



Farm and Ranch Financial Statements

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For many years and for many agricultural producers, the major motivation for keeping farm financial records was to fill out a Schedule F for income taxes and to have a “good set of books” to obtain credit from lending institutions. Often the numbers reported on a Schedule F and the numbers shown to a lending institution have not much in common. To the Internal Revenue Service (IRS) minimum profits were reported and to the banker maximum profits were projected. With that motivation for record keeping, it is not likely that the records were of much use in making management decisions on the farm or ranch.

A good set of financial records will do much more than satisfy the IRS or your banker. Today’s successful farmers and ranchers are using detailed financial statements to identify the most profitable farm enterprises for their operation, determine per unit production costs, track trends and financial progress in the business and to create comprehensive business plans. Accurate and detailed financial records can be used to more effectively manage cash flows, to make investment or disinvestment decisions and to explore alternative uses of capital investments in the operation.

This fact sheet is designed to be a brief overview of the financial statements and budgeting tools that are likely a part of most farm financial record keeping systems. Links are also provided where the reader

can go to see additional detail on any one financial report or topic.

A brief description of a Balance Sheet, a Profit Loss Statement or Income Statement, Statement of Cash Flows and Enterprise Analysis will follow.

Example forms for farm financial statements can be found at:

<http://www.extension.iastate.edu/publications/fm1824.pdf>

Before discussing each of these statements there are a few important concepts that apply to all of them. Records and the management decisions made from prepared financial statements are only as good as the data entered. The old adage, “Garbage in – Garbage out” really does apply to financial records. It is important to be consistent in how values are entered in the different statements. If you are going to conservatively value assets, then do it consistently across all assets and enterprises. If you are selling commodities at market value from one enterprise (i.e., crops), then it is important that the enterprise (i.e., dairy) that is buying that commodity also buys it at market price. One other consistency concern is to try and match expenses with production for making management decisions. For example, you may have the cash on hand at the end of one fiscal year, and for tax purposes, you may choose to buy fertilizer in December for the following year’s crop. For management decisions you should view that fertilizer expense as occurring in the year actual production occurs, even though

the expense was pre-paid earlier to reduce tax liability.

Balance Sheets

The first statement we will discuss is the Balance Sheet. The Balance Sheet lists assets, liabilities and net worth or equity. This statement has been described as a snap shot of the business at a given point in time. It answers the question; Are we financially sound? Assets (total value of the business) minus liabilities (what you owe) equals equity (what you really own). A detailed balance sheet should be prepared at least annually. It is also wise to prepare this statement at the same time each year since the combination of assets and liabilities varies according to the seasons. It is also essential that assets be valued consistently. Some Balance Sheets are prepared on a cost value basis and others on a market value basis. A cost based balance sheet will show changes in the farm or ranch equity position based solely on the farms profitability. The market value approach will show changes to owner equity that are the result of profitability and the result of inflation or deflation in asset values. Inventories, such as livestock and feed, need to be accurate if the statement is to be useful. Successful farm managers will actually count inventories instead of simply estimating. Careful managers are not satisfied with an educated guess. Additional information on a Balance Sheet can be found at: <http://www.ksre.ksu.edu/bookstore/pubs/mf291.pdf>

Profit and Loss Statement

The Profit Loss Statement is sometimes called an Income Statement. It is a summary of income and expenses over a specific period of time. It includes Revenue (what you earned) minus Expenses (what it cost to earn it) to equal Profit or Loss. This statement is all that most need to file a Schedule F income tax return. However, real farm profitability cannot be measured without combining the Income Statement with the Balance Sheet. Inventories can increase or decrease and assets can and do change value independent of cash transactions. These changes need to be used to determine actual income even if they are not used when filing income taxes. Addition information on an Income Statement can be found at: <http://www.ksre.ksu.edu/bookstore/pubs/mf294.pdf>

Cash Flow Projections

With the Profit Loss Statement complete, it is usually much easier to create Cash Flow projections for the new fiscal year. Cash Flow is just that, the flow of cash through the business during the fiscal year. What cash do we expect to receive during a given month? What cash do we expect to pay out during a given month? What will our cash balance be at the end of the month? Good Cash Flow projections help managers to know if they will have enough cash available at the right time to meet financial obligations when they are due. It may be necessary to borrow money during the year to make up for cash short falls. Cash Flow projections help managers know when they need to borrow, how much they need to borrow, and when the money can be paid back. The Cash Flow Statement helps producers look to the future and plan with increased confidence. It must be remembered that making these projections is not an exact science and that they will undoubtedly not reflect what actually happens during the year because changes in the business or markets will alter the results. But, comparing what was projected with what actually occurs on a regular basis during the year is a key to managing the finances of your farm or ranch. Additional information on a Cash Flow Statement can be found at:

<http://www.ksre.ksu.edu/bookstore/pubs/mf275.pdf>

Enterprise Analysis

Another useful financial tool is an Enterprise Analysis. Without Enterprise Analysis, managers may not know which segments of the business are making money and which segments are losing money. It is also impossible to know how incremental changes in markets, such as milk prices, will impact the business. It is also impossible to determine the cost of production on a per unit basis without evaluating specific enterprises.

The consistency in how items are valued that was previously discussed is very crucial in conducting enterprise analysis. It may be tempting to show a favorite enterprise in the “best” financial position. Don’t do it. Treat all enterprises equally from a records standpoint. Only then can managers make the best management decisions. For example, managers may find that they are making more money growing crops than they are feeding cattle. Managers may still choose to feed cattle rather than simply sell crops, but they do so knowing the

financial impact of such decisions. Additional information on Enterprise Analysis can be found at: <http://pods.dasnr.okstate.edu/docushare/dsweb/Get/Document-1658/>

It may be true that there is a bit of luck involved in being successful on a farm or ranch because timing is everything. However, without good production and financial records, farm and ranch operators do not know where they are where they are going. In the agricultural industry, where margins are slim, good record management is no longer an option. It can easily be the difference between survival and failure.

References

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