

# Mind your 'Financial' Business

*The most important calculation you can do is to work out how much it costs you to run your business.*

## Calculating vehicle and administration expenses

It's important that you know exactly how much it costs to run your business. You should always have a good idea of how much it costs you every day. Then you'll know how much it costs you **not** to operate and how much you need to earn so that when you do operate, you still make a profit.

### Know your costs

- You need to know what your costs are before you can work out how much you'll need to charge your customers.
- However you are paid – by the load, by the hour or by the kilometre – knowing your costs and being able to convert them from a per-hour to a per-kilometre figure and vice versa will help you compare different jobs and different plans.
- It will help with making choices such as changing your rig. If you know how your costs will change, you'll be able to work out what you'll have to do to continue making a profit.
- Monitoring your costs will help you manage your finances better, particularly your cash flow, and will give you an easy way of setting goals and working out budgets and forecasts.
- Information about your costs will be vital when you come to borrow money to update your truck or expand your business.

The best way of calculating your costs is to keep records for a period of six months. You'll need to keep track of the kilometres you've travelled or the hours you've been on the road as well.

If you're just starting out in business on your own, you'll be able to estimate some of your costs from previous records like tax returns or predict them from your experience and a little research.

But as soon as you can, keep accurate records, and do the calculations again. In fact, you should do the calculations on a regular basis so that you can monitor what's happening in your business and take action if something is going off track.

When you've got enough figures, use the 'Cost of operations' worksheet in the next section to record the totals.

### **Fixed and variable costs**

There are two types of costs you need to keep track of – fixed costs and variable costs.

Fixed costs stay the same whether your truck stays in your driveway, travels one hundred kilometres or one hundred thousand. Fixed vehicle costs include your loan repayments, vehicle insurance, registration and depreciation. Many of your administration expenses fall into the same category – eg your phone, accounting and bank fees, subscriptions, health and accident insurance, public liability insurance, and superannuation have to be paid whether your truck is working or not.

On the other hand, there are some things you'll only have to pay for when your truck is running and generally, the further your truck travels, the more you'll pay. These are variable costs. Variable vehicle costs include fuel, oil, tyres, repairs and services, and even loading equipment. If you employ another driver, wages will be a variable cost. The largest of these will be fuel.

### ***Cost of operations worksheet***

In the cost of operations worksheet (see next page), fixed vehicle costs have been separated from other fixed costs such as overheads, finance expenses and depreciation. Finance expenses include interest on loans and lease payments for your vehicle. Depreciation is the difference between what is paid for an item and what it is sold for, and is calculated on an annual basis.

The worksheet includes most of the expenses that you will have in your business. However your business won't be exactly the same, so you should adapt it before trying to use it.

The first column of figures contains annual costs for each category. These are then divided by 12 to give you average monthly costs. The third column of figures is the result of dividing the annual costs either by the number of kilometres you travelled during the year to give costs per kilometre, or by the number of hours on the job with your truck to give costs per hour. For example, if your annual interest payment on your truck was \$16,000 and you travelled 160,000 kilometres, the interest payments would be costing you \$0.10 per kilometre (16,000 divided by 160,000).

You can copy or print out the worksheet separately from the 'Useful Forms' chapter of this guide, or download it from the 'Owner-drivers guide' website, [www.dpi.wa.gov.au/ownerdrivers](http://www.dpi.wa.gov.au/ownerdrivers). The Internet version of this worksheet is set up to do the calculations automatically.

Cost of operations worksheet		
TOTAL KILOMETRES (OR HOURS) RUN: .....	km or hrs per year: .....	km or hrs per month: .....

	Annual \$	Monthly \$	\$ per km (or per hr)
<b>FIXED COSTS</b>			
<b>Overheads</b>			
Accounting fees			
Audit fees			
Bank fees & charges			
Bad debts & debt collection costs			
Rent			
Building repairs/maintenance			
Cleaning			
Electricity			
Printing & stationery			
Postage			
Telephone/fax/modem			
Data processing			
Insurance – general			
Insurance – public liability			
Insurance – sickness and accident			
Employee benefits and amenities			
Uniforms			
Wages			
Superannuation			
Donations			
Other expenses			
Total overhead costs			
<b>Finance costs</b>			
Loan repayments			
Total finance costs			
<b>Depreciation</b>			
Cost of item	\$		
Minus sale price (estimated)	– \$		
Equals total depreciation	= \$		
Divide by number of years	÷ yrs		
Equals annual depreciation			

	Annual \$	Monthly \$	\$ per km (or per hr)
<b>FIXED COSTS</b> (cont.)			
<b>Other vehicle costs</b>			
Insurance			
Vehicle registration			
Licences and permits			
Security			
Total fixed vehicle costs			
<b>TOTAL FIXED COSTS</b> (overheads + finance costs + depreciation + fixed vehicle costs)			
<b>VARIABLE COSTS</b>			
Fuel (less rebate)			
Oil			
Tyres			
Repairs			
Services			
Loading equipment			
Hire/equipment			
Truck wash			
Loading/unloading charges			
Administration fees			
Accommodation and meals			
Other variable costs			
<b>TOTAL VARIABLE COSTS</b>			
<b>TOTAL COSTS</b> (total fixed costs + total variable costs)			

### Using the cost of operations calculations

The cost of operations worksheet is useful for both reporting and planning. It will report your business expenses, but it also allows you to try out 'if/then' scenarios.

#### Personal income

There are a number of ways you can use figures from the spreadsheet to look at your income.

If you know how much you are paid per kilometre, you can figure out how much you'll earn in a year.

Rate per kilometre	\$
Less total costs per kilometre	– \$
Equals how much you'll clear per kilometre	= \$
Multiplied by total kilometres run per year	x km
Gives annual personal income	\$

The same calculation works if you are paid for the hours your truck is on the job.

Rate per hour	\$
Less total costs per hour	– \$
Equals how much you'll clear per hour	= \$
Multiplied by total hours run per year	x km
Gives annual personal income	\$

Another useful calculation is to add the income you would like to the total cost from the spreadsheet and this will give you the total cost of operations, which will also be your gross income for the year.

	Annual \$	Monthly \$	\$ per km or per hr
Personal income			
+ Total cost (from spreadsheet)			
= Total cost of operations (or gross income required)			

You may like to calculate the personal income you can expect if you take a percentage of your gross business income. A typical business might expect total costs to be about 70% of total gross revenue, giving 30% as personal income. The taxes you pay will have an effect on what your net income will be. You'll need to talk to your accountant about this, because every business is different and there's no simple formula that applies to everyone.

Doing these calculations and comparing them with what is actually happening with your business will help you stay afloat.

If your actual gross income was more than the amount you calculated, you made more than you planned for. If it was less, you might need to take steps to control your expenses or raise your gross income, or both.

### ***Per kilometre costs***

As the number of kilometres you drive increases, the cost per kilometre figure will decrease. (The same will happen if you use hours rather than kilometres in your calculations.) Your personal income should also increase the more kilometres you drive.

## Understanding financial statements<sup>5</sup>

There are two important statements that your accountant will prepare for you – a profit and loss statement and a balance sheet.

### *Profit and loss statement*

The profit and loss statement will let you know the underlying profitability of your business. This is not as simple as how much profit you have made. To understand profitability, it is important to understand that interest on borrowings is not an operating expense of the business. It merely reflects the business's debt structure. The following example illustrates the point.

Take two typical truck owners with the same 'sales'. In this example, owner B has borrowed \$200,000 to buy his truck and has paid \$20,000 interest during the year.

	<b>Owner A</b>	<b>Owner B</b>
Sales	\$100,000	\$100,000
Running costs & overheads	\$50,000	\$40,000
<b>Net operating profit (earnings before interest and tax)</b>	<b>\$50,000</b>	<b>\$60,000</b>
Interest	-	\$20,000
<b>Net profit</b>	<b>\$50,000</b>	<b>\$40,000</b>

From the net profit figures, it looks as if owner A is running a better business, earning \$50,000 net profit compared with owner B who has earned \$40,000. But owner B has the more profitable business, earning \$60,000 before interest and taxes compared with owner A, who has earned \$50,000. This is because owner B has lower running costs and overheads, which, together with sales figures, affect profitability. The amount of interest paid reflects the debt structure of the business, not its profitability.

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<sup>5</sup> Based on "Financial Statements" section in *Do I Want to be an Owner-driver?* with permission from the Owner-drivers Association of South Australia Ltd.

### Some definitions

**Current assets** are assets that, under normal business operations, will be converted into cash within a reasonably short time period, usually a year – eg deposits in bank accounts, stock, prepaid expenses and money owed by clients to the business.

**Non-current assets**, also called fixed assets, are assets that will not be converted into cash in the short term – eg vehicles, plant and equipment.

**Current liabilities** are financial commitments that must be met within 12 months – eg money owing to creditors, short-term loans or bank overdrafts, GST and PAYG commitments and unpaid entitlements such as accumulated annual leave.

**Non-current liabilities**, also called long-term liabilities, are financial commitments that are not due within 12 months. A good example might be the loan for your prime mover.

**Working capital** is defined as *current assets minus current liabilities*. It changes from time to time, but not with every transaction. For example, if a creditor were paid \$5,000 with cash from the bank, both current assets and current liabilities would fall by \$5,000 and the working capital would stay the same. But if the \$5,000 from the bank were used to buy plant and equipment (a long-term not a current asset), working capital would fall by \$5,000. Working capital is funded by capital investment by the business owners, by long-term loans to the business and by accumulated profits, or retained earnings.

**Equity** is defined as *total assets minus total liabilities*. Also called owner's equity, it can be seen as the owner's residual claim on the assets of the business after all the other liabilities have been settled. It is normally left in the business as long as it is required. Equity is often shown under two headings – equity or capital that is put into the business and equity or retained earnings (or profits) that are left in the business.

## Balance sheet

The balance sheet is like a snapshot – it shows your financial position *at any given point of time*. It's called a balance sheet because the assets on one side equal the sum of your liabilities and your equity in the business on the other side. On one side are the assets, which are used to generate earnings for your business. On the other side you can see who has provided the money to finance the assets – both your funds (owner's equity) and those provided by banks and finance companies (liabilities).

The balance sheet you'll see from your accountant will probably have a bottom line called 'equity' which is represented by 'net assets', ie total assets less total liabilities. This doesn't really tell you much about your business. But the balance sheet does contain important information that will.

Here's a balance sheet presented for 'tax' purposes:

### 'Tax' Balance Sheet

	\$
Current assets	140,000
Non-current assets	<u>120,000</u>
Total assets	<u>260,000</u>
Current liabilities	120,000
Non-current liabilities	<u>80,000</u>
Total liabilities	<u>200,000</u>
<b>Net assets</b>	<b><u><u>60,000</u></u></b>
<b>Equity</b>	<b><u><u>60,000</u></u></b>

Here's the same information presented in a slightly different way:

### **'Management' Balance Sheet**

	\$
Current assets	140,000
Current operating liabilities	<u>120,000</u>
Working capital	20,000
Non-current assets	<u>120,000</u>
<b>Net operating assets</b>	<b><u>140,000</u></b>
Interest bearing debt	80,000
Equity	<u>60,000</u>
<b>Total capital</b>	<b><u>140,000</u></b>

This presentation clearly separates the investment and the financing side of the business.

The top half of the balance sheets shows the net operating assets, which are used by the business to generate earnings. They include your vehicle and other plant and equipment (in non-current assets) and your working capital (the difference between how much you currently have and how much you currently owe).

The bottom half of the balance sheet simply shows who has put the money up to finance the net assets used by the business. There are only two sources of capital that a business can use. First, it can obtain interest-bearing debt from banks and finance companies. Second, it uses owners' funds (by way of either capital or retained earnings). In this style of presentation, non-interest bearing loans – eg those provided by family members – are included in the equity section of the balance sheet.

### ***Interpreting your performance***

The key point in looking at financial statements for your business is to clearly separate the investment and financing aspects of the business.

Comparing profit and loss statements and balance sheets from one period to the next will make it easier to assess your business's performance and financial standing.

One very common issue, which can now be clearly seen, is where a business increases its debt from one year to the next. The 'management' format makes it clear whether the increased debt is funding an increase in the net assets of the business (ie an increase in the scale of operations) or an operating loss.

It is also very easy to see whether or not a business is expanding in size or shrinking. This information can be of critical strategic importance in the future management of your business.