

## Why We Keep/Use Financial Records Survey

For what reasons do farmers and business owners keep/use financial records for their business?

Rank the following reasons from 1 to 6 (1 being most important). If you can think of another reason to keep/use financial records or a reason not shown below, add it to the list.

Farmers and business owners keep/use business financial records:

- ☐ A. to measure farm profits and assess financial condition
- ☐ B. because they are required by their lenders
- ☐ C. to measure whether goals have been reached
- ☐ D. to provide data for business analysis
- ☐ E. for income tax reporting
- ☐ F. to measure the profitability of individual enterprises
- ☐ G. to keep other family members happy
- ☐ H. for reporting to National Agricultural Statistics Service for the Agricultural Census
- ☐ I. to assist in the analysis of new investments
- ☐ J. other: \_\_\_\_\_

## Elements of an Effective Farm Financial Record System

Joan Sinclair Petzen  
with Information from  
*Farm Management*  
Sixth Edition  
By Kay, Edwards, & Duffy

## Purpose and Use of Records

- Measure profit and assess financial condition
- Provide data for business analysis
- Assist in obtaining loans
- Measure the profitability of individual enterprises
- Assist in the analysis of new investments
- Prepare income tax returns

### Measure Profit and Assess Financial Condition

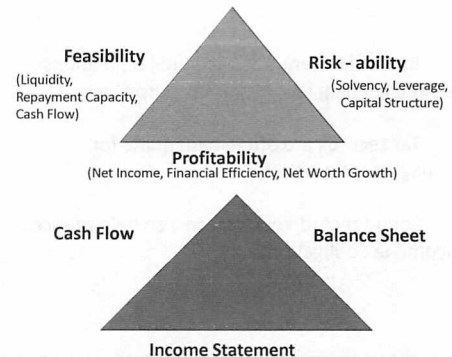
These are among the most important reasons for keeping records.

Profit is estimated by developing an income statement.

The financial condition is shown on the balance sheet.

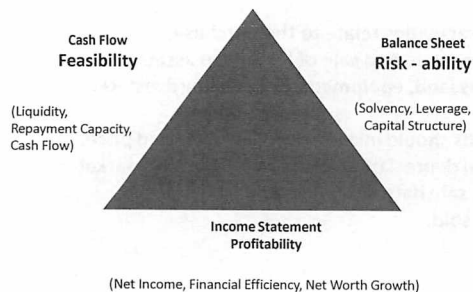
### Framework for Financial Analysis

-----Business "Abilities"-----



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-----Business "Abilities"-----



## Farm Financial Standards Council (FFSC)

- Formed in 1989 to address accounting and record problems on farms and ranches
- Recommendation to bring farm records into closer compliance with basic accounting principles
- Standardized and consistent financial reports, terminology, and specific measures to analyze farm financials

### *Provide Data for Business Analysis*

- Use the information from the balance sheet and income statement to perform an in-depth analysis.
- Analysis of past decisions is useful for making current and future decisions.
- There is a difference between making "a profit" and having "a profitable" business

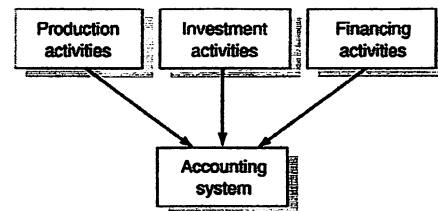
### *Assist in Obtaining Loans*

- Lenders require financial information about the farm business to assist them in their lending decisions.
- Following the farm financial difficulties during the 1980s, many agricultural lenders are requiring more and better records.
- Good records increase the odds of getting a loan.

### *Prepare Income Tax Returns*

- Internal Revenue Service (IRS) regulations require keeping records for tax purposes.
- Tax records are often inadequate for management purposes.
- Sound record-keeping can also help reduce income tax obligations.

**Figure 3-1**  
Farm business activities included  
in an accounting system



### *Production Activities*

- These accounting transactions involve activities related to the production of crops and livestock.
- Revenue from product sales or other farm revenue is included here, as are production expenses.

### *Investment Activities*

These activities relate to the purchase, depreciation, and sale of long-lived assets, such as land, equipment, or breeding livestock.

Records should include purchase date and price, annual depreciation, book value, current market value, sale date and price, and gain or loss when sold.

### *Financing Activities*

These transactions relate to borrowing money, and paying the interest and principal on loans.

Financing activities include money borrowed to finance new investments and money borrowed to finance production activities.

### *Basic Accounting Terms*

- |                      |                   |
|----------------------|-------------------|
| • Account payable    | • Inventory       |
| • Account receivable | • Liability       |
| • Accrued expense    | • Net Farm Income |
| • Asset              | • Owner Equity    |
| • Credit             | • Prepaid Expense |
| • Debt               | • Profit          |
| • Expense            | • Revenue         |

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### *Basic vs. Complete*

- The most basic accounting system is one that is very simple and uses cash accounting.
- A complete system would be computerized with capabilities for both cash and accrual accounting, and with the ability to track inventories, loans, and depreciation, and to handle payroll accounting and perform enterprise analysis.
- Between these extremes are many possibilities.

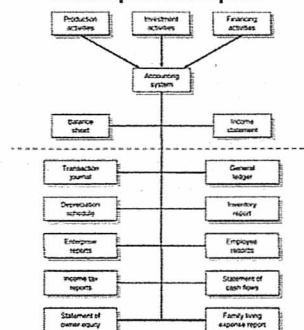
### *How Complete?*

- How much accounting knowledge does the user have?
- How large and complex is the farm?
- How much and what kind of information is needed or desired for management decision making?

### Farm Financial Standards Council Recommendations

- Accrual-based system recommended, but cash system accepted, with end-of-year adjustments
- A full discussion of the adjustments will be provided in chapter 6

**Figure 3-2**  
**Twelve possible reports**



### Summary

- This session emphasizes the importance, purpose, and use of records as a management tool.
- Records provide the information needed to measure how well a business is performing.
- They also provide information needed to make sound decisions in the future.
- Any accounting system must be able to handle production, investment, and financing activities.
- The output desired from the accounting system must be considered when choosing one.

### Framework for Financial Analysis —Business “Abilities”—

