



smith mccoy alford

chartered accountants and business advisors

CHARTERED
ACCOUNTANTS

Building better business.

Welcome to our final newsletter of 2010.

A few years ago we started giving donations to local charities in lieu of Christmas gifts to our clients. With the challenging economic environment and the ongoing impact of the September earthquake we are even more conscious of the hardship that many families have been going through and have this year donated to the following charities:

- Christchurch City Mission
- The Battered Women's Trust
- Odyssey House Trust

In this update we include some important information about the impending changes to the Loss Attributing Qualifying Company (LAQC) rules, provide some tips for analysing the profitability of your products and services and look at some emerging trends for small medium enterprises (SME's).

Please note that our offices are closed from 2pm on Wednesday 22 December 2010 and will re-open on Wednesday 12th January 2011.

We would also like to take this opportunity to thank you for your ongoing support and wish you and your family a safe and enjoyable holiday season.

Craig McCoy - Director



We offer:

- Fixed price annual accounts
- Monthly payment options
- Agreed deadlines for delivery of accounts
- Free initial consultation
- Business advisory services

Important dates 2010:

- October / November 2010 GST due for payment on 15 January 2011
- Second Provisional Tax payment due for March balance date on 15 January 2011
- Terminal tax due date for those with no extension of time 7 February 2011
- Fringe benefit tax due date for the quarter ended 31 December 2011 – 20 January 2011

Is It Time to "Look Through" Your LAQC?

Last Friday, the legislation outlining the changes to the Qualifying Company ("QC") and Loss Attributing Qualifying Company ("LAQC") regimes passed through its final stages in Parliament, and is expected to receive Royal assent to become law this week.

The legislation proposes the creation of a new "Look Through Company" ("LTC") which will be treated as a limited liability company for legal purposes but will be taxed as a flow-through entity for income tax purposes, with each shareholder ("owner") deemed to own a proportion of the underlying assets and liabilities of the LTC. The draft legislation also proposes to keep the existing QC regime at present, but will end the attribution of losses from an LAQC to its shareholders. These changes are to address the perceived advantage that taxpayers can offset LAQC losses against their personal income at tax rates historically as high as 39%, while sheltering profit at the current company tax rate of 30%.

Look Through Companies

A LTC has many features in common with an existing QC and LAQC but also includes some significant differences such as a loss limitation rule for losses attributed to owners. Losses flowing to an owner from a LTC are limited to the owner's economic interest in the LTC for a particular tax year. An owner's economic interest is specifically defined in the legislation and includes current account advances and personal guarantees.

Owners who sell their shares in a LTC will be deemed to sell their respective interest in the underlying assets and liabilities of the LTC, which may give rise to tax consequences such as depreciation recovery income or trading stock profits.

Transitional Provisions

The above changes to QCs and LAQCs, along with the introduction of LTCs will take effect from 1 April 2011 for most companies.

Existing QCs and LAQCs can elect to transition to a LTC, Limited Partnership, Ordinary Partnership or sole trader structure in most cases without any tax consequences, but subject to a number of criteria. Alternately, they can simply elect out of the QC and LAQC regime altogether and become a standard company.

The timeframe for notifying Inland Revenue of the election in order for the transition to take effect in the 2012 income year (the "transitional year") expires six months after the start of a QCs or LAQCs 2012 income year. For most QCs and LAQCs with an income year starting on 1 April 2011, this will be 30 September 2011.

For a QC or LAQC transitioning into a new business structure, such as a Limited Partnership, this must be operational and completed by the end of the transitional year, which would be 31 March 2012 for most companies with a standard balance date.

If you own a LAQC and have any immediate concerns please feel free to contact our tax consultant, Bevan Ralfe to discuss.

Analysing The Profitability of Your Products and Services

Knowing the profitability of individual products and services can help you make decisions to improve your bottom line. You may want to discontinue products and services that aren't as profitable, while promoting ones that improve your overall results.

One basic method of looking at profitability is called cost-volume-profit analysis (CVP). It makes basic assumptions, and should be used in conjunction with other information when making business decisions.

At its core CVP relies on the separation of fixed and variable costs to determine the breakeven point of a product (or service) and how much it contributes to profit after reaching this point.

Fixed costs are those that stay the same regardless of the amount of products produced or services delivered. These are often called overheads. Variable costs vary as the volume produced changes. In a manufacturing setting, each additional unit produced will add to the variable cost. In a service business, each additional customer served adds to the variable cost. For purposes of simplicity, we'll focus on products in this article.

CVP analysis assumes that the sales price, variable cost per unit produced, total fixed cost and the sales mix are constant for a product or service. While, in reality, these amounts can vary with changes in the amount produced. CVP also assumes that the number of units sold is equal to the number of units produced.

Under these assumptions, **total cost = total fixed cost + total variable cost.**

Where **total variable cost = variable cost per unit x the total number of units produced.**

Let's look at a hypothetical example.

If a company sells one product and has:

- \$100,000 fixed costs per year
- a unit variable cost of \$500
- a unit selling price of \$1200
- total costs = \$100,000 + \$500x, where x equals the volume of products produced

The number of units required to breakeven is calculated as:
 $\$100,000 - (\$1200 - \$500)y = 0$, where y is the breakeven volume.

So breakeven volume = $\$100,000 \div \$700 = 143$ units.

The difference between the sales price and the variable cost is called the **contribution margin**. This is how much each unit of product contributes to fixed costs, and eventually to profit after fixed costs have been covered. On a larger scale, the contribution margin for a company equals the total sales minus variable costs.

Looking at our example again, we can use CVP to calculate the total number of units required to reach a profit target.

Let's say we want to earn \$200,000 profit from the product we are producing. We can calculate how many units we need to produce to in order to reach this target.

(Profit Goal + Fixed Cost) ÷ Contribution Margin = number of units required

$(\$200,000 + \$100,000) \div \$700 = 429$ units

We can also use CVP to compare several products once we know the difference between the selling price and our variable cost to produce each product.

Let's say we are thinking of replacing the product in the previous example with a new one. This new product has a selling price of \$1,000 and a unit variable cost of \$500. So its contribution margin is \$500. If we want to breakeven with this product, we'll need to produce 200 units ($\$100,000 \div \500). If we want to reach our profit goal of \$200,000, we'll need to produce 600 units ($\$300,000 \div \500).

So, all other things being equal, we wouldn't want to switch to the new product with its lower contribution margin.

When using CVP analysis, it's important to realise that it makes several simplifying assumptions. You also need to look at qualitative factors before making decisions. For example, a product with a lower contribution margin might be more popular, resulting in a higher sales volume.

Some products will have lower contribution margins and can be viewed as 'loss leaders' that enable sales of more profitable products. Manufacturers of laser printers, for example, earn very little profit from their printers but earn substantial profit from the sale of their printer cartridges.

CVP analysis can be a good starting point when looking at the profitability of individual products and services, but it's also important to consider qualitative factors when making decisions.

If you have any further questions about Cost Volume Profit analysis please contact our in-house expert **Shane Welsh**.



Emerging Trends For Small Medium Enterprises (SMEs)

The great news for business is that emerging technologies are making possible a return to earlier times when business owners and their customers knew each other and had personal relationships that extended beyond the tight boundaries of buying and selling goods and services.

Personalisation

The public face of a business has moved from the corporate to the personal. These days the word on the street is that people like dealing with people. They want to know specific names and faces. They want their business dealings to be with other humans. The upside is that they might be more loyal because they like and trust you. The downside is that they might not buy a perfectly good product because they had a bad experience with you.

Taking this on board, and acting on it, might seem counterintuitive to those who are trying to avoid tying their business too closely to their personal brand. Will it become harder to remove yourself from the business when you want to sell it? Well, no; you still need to make it a priority for your business to have the systems and processes in place to run without relying solely on you. Blame automated phone answering services, with robotic voices offering so-called "customer service", but there's no getting away from the fact that it's become essential to personalise your business. This means that when you are picking the name you are going to use on Twitter or other social media, in most cases, you should consider using your real name. Similarly, don't upload your logo, show your real face. If you are the person with the vision behind your business, be proud of it and use yourself to promote it.

Social media

Do you believe that customers in your industry aren't really into social media? Statistics indicate that even if they're not now, it's only a matter of time. Remember we just mentioned that people want to deal with the people in the business, NOT the business. Social media is a clear offshoot from that trend. Social media is about building communities and relationships. In the business world, that translates to making connections with customers and prospects. It's marketing 101 upgraded by a new style of technological support.

If your competitors and your customers aren't there yet, grab a golden opportunity to get ahead of the curve and start finding your feet in the social media sphere using Twitter, Facebook and LinkedIn. Grab a spot before your competitors do and be ready to greet customers and prospects when they arrive.

Video marketing – pictures tell a thousand stories

YouTube is the second biggest search engine after Google these days; people are searching for what they want online and the great news for business owners is that YouTube allows you to upload your videos for free!

YouTube visitors don't expect to watch an Oscar winning movie; in fact they're well trained to viewing all sorts of home grown efforts. Any business person can purchase a decent video camera at an affordable price and start shooting testimonials, behind the scenes at work, interesting tidbits and information about their product or industry, and visual demonstrations of just how their products work.

It's an enormously powerful way to connect to your prospects in a very personal way. 80% of page visitors will view a video and 52% will act as a result of watching it - these are statistics you shouldn't be ignoring when planning your marketing mix.

"Utility computing"

The average small business doesn't have an entire IT staff or the budget needed to fiddle about building a code-heavy proprietary network - open the door to "Utility computing".

Utility computing allows you to ditch a number of IT related expenses such as backup systems and servers and reduce support costs. You aren't tied to your office for access to emails or files. It can all be done, even storing your data, by using applications that are stored and delivered via the internet. It's called cloud computing, and as long as you can access the internet, you can view your data, collect emails and run your business - from wherever you are.

If you're a newbie, try sampling Google Apps. The free version - which is more than adequate for a small organisation - allows you to host your email on Google's servers, store documents, and even create intranet sites and share calendars. Aside from Google, there are many other service providers, offering everything from hosting your customer relationship management system (such as Infusionsoft.com or Businesscatalyst.com) to your accounting records (xero.co.nz or sassu.com).

Are you headed in the right direction?

We can assist you with the following key performance areas of your business:

- Vision
- Strategy
- Structure
- Products and services
- Marketing and sales
- People
- Culture
- Systems and processes
- Finance

Call us today on 03 3661058 to arrange a time to discuss how our business advisory services can help you drive your business in the right direction.

Building better business.



Directors (left to right), Kate Alford, Shane Welsh, Craig McCoy, Associate Bevan Ralfe