Financial Management 101:

Financial Statements

Financial statements allow you or your bookkeeper to analyze and understand your business. Financial statements:

- are vital to measuring the overall health of your business;
- provide an accurate snapshot of where your business stands financially at a moment in time;
- help maintain clear communication when multiple people are involved in the business;
- separate your business finances from your family finances;
- provide vital informtion as you plan for the coming year, and;
- serve as legal documents for your business.

Effective management of your farm business finances will involved several different types of tracking. It's easiest to understand the value of each form in terms of the question that they answer.

WHERE DO I STAND?
BALANCE SHEET OR NET WORTH

Balance Sheets track your current, intermediate, and long-term assets and liabilities. Their purpose is to show your net worth, which is defined as what you own minus what you owe, at any given moment in time. Below is an extremely simplified depiction of what a balance sheet tracks:

Assets (you own)	Debt (you owe)
current	current
+ intermediate	+ intermediate
+ long term	+ long term
+ personal	+ personal
= Total Assets	= Total Debt
Total Assets-Total Debt = Equity or Net Worth	

Some examples of what would be considered current, intermediate, and long-term assets and debts:

	Assets	Debt
Current	- livestock to be slaughtered soon - hay and feed currently in inventory - leftover packaging material - current checking account balance	- debts to bank for day to day operating costs - farm credit card bill - month bills
Intermediate	- livestock used for breeding - farm equipment you own	- loans for farm equipment
Long Term	- farm real estate	- mortgage on real estate

WHERE DID THE MONEY GO?
CASH FLOW STATEMENTS

Cash Flow statements track expected cash expenses and income by category for a set period of time and can help you keep track of your liquidity and future cash needs. Cash Flow statements do not calculate profit or include non-cash assets or debts outside of payments owed during the time period you are tracking. They usually include both your business and personal finances.

Below is an extremely simplified version of what the Cash Flow statement includes and examples of what would fit into each category:

	Cash in	Cash out
Operations	Projected product sales	Immediate farm expenses
Assets	Plans to sell assets	Plans to purchase assets
Debts	New loans	Principal owed during the time the statement covers
Family	Off-farm income	Family living expenses
Total	**= cash available**	**= cash used**

DID I MAKE A PROFIT? PROFIT AND LOSS

Also known as an income statement, the Profit and Loss statement measures your sales, expenses, depreciation and profit. It tracs how revenue is transformed into net income over a set time period, usually a year.

The basic formula of the Profit and Loss statement:

	Business cash receipts
-	Business cash expenses
=	Net cash income from operations
-	Depreciation
+/-	Accrual adjustments to cash receipts, expenses, inventories, equipment
=	Profit, Net farm income (loss)

Unlike the Cash Flow Statement, on the Profit and Loss:

- depreciation is included, because it is a write-off. In other words, it is an expense that will not realize any return.
- the principle paid on loans is not included in the expense line. This is because it results in an increase in assets, and is therefore not an expense that comes out of profit.
- the profit shown does not represent cash on hand.
- family living expenses are not included.
- accrual, such as sales that have been made but not paid for, or items that you have purchased but not paid for, is included.

Unlike the Balance Sheet, the Profit and Loss is in constant flux and should be tracked in an ongoing way. The Balance Sheet is a snapshot that acts as a monthly checkpoint.

WHAT'S THE MATTER? RATIOS

There are several simple ratios you can use to measure your farm's financial health.

Solvency: debt to asset ratio

- Measures solvency, or what part of business is owned by creditors and what portion you own.
- The ratio is: total debt/total assets
- Ideally, should always be less than 0.70

Liquidity: current ratio

- Measures liquidity, or your ability to pay bills as they come due.
- The ratio is: current assets/current liabilities
- Best if greater than 1.0

Profitability: return on assets

- Measures profitability, or how hard your assets are working.
- The ratio is: (net farm income-family living)/total assets
- Compare the ratio to the going rate on a CD.

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