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Financial Information Memoranda **PKF**

INTRODUCTION

We are doing well to follow up our Xmas 'Summer 2004/05' issue of In Touch with an 'Autumn 2005' issue. There are, however, always issues and announcements to be made and the newsletter, hopefully, is still a convenient form of doing so.

The main item of news for clients is of course Gus Gaskin's retirement as a Partner of the firm and this is covered below. For those clients directly affected by this please be assured that your affairs will indeed continue to be well attended to and directly overseen by the ongoing Partners, Managers and team at Martin Jarvie PKF. **PKF**

GUS GASKIN TO RETIRE

After almost 25 years as a partner of Martin Jarvie PKF Gus has announced his intention to retire from the practice.

His retirement will be effective 31st March 2005, although Gus will be around for a number of months to ensure a smooth transition of his clients to the other partners of the firm.

Gus started work with, what was then, Martin Jarvie Underwood and Hall in November 1970. Apart from four years overseas in the mid seventies he has worked all his professional life with the firm.

His clients will remember his catch phrases – "if you don't have a plan, you don't know where you are going", "diversification", and "the trend is your friend" – to name a few.

Gus has worked mainly in Business Advisory during his career, although he was our Audit Partner for a number of years. He has had special interests in taxation, family trusts and developing appropriate business structures for his large range of diversified clients. "It's been great assisting clients and watching their successful development and growth."

Gus intends to move north in a few months to Tauranga, with his partner, Jan. He aims to get a golf handicap and to travel, as time permits.

The partners and staff wish Gus all the best on his retirement and look forward to working with his clients to ensure they receive the same high level of service going forward.

Should you have any questions about the changes resulting from Gus's retirement please don't hesitate to contact one of the other partners, Graham Langridge (graham.langridge@mjpgk.co.nz), Owen Gibson (owen.gibson@mjpgk.co.nz) or Robert Elms (robert.elms@mjpgk.co.nz). **PKF**



Gus Gaskin

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MOTOR VEHICLE OWNERSHIP OPTIONS



Robert Elms

There are several alternatives when it comes to the ownership and operation of a business motor vehicle. You should consider whether to purchase (outright, hire purchase) or whether to lease (finance lease or operating lease) and the most effective ownership option (business ownership, private ownership).

The most viable option for your purchase will vary according to your individual circumstances and will take into account:

- the value of the vehicle
- annual mileage
- the extent of business and private usage
- whether the vehicle is available for private use
- the taxable income of the person provided with the vehicle
- available business funds.

Leasing

Leasing has become more popular in recent years. Leases are no longer restricted to new vehicles and are now available for quality used vehicles. Leases generally fall into two categories – operating and finance leases.

Under a fully maintained operating lease, the lease company takes full liability for the ownership and maintenance of the vehicle and the cost of the vehicle for the period of the lease is fixed in advance. A finance lease, also known as a lease to own, usually means the lessee can make an offer to buy the car at the end of the lease period based on a residual value set at the beginning of the lease term.

For tax purposes operating lease payments are expensed over the term of the lease in contrast to the finance lease arrangement which is treated in much the same way as a hire purchase, that is the vehicle is treated as being 'owned' by the business and depreciated accordingly.

Leasing is not necessarily more expensive. The cost of a lease is based on the initial cost of the vehicle, the maintenance costs, finance costs less calculated residual value based on the lease company's experience in disposing of the vehicles at the end of the period. It is usual for a lease company to have favourable fleet discount arrangements which means the buying price is usually a lot lower than available outside the trade. Comparing a lease arrangement to a hire purchase arrangement with a guaranteed buy-back price gives a good comparison of the finance rate and competitiveness of a lease deal.

Hire purchase developments

Hybrid hire purchase arrangements have developed in recent years offering flexible principle repayments including small or no deposit, balloon payments at the end of the hire purchase term and also a guaranteed buy-back price that the dealer will pay for the vehicle at the end of the term. These arrangements are more geared to the private market and offer some of the benefits of a lease arrangement as the cost of the vehicle can be calculated at the outset.

FBT issues

If a company owned vehicle is available for private use then the company is generally liable for Fringe Benefit Tax ("FBT"). FBT can be a large cost for a vehicle operator given it is geared to the original purchase price (GST Inclusive) for the vehicle for the whole of the vehicle's life.

"9 to 5" Leases

9 to 5 leases or flip leases have evolved over recent years to reduce the impact of FBT particularly in cases where expensive vehicles are used primarily for business use. Under these arrangements the business only leases the vehicle for the period of the business day or when the vehicle is used for business use and therefore there is no private usage. Arrangements of this nature require the employee to assume some or all of the risk of vehicle ownership.

Leases of this type need to be properly constructed and documented, and log books and records need to be maintained. To maximise the benefits under such an arrangement the employee will be GST registered. Such lease arrangements can easily fall over if the documentation is not properly prepared or correct records are not maintained for the duration of the lease term. Common mistakes include failing to make lease payments on a regular basis, keeping the car for more than 45 months so that the lease becomes a finance lease, selling the car and replacing it with another vehicle without establishing a new lease arrangement, making the provision of the motor vehicle and condition of employment and importantly failing to monitor compliance with the arrangement on an ongoing basis.

GST considerations

GST must also be factored into the equation. Business ownership usually allows GST on the up front purchase and ongoing running costs to be claimed. It is not uncommon for businesses to utilise the GST claim on the purchase of vehicle as their deposit under a hire purchase arrangement.

There is no one correct way to structure your vehicle ownership, the key is to consider your circumstances and choose the alternative most suitable for you and your business. To discuss your circumstances contact one of the partners or our Manager of Taxation Services, Mike Ruffell, mike.ruffell@mjpgkf.co.nz **PKF**

FINANCING YOUR BUSINESS



Owen Gibson

There are three main sources of funds for a company: contribution by the owners or shareholders, retention of profits, or other people's money i.e. borrowing from banks or creditors. There is no single correct way to finance a business but the way you do it can affect your business every day and can either help you grow or prove to be a burden.

You should not only carefully consider your options when requiring more debt and take appropriate advice, but also review your finances periodically to confirm that the various sources are still appropriate and working as intended.

Some of the factors that need to be considered are:

- The needs of the business, such as the purpose of the funds, the term and repayment program for which the money is to be borrowed and the amount that is required.
- The method of finance to be used including where the finance is to be sourced and what is the most appropriate form of finance.
- Any tax or accounting implications?
- The restrictions and responsibilities attaching to the finance, i.e. covenants including reporting requirements, equity ratios.
- The timing of the funds being required and when available.
- The cost of financing including interest and all associated costs such as establishment fees, guarantees, legal fees.
- The effect of the financing on the objectives of the business.

What is the impact of debt on the business?

Businesses strive to maximise the wealth of the business and the return on investment for the shareholders at a level of risk which is acceptable. Debt, however, adds risk to the business. The level of risk is determined by the financial policies of the company, with one of the main ones being the debt to equity (or gearing) ratio. If you increase the borrowings, you increase the leverage or risk to the business.

The risks associated with debt are:

- **Liquidity risk;** the risk of the company is unable to meet the interest and principle repayments as required,
- **Interest risk;** that the interest costs associated with the finance are excessive or incorrectly structured and the exposure to interest rate movement,
- **Security risk;** the risk that the security cover is inadequate or that personal assets are potentially exposed.

Correctly structuring the finances of a business

It is important that the finances of a business are structured correctly to ensure the desired benefits will accrue. If the finance structuring is out of balance there will be added costs and increased risk to that business.

In structuring the finances there is a need to address certain aspects:

- **Mix of debt to equity**
This is an important mix and one in which a balance must be found. Being out of balance may mean excessive risk or, conversely, under realisation of the potential of the business.
- **Sources of finance**
There can be a risk in obtaining funding from alternative sources, but equally there is a risk in being too limited in your use of financiers. Building a solid relationship with your financiers is important.
- **The types of finance**
Examples are leases, short term facilities, long term funding, mezzanine finance, perpetual debt, etc. and any may be more appropriate in any given circumstance.
- **Terms of finance**
These include the period of finance, repayment programme, interest rate, costs in obtaining the finance, covenants and requirements placed on the business, the required level of security and the information flow that is required by the financiers. All of these need to be considered.
- **Planning**
You are not borrowing for today's events, you are borrowing for the future and, in this regard, planning is essential.

Every business should review their debt requirements and structure it in accordance with the asset base of the business.

This means matching the source and type of finance with the use of the funds, for instance using overdraft for shorter term operating requirements and term debt to purchase fixed and long term assets.

It should also be considered that shareholders funds are a key source of funds, and whilst they stand behind external debt finance they provide the foundations of the business and financiers will require a certain level of owner's equity to be present and maintained.

We would recommend all businesses undertake a review of the type, purpose and quantum of their borrowings to ensure they are appropriate. This should be done in conjunction with a detailed plan so that the future finance requirements of the business are covered.

To discuss your requirements or to review existing arrangements contact any one of the partners. **PKF**

ESSENTIALS OF SAFE AND SECURE COMPUTING

Computers have become essential business tools, but unfortunately there are numerous viruses and other attacks being made on them. In order to protect our businesses and the integrity of our systems and information, we all need to guard against such threats. We recommend the following steps are taken, but like all things take appropriate advice to ensure you are doing all you can.

Install Virus Protection Software

It is critical today to have virus protection to stop viruses getting through to your computers. Virus checking software is a must and there are a number of good software options available.

Virus checking software must, however, be kept up to date to be useful as the viruses are changing so often. Virus definitions should be updated at least weekly and this can be automated but, unfortunately, even this doesn't guarantee safety. So see "Backups" and "Use a Firewall" as outlined below.

Viruses are often associated with junk mail. Junk mail filters are now very good and we recommend that you consider implementing one along with your virus protection.

Use a Firewall

Most businesses now have a high speed or broadband Internet connection i.e. Jetstream. As you are then connected to the internet at all times this increases the chances that hackers can break into your computers or network. You should therefore have a hardware firewall or router to protect your business, or at least use Microsoft's software firewall.

Keep Software up to Date

Software companies like Microsoft are working hard to eliminate security flaws and improve protection. You can take advantage of this effort by adopting the latest software versions and applying the patches to software regularly. Similar to the Virus

Checking Software, updates and patches to software should be run once a month if not every couple of weeks.

A number of companies have moved to non-Microsoft software, partly on the basis that Microsoft software is most often targeted, but there is no guarantee that non-Microsoft environments are safe.

Train Your Staff

One of the best defences is to have staff who understand the dangers and practice precautions on a day-to-day basis. For example, e-mails purportedly from banks requesting they 'confirm' their Internet banking user ID and password. If they are aware of the dangers they are less likely to be fooled by them.

Staff should be cautious when opening e-mail attachments and downloading anything from the Internet.

Passwords need to be changed regularly

All these tips should be backed up by corporate policies on passwords, use of the Internet, the risks of SPAM, etc. Do Not reply to SPAM (emails from a source unknown with offerings) emails ever. Not even to ask that they no longer send you emails. This only confirms your email address to the sender and you will receive many more emails.

Guard Your Computers

There are mechanisms to secure PCs and portable computers to desks to make it hard for thieves to remove them off the premises. All users should use the 'Lock Computer' function when moving away from their computer for a decent length of time.

Backup Your Computers Frequently

We still come across situations where clients have not backed up their computers. Often they find out when it's too late! Now that you can buy a writeable CD drive (or even

a writeable DVD drive) for a minor sum of money, there is absolutely no excuse for not doing backups.

Your company's server may be backed up but have you checked that the C: drives on your employee's desktop computers and portable computers are also being backed up regularly, including e-mails daily? Remember, backups may still be the only thing that saves your company if any viruses or other dangers on the Internet get through to your computers despite the other protection mechanisms you put in place.

Spyware

The big buzz word these days is 'Spyware'. Essentially Spyware is software that loads itself onto your computer without your knowledge when you are browsing the Internet or from software downloaded and installed onto your computer. The biggest concern with Spyware is the information it can gain from your computer and then pass back to where it originated from. Information like email addresses, personal user details and user names & passwords are generally what Spyware software looks for.

In conjunction with a firewall or router, Spyware detection software can help reduce fear of information burglary.

Summary

Unfortunately, as technology has improved so have the dangers. Your computer is like a car, it needs a little TLC every now and then to ensure safe, secure and reliable use. Ensure you spend the time needed for general upkeep and maintenance of your PC.

Should you wish to discuss any of the above issues or you have any additional questions or concerns, or should you simply like a PC 'Check-Up' please contact any of the partners or our manager of Business IT, Daniel Feutz, daniel.feutz@mjpgk.co.nz DDI 496 9064. **PKF**

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