BusinessPlus+ Newsletter

CMA Collins Mellody

INDEX

Issue 218 - November 2022

Virtual Chief Financial Officer Service

A “virtual Chief Financial Officer Service” (vCFO) service is where an accountancy firm supplies a total in-house Accounting/Chief Financial Officer service on a virtual basis by the utilisation of technology and communications.

The “vCFO” service is normally provided on the basis that we would be involved in many aspects of the financial affairs pertaining to a business on a 52 weeks of the year basis.

To deliver this type of service accountants need to have a more in-depth knowledge of a client’s business than what we normally have when preparing annual accounts and income tax returns. This requires us to conduct a review of how a business operates just as we would if we were employed as the full-time accountant within the firm – we would be expected to know additional information to what we know about a client when only preparing the annual accounts and income tax return. This process is known as the “business of business” review.

The member of our team who has been designated as the “vCFO” for the client would then meet with the client and leadership team to gain a clear understanding of the vision for the business preferably for the next five years. This would incorporate matters such as expansion, succession, development of new intellectual property by undertaking research and development, commencing export operations, building a new factory, office, warehouse etc., scaling up the business.

The next step is to either update the Business Plan or to prepare a Business Plan for the business that incorporates the matters discussed in the vision review and outlines a strategy for the business to implement over the next five years and longer if the client requires.

We are then in a position to undertake the “Financial Forecasting” work which is the most important component of the “vCFO” service. This comprises the preparation of:

- Budgets for each business unit within the organisation;
- Cash Flow Forecasts based on the information contained within the Budgets;
- Projected Balance Sheets based on the information contained within the Budgets and Cash Flow Forecasts.

The Projected Balance Sheet enables the client to have a snapshot of what the results will be of the current business operations and the decisions that are being made such as borrowing money to undertake the research and development project or to expand the business or to commence export operations – what will the business look like in five years’ time?

It is normal to prepare a valuation of the business annually so that the client can identify the financial impact of implementing this new type of process to an SME and what influence it may have on the multiplier that is used in the valuation process. In this way you can see if there has been an appreciation in the value of the business from one year to the next.

The “Financial Forecasting” documentation has set the targets for the business. The next part of the process is the ongoing work that will then be linked to the Financial Forecasts. This work involves:

- Weekly performance review for each business unit comprising:
  - Profit And Loss Account
  - Key Performance Indicators
  - Comparison to the budget
  - Weekly Performance Reports are utilised by many businesses large and small to enable management of those individual business units to receive prompt information each week about the performance of a business unit and to compare that performance to what was anticipated within the budgets.

- Monthly financial accounts for each business unit:
  - Profit and Loss Account
  - Balance Sheet
  - Key Performance Indicators
  - Comparison to the Budget

The monthly “Financial Performance Report” gives an overall report which can be reviewed by the Leadership Team to determine whether changes need to be made to a particular unit’s operations.

A report would be prepared on the cash flow position as compared to the Budget and an analysis of items such as:

- Debtors – who are the problem debtors? Debtors’ Days Outstanding – how does this compare to the Budget?
- Stock – what is the investment in stock? How does this level of investment compare to the Budget? What is the stock turn rate how does this compare to the Budget?
- Work In Progress – are progress claim invoices being raised?
- Bank/Cash Flow Forecast position – how does the current balance compare to the Budget? Is there a need for special meeting with the bank? Is there a funding shortfall emerging?

This whole process assists SMEs to be able to react to changes in market conditions and to anticipate cash management problems. Cash management problems are the most significant issues that confront SMEs and this type of financial management system ensures that these issues are identified and can be managed on a far better basis then when they “just occur” which normally causes significant problems to the SME.

Are you interested in having further discussions on a no obligation basis with us relative to a vCFO service as to how it might relate to your business? If so, could you please contact the accountant in our organisation that you normally deal with?

Does Your Charge Out Rates Need Reviewing?

If you are operating a trade or manufacturing business you will know that your business income is based on a number of variables. A variation in one of the components can mean that the income that you thought you were going to generate will not occur.

The variable items are:

- **Labour on costs**
  This relates to a range of matters including training time, apprenticeship training, holidays granted to individual team members – if you make any changes to any of these items it is necessary to adjust the calculation of the charge out rates to reflect those changes.

- **Wages/Salaries**
  Obviously, if there are any changes made to the wages/salary package for a team member there will need to be a new calculation made on the charge out rate for that person.

- **Productivity Percentage**
  This item is one that there can be variables that in some cases vary from day to day or week to week. When a charge out rate budget is set an assumption is made on a team member’s productivity for a year. If you find after a couple of months that the productivity rate has varied and it is likely to continue to vary because of a reallocation of the work responsibilities for that team member then it is

time for the team member's charge out rate to be recalculated based on the new expected productivity percentage to be achieved.

- **Business Overhead Expenses**
  This relates to all overhead expenses of the business excluding the items included within labour on costs and the direct wages/salaries of team members. It is beneficial if there is a review on a monthly basis to see whether there has been any significant changes in any of the overhead expenses – we know that costs are increasing significantly at present especially costs relating to electricity and gas and these will need to be closely monitored and could mean that you need to adjust the overhead expenses that have been utilised in the determination of charge out rates a few times during the year to reset charge out rates. Obviously, if you decide that you cannot increase your charge out rates this will mean that your business will earn less profitability than the target that was set in the original calculation.

- **External Purchases for Clients**
  Most tradie businesses purchase goods and services for clients. The calculation of charge out rates requires an estimate of the total of those external purchases for a year so that a calculation of the mark-up on those purchases can be made. Obviously, if after a few months you notice that there is a significant variance in the amount of those purchases it would be desirable to revisit the charge out rate calculation.

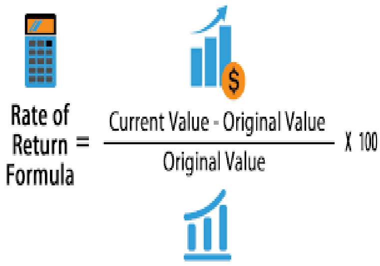
- **Mark-up On External Purchases**
  It is normal business practice that businesses mark-up the cost of external purchases for a client to reimburse the business for the time spent in purchasing the external purchase products and being responsible for the payment of those purchases to the suppliers. Is the mark-up percentage that was used in the original calculations for the current financial year still appropriate? In some instances, the mark-up percentage gets changed for commercial reasons. If this is going to be a permanent change because of market conditions than the calculation of the charge out rates should be revisited.

  Another question is, will the mark-up on external purchases amount be utilised as a contributor to the charge out rate calculation or is it to be treated as a separate profit item that the business hopes to retain as business income?

- **Rate of Return Target**
  Is the rate of return or desired profit that was utilised in the original calculation of the charge out rate for the current year still appropriate or should a change be made?

  Is the value of the investment in the business the same as what was utilised in the original charge out rate calculation?

  If you do not want to calculate a rate of return on the amount invested in the business you can utilise the amount of profit that you would like to earn from the business as the rate of return amount in the calculation of the charge out rates.



- **Overall Result**
  This methodology of setting charge out rates sets the individual team member's charge out rate which is based on the calculation of net chargeable hours for the team member. A report summary can be prepared showing:

  Sales:
  Materials purchased for clients
  Labour charged to clients
  Total Sales

  Less: Cost of Sales
  Cost of materials purchased for clients
  Labour and labour on costs
  Total Cost of Sales

  Gross Profit
  Gross profit percentage
  less
  Overhead Expenses

Forecast Net Profit
The Forecast Net Profit should be the same as the calculated Rate of Return

If you would like to have a discussion with us relative to the review of the charge out rates that you are utilising, please do not hesitate to contact the accountant in our organisation who you normally deal with.

Directors ID Deadline

Company Directors have until **30 November 2022** to register with the Australian Business Registry Services – Telephone 136 250.

Directors need to apply in person.

Click here to register.

If you have any questions relative to this registration requirement, please contact us but please note you need to apply in person.

Research and Development – Systematic Progression of Work

In previous editions of Business Plus we have discussed the start of a research and development project. We will now move into the segment known as the "systematic progression of work". This is the phraseology utilised by AusIndustry and the Australian Taxation Office and companies are required to keep their records in a systematic basis.

- It is a good idea to allocate a project code for each component of the research and development project so that you can readily identify components.

- The names and contact details of any researchers, technical assistants should be documented.

- You need to clearly identify the hypothesis or hypotheses that you have developed for your research – this is a fundamental requirement if you wish to claim the research and development tax offset.

  Hypothesis is defined as:
  - An "hypothesis" relates to a particular matter;
  - Experimental activities (whose outcomes can only be determined by a progression of work);
  - That proceeds from hypothesis to experiment, observation and evaluation and leads to ultimate conclusions, and
  - The systematic progression of work is conducted for the purpose of generating new knowledge.

- You need to maintain records of the experiments conducted including details of the date that the experiment was conducted, who conducted the experiment, what was the result – it does not matter if the experiment did not prove the hypothesis the key thing is to document that you did in fact undertake the experiments if you are claiming that expenditure as part of the research and development tax offset claim.

If you are interested in finding out more details about undertaking a research and development project please contact the accountant in our organisation that you normally deal with.

Contact us:
CMA Collins Mellody
P: 03 9836 1533
E: admin@colmel.com.au
W: http://www.cmagroup.com.au
Ground Floor 1 Chapel Street, Blackburn, VIC, 3130