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Understanding Financial Statements South Island Dairy Event

Presented by: Frazer Weir
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 PdsolHiggs 2011

Introduction

- Why do we prepare Financial Statements?
- Different forms of Financial Statements.
- Key aspects to Financial Statements.
- Accountant vs Bank Profit.

Why do we prepare Financial Statements?

- Legislative Requirements (Companies 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.

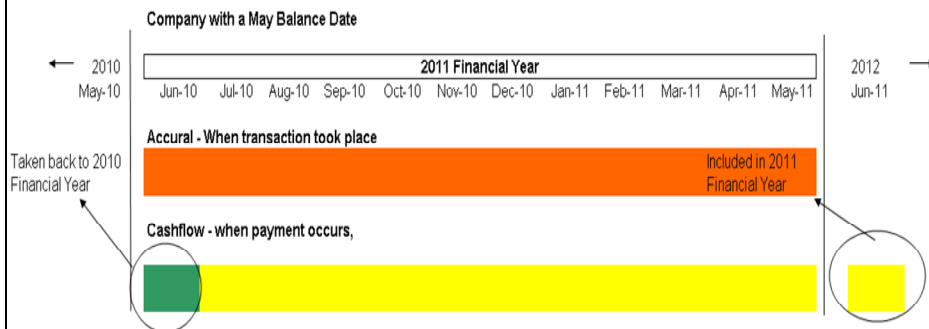
CASHFLOW	
Cash Income	
Cash Farm Working Expenses	
TRADING SURPLUS	
Bank Loan Payments (Often include Interest and Principal)	
Rent	
NET CASH SURPLUS	
Terminal and Provisional Tax Payments	
Capital Expenditure	
Borrowing or Loan Repayments	
Drawings	
GST	
CHANGE IN BANK BALANCE	

Cash Basis / Cashflow

Understanding Financial Statements


- ## Accrual Basis
- Transaction is recorded when it occurs, not when item is paid for.
 - Most NZ financial Statements prepared on accrual basis.
 - More complicated to produce.
 - Produces more accurate picture if understood.
- Understanding Financial Statements**


Accrual Basis



Statement of Financial Performance

- Records Business Income and Expenses over a specific period adjusted for the following:

Adjustments included in Statement of Financial Performance

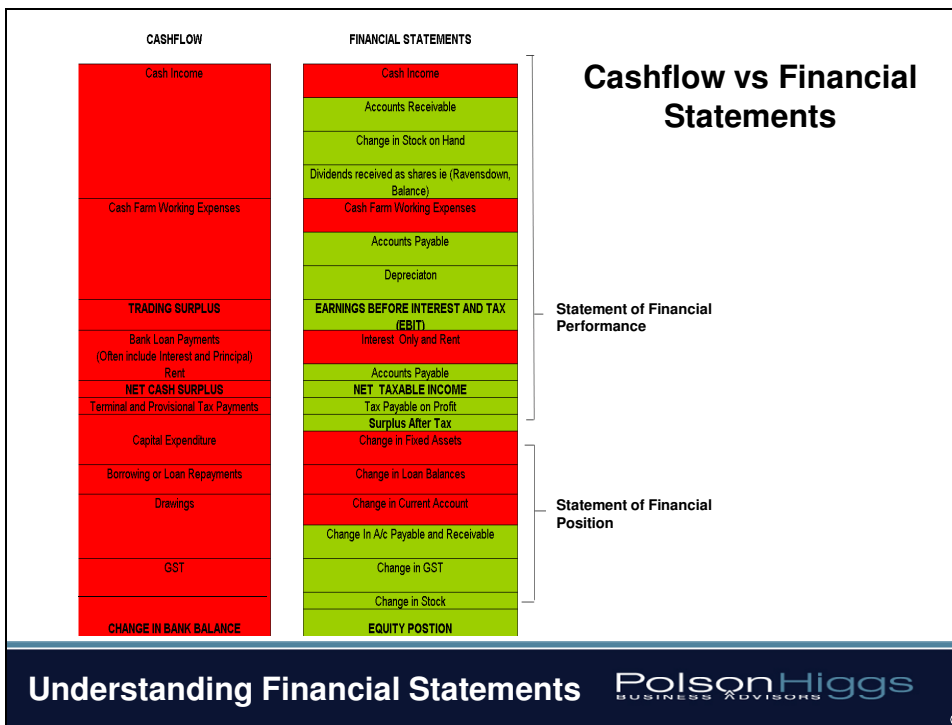
- Accounts Receivable
 - To reflect true results for period.
- Changes in Stock
 - Livestock
 - Feed on hand for sale.
 - Retaining stock decreases cash income, but increases wealth and future income generating capacity.

Adjustments to Cash Results

- Depreciation
 - Assets still go down in value and become obsolete regardless of how much you spend on repairs and maintenance.
- Net Surplus
 - True reflection of sustainable business profit.
 - Does not include all expenditure (capital, drawings etc).
 - Can generate good surplus but still have large cash loss.
- When assessing performance review both cashflow and Statement of Financial Performance.

Statement of Financial Position

- Snap Shot of the Assets and Liabilities at a specific date.
- In Management Accounts
 - Fair Market Values
 - Cost of Valuations an issue
- Financial Statements for Tax.
 - Often assets recorded at Cost
 - Simple and clear
 - Results in distorted equity.
- Some accountants prepare accounts that report tax and management
 - Good information
 - Complex
 - Can be difficult to understand.



Current Accounts

Asset or Liability of the business.

- Records transactions between the owners and the business i.e. drawings.
- Not well understood.
- Cash Drawings from a business do not reflect business performance.

Management Accounts

- Prepared by business on an accrual basis.
- Often compare actuals to budget.
- Focuses on financial performance from managements perspective.
- Key adjustments based on management economic assessment.
- Prepared by large corporate groups with independent shareholders.

Taxation Accounts

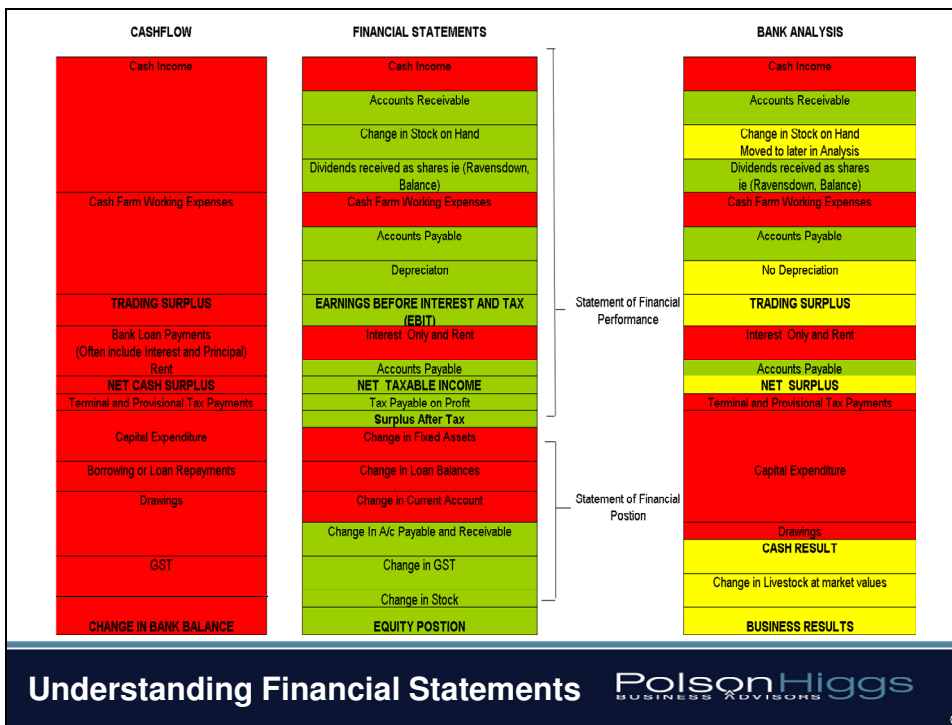
- Most common form in NZ.
- Key focus is preparation for tax.
- Adjustments are based on tax rules.
- Examples :
 - New Fencing can be expensed, not capitalised.
 - Fertiliser can be deferred to next year.
 - Livestock can be valued at below market values
 - Depreciation does not always reflect economic depreciation.

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
 - EFS per kgMS and per hectare.
 - Interest and Rent as a % of GFI
 - Debt per kgMS

Bank Analysis

- Taken from Financial Statements.
- Hybrid of cashflow / Financial Statements.
- Shows Business Result after all expenditure
 - Including:
 - Capital Expenditure
 - Drawings
 - Tax.
- Banks interested in what is available to pay off debt after all expenditure.
- Some accountants now produce a similar separate report as well.
- Similar to Dairy Base Analysis.



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.

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?