

FARM FINANCIAL RECORDS

For years, the major motivation for keeping farm financial records was to fill out a Schedule F for income taxes. Soon it became essential to have a good set of books to obtain credit from lending institutions. Historic financial statements also made it easier to create cash flow projections. Today, a high percentage of farmers and ranchers are creating detailed financial statements for tax planning, to identify the most profitable farm enterprises, determine specific production costs, track trends and financial progress in the business, and to create detailed future business plans. Perhaps a brief review of some essential financial statements will be useful to the reader.

The Balance Sheet lists assets, liabilities and net worth or equity. It 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 (what you own) 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 that 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. Inventories, such as livestock and feed, need to be accurate if the statement is to be useful. I have observed that the most successful farm operators actually count inventories. They are not satisfied with an educated guess.

The Profit Loss Statement is sometimes called an Income Statement. It is similar to a video that shows flows of income and expenses over 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 an 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 accrued changes need to be identified to determine actual income or loss, even if they are not used when filing tax returns.

Labor records also need to be finished early in the year. Employers should have a current W-4 and I-9 for every employee employed at the farm. Accurate earnings records are required to prepare W-2's for the employees and a W-3 for the Social Security Administration. Form 943 also needs to be filed with the IRS before the end of January for most farms and ranches.

With the Profit Loss Statement complete, it is much easier to create Cash Flow Projections for the new 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. Cash Flow's help managers know when they need to borrow, how much they need to

borrow, and when the money can be re-paid. 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. However, comparing what was projected with what actually occurs during the year is a key to managing the finances of a farm or ranch.

Another useful financial statement is an Enterprise Analysis. Without this process managers will 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 or meat prices, will impact the business. It's also impossible to determine the cost of production on a per unit basis without evaluating specific enterprises.

A friend once told me that there's a bit of luck involved in being successful on a farm or ranch because timing is everything. We agreed there is some truth to that assessment. However, without good production and financial records telling you where you are, you don't know where you're going. In the agricultural industry, where margins are often slim, good financial management is essential. It can easily be the difference between survival or failure of the business.

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