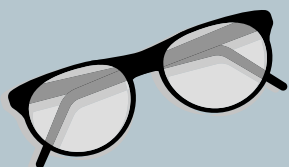


Get it all in *writing*

It's easy to get burned with a handshake arrangement. Set up a formal contract, **Anne Lee** writes.



No matter how well you know them or how great you think it is that someone's giving you an opportunity – never go into a contract milking agreement on a handshake, warns Jon Jarman, chartered accountant and director of Leech and Partners in Christchurch.

"For some there's a temptation to think - well this person is giving me an opportunity so I won't push them too much on the detail. They get caught up and think it'll be okay in the end – well, often it's not.

"You can get burned badly.

"You must have a legal agreement and have the detail down on paper in a formal contract.

"You can use your accountant or rural professional as the bad cop if you like – tell your farm owner that they won't sign anything off unless there's a proper contract with all the details."

In setting up your budget to calculate what the contract rate will provide, he says wages are likely to be the biggest cost "by a country mile".

"So, understand the staffing requirements – the number needed and the salary bands.

"Then sit down and do a draft roster, will you have a 2IC, how many dairy assistants will you need?"

Do a draft roster for each seasonal period and work out what the wages bill is likely to be for each pay period over those different seasonal times so you can work out what your cash flow needs will be.

Unless the agreement offers contract payments through the winter months, you'll have to meet the wages bill from savings or overdraft.

Ask for records for shed running costs and production history and get right into the detail of other costs.

Understand the policy on supplementary feed and the effect of lower nitrogen inputs on production and seasonal production variability.

Have good insurance cover - look at income/profit protection, key man insurance, talk with a broker who understands the risks in farming.



Chartered accountant Jon Jarman, Leech and Partners in Christchurch.

'Do your budgeting and financial work in the morning, not late at night after everything else. The best budgets are done at 10am, not 10pm.'

If it's your first year it will be difficult to prove income.

"Look into using ACC's CoverPlus Extra (CPX) – you can nominate the amount of income you want to be covered for if you can't work so it's a set amount and doesn't fluctuate with your annual income."

Tax is the cost people forget about.

It can be almost two years before the tax from your first season contract milking has to be paid given you don't have to file a return until 12 months from the end of the season and you then have until April 7 the following year to pay the tax owing.

"The problem is people think great, I have all this money in the bank but they'll also have to start paying provisional tax for the coming year as well as their tax from the previous season.

"Talk to your accountant early on about tax and how much it might be and think about setting up a tax account so you can start putting money into it.

"You'll pay roughly 30% of your profit as tax and in a good year that can be a significant amount.

"If you're not a good saver and know you'll be tempted to dip into that tax account, then make voluntary payments to the IRD monthly as you go."

Some accounting software will include a tax calculation so you can see your tax position as you go.

"Do your budgeting and financial work in the morning, not late at night after everything else. The best budgets are done at 10am not 10pm.

"If you're doing them the night before you go and see the bank, there will be holes in it – you won't have had time to think about it.

"Your accountant should be someone you feel comfortable to pick up the phone and ask questions, not just someone you see once a year when you pick up your accounts.

"Likewise, it doesn't work only telling the bank manager as much as you have to – put them on your team and make sure they understand what you're doing and what you're trying to achieve.

"Work with them early on and keep them in the loop."

Business structures for contract milkers

There are three main business structures – partnership, sole trader and company.

Each has its own benefits depending on your situation and each has its pitfalls. A company structure is the most common.

Partnership



"Jointly and severally liable" – so if one partner runs up a debt the other is liable for the full amount, not just their own share of it.

It's quick and easy to set up but the downside is the liability. There are also tax advantages in the ability to split the profit between the partners.

Sole trader



If you're a sole operator this is a good structure because it's quick and easy to set up with minimal paperwork required.

The downside is you're the only person liable for the debt rather than any other entity – so if you have debts all of your assets are up for grabs. Tax is calculated on your personal tax rate, so the tax rate could be high with good earnings.

Company



The most common structure, a company is a separate legal entity to you personally so if things don't go well the debt is limited to the company assets and not your personal assets. However, a bank may want a personal guarantee which would override this.

This limited liability also doesn't extend to health and safety or wages – you personally must pay if the company can't.

The company pays tax rather than the individual which gives you more flexibility – profits can stay in the company or be allocated out to shareholders in recognition of the work they undertake for the company.

It costs approximately \$500 to set it up and there are increased compliance costs due to a few extra hoops for preparing accounts, so ongoing costs will be higher.

Also, be aware that directors of a company have serious responsibilities, particularly in terms of health and safety so if you're a director make sure you're aware of how the business is being run. If you aren't actively involved in the business – for instance working off-farm and don't have an influence on policies or actions relating to health and safety, don't be a director.



Contracts must work for

both parties

'A good contract milker may also add more value so shouldn't always be looked at as being more expensive.'

Words by: **Anne Lee**

If washing your hands of staffing issues is your key motivation for taking on a contract milker then you probably shouldn't do it, FARMit Accountants director Brett Bennett warns.

Employing a contract milker requires effort and care in setting up the system so it works for both parties.

It's not simply a farm manager minus the staff employment, Brett says.

"It will cost you more to run your farm business because the contract milker is taking on a level of risk and additional responsibilities and they need to be rewarded for that.

"So, it can be financially more expensive but it comes down to how you value your own time – the time you get back as a result, what does it allow you to do?

"A good contract milker may also add more value so shouldn't always be looked at as being more expensive."

While it may mean many of the responsibilities of employing staff are handed over, there are some responsibilities you can't contract out of.

"Health and safety for one – as the farm owner there's still a legal responsibility to ensure the farm is safe for people to work on, that any hazards are identified and any infrastructure issues are dealt with."

Minimum staff numbers should be stipulated in the contract – not only to

ensure the farm is run well but to ensure hours worked or burnout don't become a health and safety issue in themselves.

"That's a minimum requirement and really you have to remember that even though the staff are being employed by someone else they're still there working on your farm, milking your cows.

"You want to be supporting your contract milker, especially if they're in their first season and being an employer is new to them."

Wages and fuel have had the biggest cost increases over the last year and are both costs born by contract milkers so it's important the budgets drawn up to calculate contract rates are adjusted accordingly.

Brett says when working with potential contract milkers it's important to give them accurate and up-to-date budgets.

"You want to give them evidence of real costs – we've had to go back to a couple of farmers and say actually we need to review the contract rate because specific costs have gone up over time and the farm owner hasn't looked at that detail for a while.

"I think farm owners understand there has to be something in it for the contract milker, in terms of margin over costs and what they could earn as a farm manager – to reward them for the additional risk they're taking.

"I have seen contract milkers with contract rates that mean it's just a wasted season – they've pretty much made nothing."

"So, you need to give them evidence of those real costs and evidence of production and a realistic expectation of budgeted production."



Brett Bennett: "Go through the details to make sure there's enough money dropping out of it to be worth it."

- ✓ *Be clear about the farm plan.*
- ✓ *Be clear about the contract.*
- ✓ *Be clear about what's on offer.*
- ✓ *Be clear about your vision.*

Work through the what if scenarios when discussing the contract so everyone's clear on what will happen given different situations such as drought.

A well-documented, formal farm plan is a must so the contract milker is clear on the owner's expectations on how the farm should be run and what the targets are for the season.

They need to understand your health and safety plan and how their plan dovetails into yours and they need to understand their responsibilities within your farm environment plan.

Brett says contract milkers should never sign the contract until it's been reviewed – preferably by a rural professional who has a good understanding of farm budgets and contracts.

"There have been a lot of changes to legislation and compliance and that has to be factored into the contract.

"We'd want to see the costs are realistic

and go through the detail to make sure there's enough money dropping out of it to be worth it."

Brett says his company has put together a booklet for farm managers who are looking at moving to contract milking.

"There are plenty of managers out there breaking their necks to become contract milkers but they're not fully aware of all that entails and what they need to know.

"One of the biggest things is improving their financial literacy and ensuring they have financial acumen.

"They've got to understand PAYE, GST and ACC for instance."

He uses a three-stage process to bring people up to speed so they aren't overwhelmed at the outset.

Having good online systems for accounting and paying staff that their rural professionals can have visibility into means they can get help quickly.

"The aim is to help them grow their own

financial acumen and build those skills quickly because that enables a better understanding of their business, helps cost control and empowers them," he says.

"We help them get their heads around using a cashflow planning tool so they can see where costs come in and how to manage that with their income flow.

"We also want them to have a personal spending budget and a cashflow for that too."

It's important at the outset to ensure expectations are understood between contract milker and farm owner, he says.

- "Be clear about the farm plan.
- "Be clear about the contract.
- "Be clear about what's on offer.
- "Be clear about your vision."

Communicate well throughout the season both with the farm owner and with rural professionals – make them part of your team, he says.



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