new customers, and various quality metrics.

Talk to us for more information about KPI based reporting.

Things to Watch Out For

Early warning signs that things are not going to plan and corrective action may be required.

The following information, obtained from an insolvency practitioner (liquidator), may be useful in determining if your business could soon be struggling. If any of the items below apply to your business, first determine if it is just a "glitch" or whether a trend is developing.

It is better to monitor these things on a regular and take corrective measures early rather than allowing trends to develop to the point where urgent crisis management is needed.

These signs are not meant to alarm, but to alert you to the need for some proactive steps, rather than waiting until it's too late.

Early warning signs may include:

1. Your overdraft is near or at its limit for a significant period of time
2. You have difficulty meeting your suppliers' payment terms
3. Staff are spending time on telephone with suppliers about outstanding payments
4. Suppliers are threatening COD terms or stopping supply
5. Suppliers putting your business last for service priority
6. Cheques/payments are dishonoured by your bank
7. Suppliers issuing demands or threatening legal action
8. Creditors' balance increasing whilst debtors and inventory/WIP remaining static
9. Difficulty paying GST and payroll tax deductions to Tax Office
10. Hesitation to lodge GST returns due to funds being required elsewhere in business
11. Correspondence received from Tax Office about outstanding GST lodgements or overdue payments
12. Needing to sell capital assets to fund ongoing trading
13. Unable to place orders for stock due to cash constraints
14. Staff morale down due to perception of cash-flow difficulties
15. Higher than normal staff turnover as a result of above
16. Bank requiring more information or security in order to maintain credit facility
17. Putting off costs of maintenance on equipment which could cause an interruption to the running of your business
18. Your bank has suggested refinancing
19. You fall behind with Superannuation obligations for employees
20. You slip behind with insurances e.g., workers compensation, product and public liability
21. Accountants express concern over financial accounts prepared

Different approaches can be used to solve these problems so talk to us if you have concerns.

Make your Business a Lean Mean Fighting Machine!

Customers

Watch out for credit-worthiness of customers. If you are a service-based business, try to get up front deposits and progress payments. If you are a product-based business, check previous payment history of your big customers and negotiate better payment terms from them.

Stock

Closely monitor stock requirements. Check sales figures for trends and allow for some decline in sales compared to previous periods. Don't get sucked into buying stock because of discounts unless you are absolutely certain you can turn stock over quickly. Think of stock or work-in-progress as cash piled up on the shelves! Work closely with good customers to predict their short, and long, term requirements.

Accounts Receivables

- Put someone in charge of Accounts Receivables and give them a system to work with. Give them targets to meet.
- Get regular reports from and meet weekly with the person who is doing your collections.
- Ensure your customers know what your 'Terms-of-business' are and that they are clearly stated on your invoices and statements.
- Provide as many ways as possible for customers to pay you.
- Make speedy follow up calls and offer arrangements to pay off larger sums if they can't be paid in whole immediately.
- Don't hesitate to call in a debt collector.
- Let your customers know you're serious about payment from day one.

Accounts Payables

Get the maximum terms possible from suppliers and know what business you're doing with suppliers monthly to get better terms. Be prepared to shop around for alternatives.

Costs and Overheads

A small reduction in costs can have as much impact on the bottom line as a big increase in sales and may be easier to achieve. Shop around and look for more effective ways to achieve the results.

Don't just 'slash and burn' when it comes to cost reduction. Get a copy of your last Profit & Loss Report and take the time to go through each line of the P&L asking what can be cut and what can't.

- Assess if you could manage with one less staff member
- Cut phone costs, rent and a lot of little things
- Look closely at all your overheads and ask yourself 'How does this cost contribute to the profit?
- Don't cut the wrong overheads e.g., marketing and good staff

Talk to us for advice about how we can help you improve your profits.

Conclusion

We trust you have found this guide informative and useful.

If you would like to contact us to discuss this information or find out how we can help you feel empowered around your finances, send an email to admin@tradiesbusinessadvisory.com.au

This Guide has been produced to assist the small business owner understand the basic financial reports as produced by typical small business accounting software and is subject to the copyright and disclaimers outlined above.