



Beany

ACCOUNTING REIMAGINED

Answering
some of the
most asked
questions
from our
Support Desk

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Finance Tips

Cash Flow vs Profit Explained

What are drawings?

Should I buy or lease assets?

How do I manage my Kiwisaver
if I'm self employed?

Should I use cloud accounting
software?



Understanding the difference between cash flow and profit and why it's important

Cash is King. This is one of those often repeated phrases and many business people run their businesses from a cash flow point of view - how much money is in the bank?

Cash flow are the ins and outs from your bank account - it's not much more complicated than that.

Profit is the amount left over after all business expenses associated from a year (or other period) are deducted from all business income for that same period. There are lots of payments that are not business expenses from a profit point of view such as:

- Debt repayment
- Tax payments
- Buying fixed assets
- Drawings (see section below for what this means)

Then there are timing differences such as:

- Debtors paying late
- You paying creditors late

You pay tax on the profit your business generates, not on your cash flow. We hear this a lot:

"I've got no money in my bank account - how can I have a tax bill? Where has the money gone?"

Often the answer is some, or all, of the following types of situations:

- You've paid down your business loan.
- You've taken drawings of \$80,000.
- You bought a new company vehicle.

Profit is of critical importance for the medium and long term of your business and you must pay attention to your profit.

But cash flow can kill you in the short term. Even if you have a profitable business, most business people will face a cash flow bump at some point in their career. This could be created by something simple like a combination of events:

- Quieter trading months due to the winter
- You bought a new vehicle
- And suddenly a customer who has always paid on time doesn't!



So how do you do your best to foresee these bumps and then manage them if they occur?

[Prepare a cash flow forecast](#) and input it to your accounting software (See our tip on Xero below). Take the time each month to see how you're progressing to your financial plan. This should enable you to avoid any obvious dangers.

But if you get caught out by a set of random circumstances (it will happen at some point), what should you do?

We have prepared a full eBook on raising cash but here's a quick summary of that:

Prepare a revised cash flow and find out how much you need

- Add 20% for unexpected events
- Consider your potential funding partners - bank, business partner, family and friends, other lender
- Consider the interest rate you will have to pay/equity you may have to sell
- Approach your most preferred funding partner (lowest rate)

In the event of not being able to find a funding partner, it's time to make the hard calls. We would strongly recommend you take the advice of a professional at this point. We're here to help at any point during this process on support@beany.com.

My accountant keeps talking about drawings! What does this mean and how is it different from the amount I pay tax on?

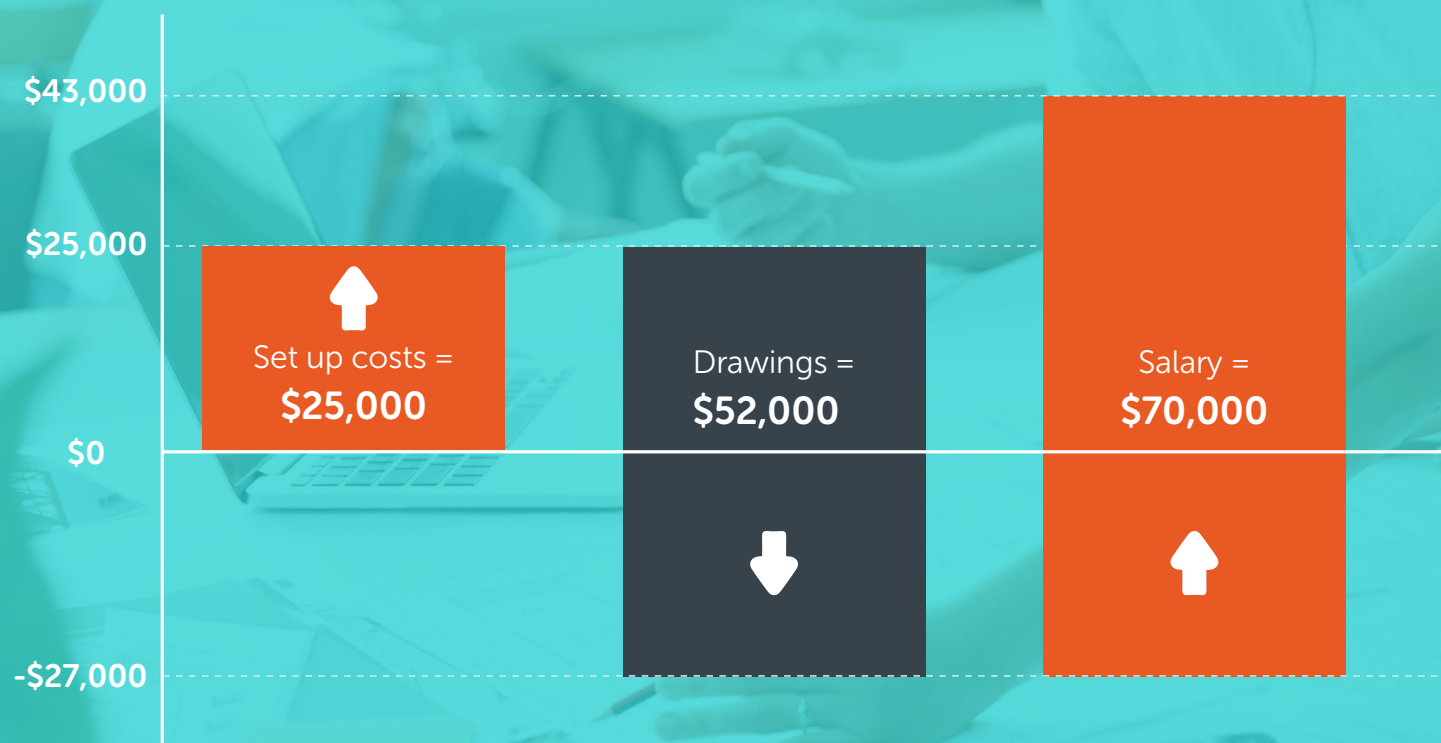
Many small businesses in NZ are owned and operated by a single owner, or a couple. The business bank account can feel like your own bank account and you freely take money from it and put money in, as required.

However, if you are running a company, this is a separate legal entity and if you take money from your company, it is like taking out a loan from someone else.

Drawings represent the money that you take out of your company. You can take as much or as little as you want and it is recorded in a loan balance between you and the company called the shareholder current account.

In practice it works like this:

- You spend \$25,000 to set the company up which includes a vehicle you brought in, some money for other equipment and some stock.
- The company owes you \$25,000.
- During the year, you withdraw \$1,000 per week to live on.
- At the year end, you owe the company \$52,000 less \$25,000 = \$27,000. You've worked 40 hours a week during the year so the company pays you a salary of \$70,000.
- Now the company owes you \$70,000 less \$27,000 = \$43,000.



Drawings go through the current account which measures the debt between you and the company.

Profit, as outlined above, is the amount of money the company makes in its business - which can be completely unrelated to the amount of money you choose to take out as drawings!

You pay tax on profit. You live on your drawings.

Some people consistently draw more money out of their business than their annual salary and they create an overdrawn current account. If this goes on year after year, it can create a problem for the business as this will be stripped of all cash and assets and will become insolvent. So if your accountant tells you you have an overdrawn current account, this matters and you should get it back into credit, if you can.



Making the most of your Kiwisaver

There are two key things to say about Kiwisaver if you're in business:

1. Set up a regular payment into your Kiwisaver account of at least \$87 per month! The government will chip in with an additional \$521 per year if you save a minimum of \$1,043 per annum. However, if you're aged 40 now, you may want to start saving at a higher rate. As an example, if you put away \$100 per week, you will have \$184,186 on retirement, or \$169 per week until death.
2. Depending where you are in life, consider what kind of fund you want to invest in - most default plans are conservative which, the NZ Herald has just reported, costs investors a lot of money! If you're young, invest in a high risk fund because you will have time to ride out any temporary ups and downs. If you're older, consider a balanced fund.

But read this in more detail on [our blog](#).



Can't decide whether to buy or lease a business asset? Here's some things to think about

In our blog, we look at the myths and misconceptions behind the [decision to lease or buy assets](#). Sales people will tend to push what suits their point of view and it can be confusing to see what the best option is for you.

To cut through some of the key decision points, think about the following:

1. Will this new asset increase my turnover or decrease my costs? If the answer is No, then you may want to re-think whether you need this asset.
2. Have I got the money to buy it outright? If you do, this will be the cheapest option (probably) and if the answer to the above question was No, you might want to just buy it anyway! Hey, you've made some money, why not spend it on something you want.
3. I need this asset in my business but I don't have the cash to buy it outright, what should I do?

You can choose to buy it on hire purchase or with a bank loan

You can choose to lease it

Hire purchase is effectively a loan to buy the asset so work out what your total repayments will be - that's the cost of the asset. The cost of borrowing can dramatically affect the total cost of the asset so work it out before you sign on the dotted line.

If you lease, you can choose to pay over, say, 36 months and at the end of the lease, you give the asset back.

There is no easy answer to the best option, you have to do the maths. Also don't believe the sales person if they say, this is better for tax. It's usually about the same with either option!

Get our help with the maths by contacting us at support@beany.com.



Should I use Xero?

You don't have to use Xero, but we would strongly recommend some cloud based accounting software. Excel spreadsheets do not provide the right information for you to manage your business or for us to prepare your accounts.

We've prepared a [checklist](#) to help you decide what would work best for you. Think about what is important to you to know in running your business:

- How much money you're owed?
- How much money you're making?
- How can I make sure that I'm paying the right tax?
- How am I doing compared to last year, or my budget?

This helps you think through your decision around the right kind of business information.

We love to help people set themselves up with the right software and make sure that the reports are giving you the information that you need so contact us at support@beany.com.

Check list for having your finances sorted



Prepare a cash flow forecast



Set up Kiwi Saver automatic payment



Sign up for Xero and connect to your bank accounts



Understand the difference between drawings and profit



Calculate the total cost of a new asset



Get busy living the dream!

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