

# THE FINANCIAL STATEMENT

A NEWSLETTER ON ECONOMIC, ACCOUNTING, INVESTMENT, TAXATION AND BUSINESS NEWS

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Where Wealth Creation Happens

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30th YEAR OF PUBLICATION

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Christmas 2010



## 2010/2011 YEARS

by Paul St. Clair, F.C.A., Dip. Fin. Services

The Australian economy bounds ahead over the 2010 year. This should continue right through 2011 thanks to China and the rest of Asia which keep on buying our minerals, oil and gas. Subject to surprises, 2011, particularly the second half, should be very strong.

The emphasis in managing the Australian economy is on controlling the strength of the Australian economy. From a monetary policy perspective interest rates are the main tool. Accordingly, we have seen the cash rate increase from 3.75 percent to 4.75 percent.

Unemployment has decreased from 5.7 percent to 5.2 percent and should decrease further.

The effect of a strong economy, record mineral prices and high interest rates sets the scene for a strong Australian dollar. Thus the exchange rate has risen significantly in 2010. With the likelihood of further rises in the cash rate later in 2011, further exchange rate rises can be expected. This

situation is putting some strain on Australia's manufacturing industry.

On the flip side the high exchange rate will assist in containing pressure on inflation over the year ahead. Since the Global Financial Crisis (GFC) wage restraint has been the order. With nearly full employment and projects worth over \$A120 billion in the pipe-line, wage constraint may be difficult to contain. Record prices for Australian iron ore are another pressure.

Glenn Stevens, the Governor of the Reserve Bank of Australia recently put it very clearly: in 2005 a shipload of iron ore was worth about the same as 2,200 flat screen television sets. Five years later, and after the GFC, it is worth about 22,000 flat screen television sets. Whilst this is all positive, the economy in Australia can be described as patchy. Higher interest rates means higher mortgage payments. Electricity costs, water bills and rents are up with a recent spike in oil price to almost \$A90 a barrel, the highest level since the GFC.



## Seasons Greetings



From all the team at **St. Clair partners** and **John Stewart, Miller Partners**, we extend to you and your families our best wishes for a joyous festive season and a safe, peaceful and prosperous New Year.

*We look forward to being of service to you in 2011 and the years ahead. Thank you for your business, loyalty and referrals, which are appreciated.*

Our office will be closed on the public holidays only. Should you wish to call us on those days phone 0418 640 305

Some individuals will find it hard, but on the positive side, interest rates may stay on hold during the early part of 2011 and unemployment is low. Whilst mining and associated industries are booming, agricultural production boosted economic growth by 0.4 per cent in the September 2010 quarter. Since then massive floods have hit the eastern states causing considerable damage particularly to grain crops.

Construction and service industries are picking up from the low GFC levels. Manufacturing and retail are finding it tough as a result of a high Aussie dollar. In the case of retail there has been a big jump in online overseas sales affecting retail outlets. This is an area of the economy which bears watching.

The Reserve Bank of Australia's most recent forecasts for the current year expect growth of 3.5 per cent and 3.75 per cent for the 2012 year. By comparison the Reserve Bank of Australia expects the world economy to grow by around 4.5 per cent this year and 4 per cent in 2011. This assessment is based on strong growth in developing economies.

In the US and Europe a fragile recovery is underway building on stimulus, rebuilding inventories and global trade. Corporate profits are recovering whilst unemployment remains stubbornly high. Interest rates on both sides of the Atlantic are as low as they can go and have been for over 18 months. Borrowers are more inclined to reduce debt and banks are cautious about lending. Governments of most advanced economies are carrying very high levels of debt.

The surprise in 2010 year was that certain countries in Europe, particularly Greece and Ireland had a serious sovereign debt problem; a follow on from the Global Financial Crisis (GFC). As I write it would seem that the EU is working on and taking care of this serious issue. The rumours have it that other countries in Europe may fall foul to a sovereign debt crisis. The EU together with other world financial bodies like the International Monetary Fund (IMF), the World Bank are involved. The strength of Germany, France and Great Britain within the EU is very positive.

As a result of the sovereign debt crisis, many European governments have tightened fiscal policy, the effects of which will be felt more in 2011 and 2012.

In the early part of 2010 rumour had it that the US would slide into a double-dip recession. This now seems unlikely. The US authorities are working hard at stabilising their economy and with some success as modest growth is continuing in the United States. A major problem for the US authorities is unemployment. Nearly 15 million people, close to 10 percent of the population are unemployed. In Australian terms, this would represent nearly three quarters of the Australian population. So one can see the magnitude of their problem. The nature of the US economy means that when a major down turn occurs, unemployment is one of the last elements in the US economy to improve.

With any renewed wave of defaults and foreclosures in the US housing market, the capacity for fiscal or monetary action appears to be limited. Our opinion is that the US economy is likely to keep improving during 2011. A survey by the University of Michigan undertaken in November 2010 indicates US consumer confidence is rising.

China and Asia are the bright spots in the world economy for 2011. China's economy is in a position of boom and whilst it shows signs of slowing, this is from an unsustainable growth rate of almost 12 percent. The government's strategy of curbing debt funded speculative property investments seems to be working, thus avoiding a hard landing. This action by the Chinese may lessen the demand for commodities, which may affect demand for raw materials from Australia. Our opinion for 2011 is that little or no reduction in demand for our raw materials will eventuate. We believe the resources boom will continue depending on the situation with the Chinese economy.

The overall Australian economy will be patchy in parts and unemployment will get tighter. During 2010, there was no pressure on wages and no consumer spending breakout but rather savings. If this continues inflation is likely to remain on the Reserve Bank target of between 2 to 3 per cent. However, some doubt exists. The cash rate may end 2011 at 5.5 per cent. Under these circumstances the Aussie dollar will be strong and around parity with the US dollar. The Australian Stock exchange will move forward particularly in the second half of 2011.

by Marc Hurwitz, B.Com, (Accounting)

When looking to buy a business most people are worried about overpaying for a business. You can often find this out from the financial records. However what can be harder to spot is when a business has been undervalued and is actually a bargain purchase. This is often due to the current owners/operators not capitalising on existing opportunities. Some ways to help identify an undervalued business are:

1. Find out why the current owners are selling, is it retirement, family moving to another state/country or are there problems with the business that the owner wants to unload? Also talk with anyone familiar with the business as this may reveal unexplored opportunities within the business.
2. Review the financial statements and tax returns for the past 3 to 5 years. This will give a good understanding of the actual sales and profit of the business as well as alert you to any tax debt owing.
3. Dig behind the scenes and get a good understanding of the realities of the business. One way is get the owners permission and shadow them during the day-to-day operations. Also talk to customers about their opinion of the business.
4. Determine how much you are prepared to pay for the business based on your valuation.
5. Examine the industry, is it struggling, growing, consolidating etc, this will help determine the price and future profitability of the business.
6. Be picky when buying a business as this is normally a major investment for you. Do not be afraid to walk away from a deal for whatever reason.

## **GROW YOUR TURNOVER**

by Karen Huynh, Adv. Dip. Acctg.

Business owners naturally want to grow their business turnover. However, their various approaches of how to grow their business turnover arises but are unsure of where to begin.

Here are four ways to help grow your daily takings:

**1. Locate your consumers** Start by assessing all the different ways you have tried to gain customers over the last say: year or so, and find out which isn't working for you. Focus on the areas in which your business is likely to grow and dispose of the ones that aren't performing so greatly.

One of the main questions to ask yourself is for example "Do I follow-up on customers that I have prepared a quote for?" The answer should be a definite YES. Always go 'that extra mile'.

**2. Sell more to current consumers** So, you have worked hard and gained your customers. Now, the important part is to keep that relationship you have built, long term. Keep in regular contact and ask them how you can assist them. Ask questions like: "What are your plans for the coming year?" or "What do you like about the work that we do or

the product we sell?". You may be surprised with the feedback they provide.

**3. Increase your price** No one likes it when you have to pay more. But think about if you could increase your price by say 2 per cent, you could gain \$10,000 extra in turnover depending on the volume of turnover. For example; a company may have increased prices by 10 percent with the offer of incentives and/or money back guarantees and in the end had lost three clients due to the change, however overall had increased in profits. It is a good idea to calculate a whole array of assumptions and see what may be feasible.

**4. Increase your margins** Make your business efficient and effective. Review all costs and see how you can economise. The best idea you could have is asking your suppliers for a better deal as you may have been with them for quite some time. Review your team's performance, find out what you could do better to avoid wasting time, money, and product. Consider providing training where needed etc.

If you have any questions, please call Peter Small at St Clair partners on (02) 9221 4088.



by Marc S Hurwitz, B. Com (Accounting)

According to Amazon.com, customers are currently buying the digital version of the top 10 selling books at twice the rate of the printed versions. The trend also extends to the top 25, 100 and 1000 selling books where digital sales exceed those of the printed versions. With continued high sales figures for the Kindle electronic reader as well as the application for the iPhone and iPad the rate of electronic book sales is looking to increase greatly over the next few years.

The popularity also comes from the fact that buying books electronically is comparatively cheaper than buying printed versions as electronic versions can currently cost between \$1 and \$10 per book as opposed to hardcover printed versions costing up to \$50 a book. The other factor with the electronic media is that multiple books can be stored on one device making it easy for you to carry many books with you particularly if you are travelling overseas.

## KEEP THE WORKPLACE CLEAN – TOP 10 GERM TRAPS

by Nuha Awad, B. Bus, (Accounting)

Germs can easily spread so it is important to know where they are. Here are 10 germ traps:

### 1. Mobile phones

They can harbour more germs than a toilet seat. As they are kept in pockets or bags and they generate heat, their devices can be a prime breeding ground for bugs, which can cause pimples and infections. Therefore we should regularly clean our mobile phone and try to keep it in a cool, dry place.

### 2. Door handles

They can be germ-laden. We need to protect ourselves against dirty door handles particularly those on bathroom doors by cleaning them regularly.

### 3. ATMS

They are touched by thousands of people so they harbour a lot of bacteria. We should clean our hands and carry bacterial wipes.

### 4. Stair railings

Germs are naturally occurring on handrails and if someone who is sick touches one, there is a possibility that we can pick up those germs.

### 5. Office desks

Telephone, office equipment and documents passed between colleagues may all hold thriving colonies of germs. We should use wet tissues to wipe and clean office desks and equipment surfaces regularly.

### 6. Pantries and toilets

Common equipment used in staff pantries and toilets can easily spread germs. We should wash our hands regularly with hand wash.

### 7. Lift buttons and light switches

Many people press lift buttons and light switches everyday. Therefore the buttons are hotbeds for germs which can survive for several hours. Therefore it is important to clean our hands after we touch those buttons.

### 8. Food poisoning

To avoid food poisoning you need to do the following:

- Wash your hands before you eat and after you have gone to the washroom.
- Ensure that the cutlery you use is clean and vegetables and fruits that are eaten uncooked must be thoroughly washed.
- Do not consume food left overnight which has become contaminated.

### 9. Supermarket Trolleys

They are grabbed and gripped by thousands of shoppers every day. They can carry germs for long periods of time. Antibacterial wipes and alcohol gels can ensure that we only bring home our shopping and nothing else.

### 10. Traffic light buttons

These are also touched by many people and can transfer germs easily. We should wash our hand or use a hand gel after we touch them.



## ❑ CHRISTMAS TAXES

Many employers provide Christmas celebrations for staff, but the tax issues associated with Christmas are complex. Generally, benefits provided to staff are subject to Fringe Benefits Tax (FBT), although “minor benefits” (provided infrequently and irregularly, and totalling less than \$300 in a year for each employee) are exempt from FBT.

The cost (food and drink, venue etc) of providing a Christmas party is an income tax deduction only to the extent that it is subject to FBT. The cost of a Christmas party is exempt from FBT if it is provided on a working day on your business premises and consumed by current employees. Christmas gifts to staff may be “minor benefits” and exempt from FBT if the cost of the party and the gift is less than \$300 per employee and the other conditions are met.

Costs that are exempt from FBT (such as exempt minor benefits as mentioned above) cannot be claimed as an income tax deduction. Costs associated with entertaining clients are not subject to FBT and are not income tax deductible.

For employers considering more substantial gifts for their staff, an FBT exemption applies to work tools such as laptop computers and mobile phones. It is necessary for these tools to be provided mainly for work purposes, and ownership must be transferred to the employee. There is a limit of one such benefit per employee per FBT year, and the exemption is not available for associates of the employee. Gifts to clients are not subject to FBT, and would generally be deductible (unless the gift is food or drink for immediate consumption – say, at a party).

## ❑ SMSF BORROWING LAWS

The rules allowing Self-Managed Superannuation Funds (SMSFs) to borrow have been amended. The most important change is that each asset acquired under a gearing arrangement must have an individual loan agreement (a parcel of shares can be a single asset). Repairs to a geared property are allowable, but improvements are not. Refinancing a facility is also permitted, but margin loan type share trading facilities are not allowed. Readers considering borrowing in their SMSF should contact us for advice, as this is a complex area with many traps for the inexperienced.

## ❑ TAX ATTACK ON TRUST LOANS

New rules affecting distributions from discretionary trusts (such as family trusts) will require care to ensure that extra tax liabilities are not incurred. Distributions from such a trust to a company, where the cash is not paid but instead loaned to associates, may be attacked as deeded distributions to the associate. Loan agreements may be necessary to ensure that tax at penalty rates is not applied. If you use a structure where a trust distributes to a company, you should check with us to ensure that you are complying with the new provisions.




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### **Does Capital Gains Tax apply if I transfer my property to a family member for no charge or less than its market value?**

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**Yes**, this transfer is a disposal for CGT purposes. Also, the CGT rules provide that it will be assumed that you have received the full market value of the property if you received less than that value and did not deal with the transferee on an arm’s length basis.

Thus you will be assessed on the full market value of the property. Under the CGT provisions, you may qualify for an exemption, such as the main residence exemption or one of the small business CGT concessions, or be eligible for rollover relief if you acquire a replacement asset.

As well, the family member who received the property will be assumed to have received an amount equal to the property’s market value.

## **THE FAIR WORK ACT**

It is very important for Australia's small business owners to know the new Industrial Relations system which applies from 1st July, 2009.

The new legislation replaces 'WorkChoices' and is known as the 'Fair Work Act'. It is vital for small business employers to understand the impact of these obligations on their business as fines and other penalties may be imposed by the industrial relations regulator, Fair Work Australia, if the rules are not followed carefully.

The current definition of 'small business' in the Fair Work Act is any business that employs fewer than 15 full-time equivalent employees. This includes the contribution of your long term casual and part-time employees, as well as any other employees who may have joined or left the employment in the four week period immediately before the dismissal. An online calculator has been provided on the website below to help you decide if your business is a 'small business'.

The Fair Work for Small Business website, <http://www.cosboa.org.au/Fair-Work-for-Small-Business.aspx> offers educational information to help small business owners understand their compliance obligations under the Fair Work Act. The portal on the website provides a comprehensive overview of the Fair Work Act and many significant changes which the Fair Work Act has made to the national industrial relations system. This

includes downloadable whitepapers, online videos and frequently asked questions.

Many of the rules which were applied under WorkChoices have changed significantly and the portal explains everything that a small business owner needs to know. The specific issues regarding the new industrial relation system as discussed in the portal include:

- ❖ The new national industrial relations regulator, Fair Work Australia, and its companion organisation, the Fair Work Ombudsman
- ❖ How the rules relating to unfair dismissals have changed.
- ❖ The new rules relating to the negotiation of Collective Bargaining
- ❖ The introduction of the Modern Award system and the ten National Employment Standards which commenced on 1st January, 2010
- ❖ How to comply with the 'general protections' set out in the Act, and
- ❖ Your rights and obligations in relation to industrial action and workplace visits by authorised union officials.

by Paul St. Clair, F.C.A., Dip. Fin. Services

**YIELDER strategy.** Consider this strategy when investing in shares. Invest in say 20 of the highest-yielding shares in the ASX 150 that pay the highest dividends each year. After 12 months, say 12½ months sell them all triggering a capital gains event, which if owned by an individual may attract a 50% discount. Three reasons for this strategy: first, you should earn a good dividend on the shares; second, high-yielding shares are usually undervalued by the market, which means the market has had a year to re-assess their value, at which time you are likely to make a profit when you sell, particularly in a market that is likely to move up; third, you are buying shares that are at the top end of the market.

**PROFITS.** Many years ago a wave of public resentment towards BHP's perceived huge profits, was answered by BHP, at the time, that if it sold all its assets and deposited the money with a bank, (like anyone can), BHP would receive more interest than the profits it made. Now it is the banks turn. I quote from journalist Terry McCrann from The Sunday Telegraph (31/10/2010). National Australia Bank (NAB) made \$4 billion. Very big numbers – but it's a very big bank with assets of \$666 billion. NAB made less than one cent on every dollar of assets it owns. Accordingly it would only take less than one percent of loans to go bad to wipe out the profit – food for thought!

**AUSTRALIA has more known** minerals in the ground than any other country. Some further detail – we have

- ❑ the largest coking coal reserves in the world (72 billion tonnes – enough for 180 years at current mining levels).
- ❑ the 10th largest gas reserves on a global basis. If we use CSG and shale gas that moves us to 4th.
- ❑ the 2nd largest iron ore deposits in the world.
- ❑ the largest uranium reserves in the world.
- ❑ the largest thermal coal reserves in the world.
- ❑ the competitive advantage – we're close to the end users.
- ❑ the largest mining company in the world, BHP Billiton Limited, plus 739 mining, oil and gas companies which are registered on the ASX.

Thanks to Shaw Stockbroking.

**ENERGY disclosure.** New Federal laws require a valid energy rating out of five stars to be displayed on advertisements for sale, lease or sub-lease of office space over 2,000 square metres. The rating benchmarks a building's greenhouse impact of one to five, five stars signalling excellent efficiency. – But wait for it – there is a maximum penalty of \$110,000 for the *first day* and \$11,000 for *each subsequent day* of non-disclosure.

**GOVERNMENT debt** as a percentage of gross domestic product (GDP) 2009 – Russia 6%: Chile 6%: China 17%: Australia 18%: New Zealand 22%: South Africa 30%: USA 53%: World Debt 56%: India 58%: Ireland 58%: Brazil 60%: UK 68%: Germany 72%: Canada 75%: France 78%: Singapore 113%: Greece 113%: Italy 115%: Japan 189%: Zimbabwe 283%. (Source: CIA World Fact Book.)

**FRANCHISING.** PwC and Griffith University have recently published very positive research findings for the industry. Griffith University found the franchising sector had remained strong through the economic downturn. In the past year revenue growth averaged a six percent increase in reported franchisee profitability.

**POPULATION density.** Australia has one of the most lopsided distributions of population of any country on earth. By comparison with the USA who has a total population of about 280 million compared with Australia's of about 22 million, the six largest urban areas in the USA accounts for 20% of their population, whereas the six largest urban areas in Australia accounts for 64% of Australia's population. With the balance of power in Australia's Federal Parliament in the hands of rural independents additional infrastructure spending in these rural areas will be many many billions of dollars. In some ways this is a good thing for neglected areas of the country – helping to increase the spread of population that is so needed. The problem is to justify such spending in small population areas. Without this expenditure these areas will find it hard to expand. In the current circumstances infrastructure expenditure must be based on visionary thinking and planning.



- ❖ The latest national unemployment rate is 5.2%. Inflation is currently 2.8% annually. The current account deficit for the latest quarter was \$7.83 billion.
- ❖ The private-sector represents 80% of all Australian businesses, worth a total of \$3.6 trillion. Over the next 10 years, a forecast \$1.6 trillion of family-owned businesses will change hands as baby-boomers retire.
- ❖ Based on market capitalisation, BHP Billiton is currently worth some \$210 billion, slightly more than the combined worth of oil groups BP and Shell.
- ❖ It is estimated that, by the year 2025, China will have 321 cities with a population of 1 million or more. At the present time, there are 35 cities in Europe of that size.
- ❖ The Reserve Bank of Australia has revealed that the number of banknotes on issue remained steady over the last 12 months, after a 14 percent increase in demand for currency in the previous year that was caused by Australians converting investment holdings into hard cash during the economic crisis.
- ❖ A report by the Financial Services Council has concluded that Australia's largest asset is not its iron ore reserves, but its superannuation system, which is currently worth some \$1.4 trillion, and estimated to grow to more than \$5 trillion in twenty years time.
- ❖ An increase in Britain's departure tax will harm tourism, concluded Sir Richard Branson. The tax will hit fares to Australia particularly hard, as it is based on distance travelled. The tax on a ticket from the UK to Australia rose from £55 to £85, an increase of 55%. By way of comparison, Australia's departure tax is a flat \$A27.

### ONE LAST THOUGHT

May your Christmas be filled with chocolate, wine and sleep, or is that just my dream?

*Help save our environment - please do not throw this newsletter away.  
When you have finished with it, give it to a friend!*

