FARM ACCOUNTING AND FINANCIAL ANALYSIS

Growers will learn how to gain confidence in understanding their own accounting data and be able to plan the farm business actions and to identify financial strategies for the farm business.

Course objectives:

Farm Accounting
• Understand and know the four parts of every business.
• Understand important accounting terminology.
• Understand the importance of accounting standards.
• Understand the difference between Cash and Accrual Accounting.
• Understand the flow of money in accounting terms.

Farm Financial Analysis
• Analyze the financial performance of an operation.
• Identify historical opportunity/problem areas.
• Determine the historical capacity of the operation.
• Measure the historical operating efficiency of the operation.
• Analyze your businesses financial performance.
• Determine financial strengths and weaknesses of your businesses financial performance.

Farm Action Plan – Control your Business
• Project desired financial performance for the next two years.
• Build high level action plans to support projected financial performance.
• Learn how to begin controlling your business.
• Learn the change issues associated with controlling your business.

Course agenda:
• 8:00am – Confirm Registration and Make Payment
• 8:30am – Managing a Farm Business
• 9:30am – Introduction to Basic Accounting
• 11:00pm – Financial Analysis of Capital
• 12:00pm – Work-in Lunch
• 1:00pm – Financial Analysis of Capital
• 2:30pm – Action Plan for Financial Success
• 4:00pm – End of Day
Farm Accounting

1. **Cash Basis Accounting** recognizes revenue when actually received (cash) and expenses when actually paid.

2. **Accrual Basis Accounting** recognizes revenue when produced (not received yet) and expenses when they are incurred (not paid).

3. **Single Entry Accounting** records are only one part of an accounting transaction.

4. **Double Entry Accounting** makes a two-part entry for each transaction, a debit and a credit.

5. **Four parts of a farm business:**

   a. **Assets:** Cash, accounts receivable, inventories, growing crops, equipment, land, buildings and personal property are examples of asset accounts.

   b. **Liabilities:** Accounts payable, notes payable, contracts payable, commodity credit loans, and payroll taxes payable are examples of liability accounts. Accrued liabilities include accrued interest, accrued property taxes, accrued income taxes and accrued payroll taxes.

   c. **Equity: Contributed Capital:** Inheritance, gifts, partner contributions, capital stock and family income. **Retained Earnings:** Profits of the operation less money withdrawn by owners and income taxes.

   d. **Operations:** Owned Assets including cash and rented assets financed by liabilities and/or equity plus production inputs such as seed, fertilizer, fuel, etc. to produce inventories of crops and livestock which are sold to produce cash which is used to:
      - Pay owners living, taxes, dividend and draws (owner withdrawals)
      - Pay debt obligations due in the current year (pay current liabilities)
      - Purchase Assets

   e. **The Balance Sheet:** is a “snapshot” showing the financial condition of a business for one moment in time, usually the end of the period covered by the corresponding Income Statement. It identifies and accounts for the financial status of the Assets, Liabilities and Equity parts of the business.

      Types of statements:
      - **Cost Basis** - lists asset values at their original cost, less amortization/depreciation, plus actual money spent for improvements to those assets.
      - **Market Basis** - the most probable price in cash or terms equivalent to cash, for which the appraised property will sell in a competitive market.

   f. **An Income Statement:** reports the profitability of Operations for a specific period of time, for example, January 1, 20XX through December 31, 20XX. This report provides management information about the Operations part of the business, which except for the profit or loss line in Equity, is not included in the Statement of Financial Condition.

   g. **The Statement of Cash Flows:** shows the actual flow of cash (no accrual entries) through all four parts of the business for a specified period. It also identifies if there has been adequate capacity within the business.
Capacity is the ability of the business to generate adequate revenues to meet the financial needs of all four parts of the business.

h. **The Statement of Change to Owner Equity**: reports activity in the Equity part of the business. It quantifies the amount of change to owner equity for the current year and identifies where changes have occurred.

**Farm Financial Analysis**

1. **Capacity (cash flow)** is the financial fuel of every business.
   a. **Operations**: profit from operations provides the only continuing source of money for the business. **Operating profit** should be the chief source of capacity. Operating losses create "negative capacity."
   b. **Assets**: the sale of assets is a source of capacity. However, when producing assets are sold, the business may have difficulty generating enough profit to support the remaining business.
   c. **Liabilities**: borrowed money is a temporary source of capacity. It is temporary capacity since repayment of borrowed money reduces future capacity when cash is used to repay debt.
   d. **Equity**: Sole Proprietorship: Capacity increases from inheritance, gifts, non-business income, reduction in living costs, and/or income taxes. Partnership: Capacity increases when partners contribute more capital or reduce partner draws. Corporations: Capacity increases when shareholders contribute capital or reduce dividends.

2. **Debt principal** may be scheduled for repayment faster than the operations area can generate the capacity (cash flow) needed for repayment. When operations cannot generate cash flow fast enough, a business must produce the cash demands from one or more of the only other three possible sources or go out of business.
   a. Borrow additional money
   b. Sell assets
   c. Contribute additional equity from gifts, inheritance, partners, shareholders, etc.

3. **Cash Flow Analysis**: The relationship of several factors is used to analyze cash flow. Two primary considerations are: Where did the money come from? How was the money used?

4. **Cash Flow analysis** does not provide solutions, but it identifies problem/opportunity areas and tests for consistency:
   a. Evaluates the operations area of the business for profits/efficiency/consistency.
   b. Capital performance evaluated - areas of equity, liabilities, and assets.
   c. Operating efficiency (profits related to revenues): operating efficiency measures how well operations produce capacity (cash).
   d. Use of operating profit: operating profit measures how much capacity is available from operations.
Farm Action Plan – Control your Business

1. **Asset Turnover Ratio** - measures the efficient use of investment capital to generate income while the operating profit margin ratio measures the efficient use of operating capital. Since they are substitutes for each other (owned and rented land, for example), farms that are high in one measure may be low in the other.

2. **Operating Profit Margin** - shows how effectively funds are spent on operating expenses to generate business income. If the operating expenses are low relative to the value of farm production, the business will have a good operating margin. A low profit margin can be caused by low product prices, high operating expenses or inefficient production.

3. **Operating Expense Ratio** - shows the proportion of gross farm income used to pay operating expenses, not including depreciation and interest.

4. **Current Ratio** - is the ratio of current assets to current liabilities. It measures the extent to which current farm assets, if sold tomorrow, would pay off current farm liabilities.

5. **Debt-to-Asset Ratio** - is the lender’s share of the business. It compares total farm debt to the total value of farm assets. The higher the ratio the greater the financial risk and the lower the borrowing capacity. A high debt load does not make farms less efficient, but principal and interest payments eat into cash flow.

6. **When developing big picture improvement**, first decide how you want each area to perform in that year of focus. The performance areas are: Operations, Interest, Owner Withdrawals, Debt Service and Asset Growth/Risk.

7. Don’t expect to always find one option that will solve the problem for the area. Usually it requires more than one option to get the desired results. Often it is impossible to solve an area problem in one year.

8. **Taking control** of your farm business entails preparing action plans to assist with the behavior change you want to accomplish. In order to change or enhance behavior, you must be able to ask yourself:
   - How do I want my business to perform financially?
   - What action steps am I willing to take to drive my business where I want it to be?
   - How do I measure the results?
   - Who is responsible to carry out my plans?