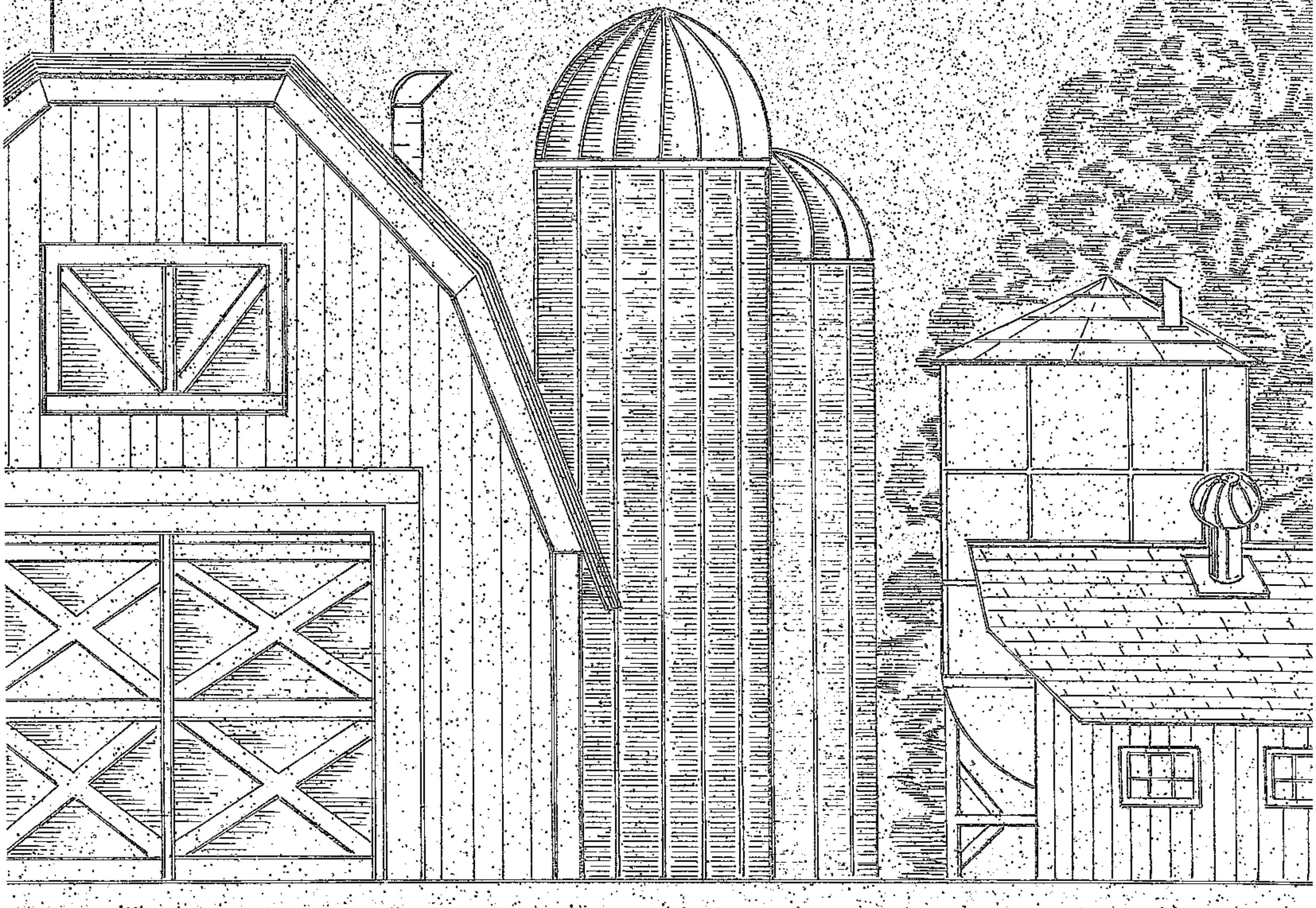
BLUEPRINT FOR FARM FINANCIAL SUCCESS



BLUEPRINT FOR FARM FINANCIAL SUCCESS

AMERICAN
BANKERS
ASSOCIATION™

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INTRODUCTION

This booklet, prepared by the American Bankers Association, describes the type of information a banker needs to make a lending decision. It also provides farmers and ranchers with a better understanding of the farm business from a financial viewpoint. Included are financial statements and financial analysis summary forms that will help agricultural producers collect and organize their own financial data. The four financial statements include: balance sheet, income statement, statement of owner equity, and statement of cash flows. In addition, a summary of financial performance ratios is included to assist in evaluating key financial measures. The Williams Farm noted throughout the enclosed statements and forms is used as an example in providing data for the completion of the forms.

The statements are designed to capture information that follows the recommendations of the Farm Financial Standards Task Force. An important advantage of the statements is that the farmer or rancher develops a common language with the lender as they discuss the farm business in financial terms.

Both the borrower and the lender bear the responsibility of ensuring the sound use of agricultural credit. Each has an interest in the careful gathering and presentation of pertinent information. The individual seeking credit must approach the lender prepared to demonstrate that the proposed financing is feasible and consistent with the farm's business and the family's goals. The lender, on the other hand, needs to do a complete analysis of the financial information in order to present an informed, timely, customized financial package to the customer.

Preparing for the Lender

In any borrower/lender relationship, it is essential that the borrower provide an understanding of the business through an up-to-date set of financial and production records. Production records should include livestock and crop records. Financial statements should include a balance sheet, an income statement, a statement of owner equity, and historical and projected cash flows. If possible, the borrower should provide three to five years of data.

The lender generally requires the following financial data and supporting information; however, in approaching a lender, the producer should ask specifically which types of financial information to provide.

- A current balance sheet with supporting schedules and inventories (essential).
- A record of earnings for three years.

- A projected cash flow. If a major change in the business is anticipated, a transitional and normal operating year projected cash flow may be required, with sensitivity analysis concerning price, cost, and capital acquisition investments.
- A good set of records showing production plans, short- and long-range goals, and procedures for implementation and evaluation.
- Information concerning personal debt, including credit cards.
- Information concerning the amount and stability of off-farm income.

Lenders don't like surprises. Just as you, the borrower, have a "wish list" of traits that a good lender should have, lenders also have certain expectations of a desirable borrower. Here are four key things you can do to help build your relationship with the banker.

1. Arrange credit in advance. Don't inform your lender of a major decision "after the fact." This destroys trust and credibility and makes future credit more difficult or impossible to obtain.
2. Allow your lender time to review plans and make suggestions. Many major purchase decisions are made on the basis of emotion. A lender can be a source of sound advice and counsel in reviewing your credit request. Remember, an explanation of goals and plans builds confidence and trust and strengthens the working relationship.
3. Inform your lender of problems and changes. Even the best businesses are faced with adversities that reduce their ability to repay. Inform your lender of changes in plans or unforeseen problems that will interfere with making loan payments. Remember, communication is important not only in the initial request, but throughout the whole credit process.
4. Maintain a high level of integrity. If the borrower expects a lender to be honest and aboveboard at all times, then the lender is entitled to the same attribute from the borrower. Inaccurate information and failure to honor commitments will jeopardize the borrower-lender relationship and could do harm that will last a lifetime.

THE BALANCE SHEET

Purpose and Perspective

The balance sheet is a financial statement showing financial position at a moment in time. Assets, liabilities, and owner equity (net worth) are the ingredients that determine financial status. Each asset and liability is identified and given a dollar value. The balance sheet is historical in the sense that it reflects the cumulative effect of past transactions, but it does not show how the existing financial position was achieved.

The term "balance sheet" results from the equality in the fundamental accounting equation:

Assets = Liabilities + Owner Equity

The equality holds at all times, as any transaction causing a change in one side will cause an identical change in the other side.

Assets include everything owned that has value, including claims against others. They are listed and valued in the left-hand column of the balance sheet. Liabilities are listed in the right-hand column and refer to any obligations owed to others. Owner equity (net worth) is the dollar difference between total assets and total liabilities and is also shown in the right-hand column.

Categories of Assets and Liabilities. The order of listing is based on declining liquidity. Current assets are the most liquid, representing cash and near-cash items. They are assets that could be converted to cash without disrupting the ongoing business and assets that will either be used up or converted to cash during the year or normal operating cycle (e.g., crop and feed inventory). "Operating cycle" is added to include items in the current asset category, such as feeder cattle, that might remain on the farm slightly more than 12 months.

Non-current assets represent working assets that yield services to the business over a period of time, on an ongoing basis. Their sale would disrupt the business. Machinery and equipment, breeding livestock, capital leased assets and real estate fit naturally here.

Personal assets are listed as a separate item at the bottom of the balance sheet.

Liabilities are also grouped into current and non-current categories. Current liabilities represent those existing obligations that are payable within the year or accounting period. Account and notes payable within the year are traditional current liabilities. The principal portions of non-current liabilities due within one year are also shown here, including the current portion of capital leases.

Accrued interest and accrued taxes are important current liabilities. Since the IRS allows farm reporting on a cash basis, little attention has been given to accrued items. Yet they are bona fide obligations that must be shown on the balance sheet for accuracy on an accrual basis. If a farmer were to sell out and convert all the assets to cash, the balance sheet would need to reflect all claims that existed against those assets.

Non-current liabilities are those associated with real estate or with an original maturity beyond one year, excluding the principal portion due within the next 12 months, which is shown in the current section.

The last business liability listed is the deferred tax on non-current assets. This is a dollar estimate of the income tax liability that would be triggered by conversion of the non-current assets to cash. Since an income tax liability would not be triggered without a gain on the sale of assets, the non-current deferred tax is only a market value liability concept and is shown as a separate entry below the total non-current liabilities. The cost column represents an ongoing business, values that would result if assets were liquidated.

As with personal assets, personal liabilities are listed separate from business liabilities.

Double Column—Cost Basis and Current Market Valuation Procedure. The toughest part of preparing a balance sheet is valuing assets. Historically, there has been a substantial lack of uniformity, and often there have been no guidelines to assist in determining appropriate values. In general, farmers prefer market values, as those values allow them to track their market value owner equity from year to year. Frequently, there is a mixture of both cost and market values reported on the balance sheet (Williams Farm). The accompanying example illustrates a two-column balance sheet.

Three principal reasons exist for having both cost and market value information.

1. The inflation or deflation of assets can be determined by comparing simultaneous changes in cost and market value.
2. Both values are needed to estimate the important hidden liability of deferred taxes. Deferred tax is a subtle area of taxation that in many cases represents a major liability in a business. Deferred taxes would be associated with the balance of current and/or non-current assets.
3. Market value is needed for a current indication of financial position, while cost value is needed to accurately complete an accrual-based income statement.

BEGINNING BALANCE SHEET

BS

As of 12-31, 19X1

☐ Business
☒ Combined (Business & personal)

Name Williams Farm
Address Anywhere, U.S.A.
Phone

ASSETS

Current Assets	Cost	Market Value	
Cash on hand & in checking accounts	$ 2,180	$ 2,180	(1)
Savings & money market accounts	8,820	8,820	(2)
Marketable bonds & securities	14,830	24,420	(3)
Futures/Options account equity	—	—	(4)
Accounts receivable:			(5)
Government program payments	12,021	12,021	(6)
Other	—	—	(7)
Notes & contracts receivable:			(8)
Portion due within 12 months	—	—	(9)
Accrued interest earned	—	—	(10)
Feeder livestock & poultry:			(11)

Kind	No.	Avg. Wt.	$/Unit	Value	
Hogs	150	212	45	$14,310	(13)
"	150	174	50	13,050	(14)
"	155	130	60	12,090	(15)
"	155	92	60	8,556	(16)
"	160	54	90	7,776	(17)
"	165	20	90	2,970	(18)
Cattle	54	450	65	15,795	(19)
"	58	975	60	33,930	(20)

	Cost	Market Value	
	108,477	108,477	(21)
Crops and feed:			(22)

Item	Quantity	Unit	$/Unit	Value	
Corn	31,500	bu.	2.20	$69,300	(24)
Beans	8,155	bu.	5.85	47,707	(25)
Hay	60	ton	50	3,000	(26)
Silage	135	ton	18	2,430	(27)
Supp.	2	ton	27	540	(28)

	Cost	Market Value	
	122,977	122,977	(31)
Prepaid expenses	1,300	1,300	(32)
Supplies	2,848	2,848	(33)
Investment in growing crops	1,160	1,160	(34)
Other current assets			(35)
TOTAL CURRENT ASSETS	$274,613	$284,203	(36)
Non-current Assets			(37)
Raised breeding livestock, not depreciated	$ 36,850	$ 49,305	(38)
Raised breeding livestock, depreciated	—	—	(39)
Purchased breeding livestock	////////////	$ 2,516	(40)
Cost or basis $ 6,900	////////////	////////////	(41)
minus Accumulated depr. (-) 3,243	3,657	////////////	(42)
Machinery & equipment	////////////	$ 128,700	(43)
Cost or basis $ 211,522	////////////	////////////	(44)
minus Accumulated depr. (-) 150,687	60,835	////////////	(45)
Capital leased assets	—	—	(46)
Investments in cooperatives	14,780	14,780	(47)
Investments in other entities	—	—	(48)
Notes & contracts receivable—portion due			(49)
beyond 12 months	—	—	(50)
Real estate	////////////	811,000	(51)
Cost or basis $ 816,000	////////////	////////////	(52)
minus Accumulated depr. (-) 168,375	647,625	////////////	(53)
Other non-current assets:			(54)
TOTAL NON-CURRENT ASSETS	$763,747	$1,006,301	(55)
	Cost	**Market Value**	(56)
TOTAL BUSINESS ASSETS	$1,038,360	$1,290,504	(57)
Personal assets	////////////	52,585	(58)
TOTAL ASSETS	$1,038,360	$1,343,089	(59) (60)

LIABILITIES AND OWNER EQUITY

	Current Liabilities		
(1)	Accounts payable:		
(2)	Labor $ 280 Feed & seed $		
(3)	Repairs Fert. & chem.		
(4)	Storage Fuel & oil 225		
(5)	Rent Mach. hire		
(6)	Other		$ 505
(7)	Credit card balances (business accounts)		
(8)	Commodity Credit Corporation (CCC loans):		
(9)	Loan on corn in storage		45,500
(12)	Notes due within 12 months:		
(13)	(to whom, maturity, purpose)		
(15)	Farmland State Bank		57,978
(16)	due March 1		
(20)	Accrued interest on:		
(21)	Accounts payable & credit cards $		
(22)	Notes due within 12 months 5,218		5,218
(23)	Accrued interest on all		
(24)	non-current liabilities		14,295
(25)	Principal due within 12 months on all		
(26)	non-current liabilities		23,335
(27)	Accrued tax liabilities:		
(28)	Property $		
(29)	Real estate 3,900		
(30)	Employer payroll withholdings 547		4,447
(31)	Estimated accrued income & soc. sec. tax		1,251
(32)	Other current liabilities		
(34)	Deferred tax on current assets		81,868
(35)	**TOTAL CURRENT LIABILITIES**		$234,397
(36)	**Non-current Liabilities**		
(37)	(Principal portion due beyond 12 months)		
(38)	Notes		$ 21,392
(39)	Capital leases		
(40)	Sales/Land contracts		
(41)	Real estate mortgages		205,600
(42)	Other loans		90,549
(43)	Other non-current liabilities		
(44)	**TOTAL NON-CURRENT LIABILITIES**		$317,541
(45)		**Cost**	**Market Value**
(46) (47)	Total current and non-current liabilities	$551,938	$551,938
(48) (49)	Deferred tax on non-current assets	////////////	97,791
(50)	**TOTAL BUSINESS LIABILITIES**	$551,938	$649,729
(51)	Personal liabilities	////////////	12,120
(52)	**TOTAL LIABILITIES**	$551,938	$661,849
(53)	OWNER EQUITY:		
(54)	Retained Earnings	$486,422	$486,422
(55)	Contributed Capital	—	—
(56)	Personal Net Worth	////////////	40,465
(57)	Valuation Equity	////////////	154,353
(58)	**TOTAL OWNER EQUITY**	$486,422	$681,240
(59) (60)	**TOTAL LIABILITIES and OWNER EQUITY**	$1,038,360	$1,343,089

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ENDING BALANCE SHEET

BS

As of 12-31, 19X2

☐ Business
☐ Combined (Business & personal)

Name Williams Farm
Address Anywhere, U.S.A.
Phone

ASSETS

Current Assets	Cost	Market Value
Cash on hand & in checking accounts	$ 5,490	$ 5,490
Savings & money market accounts	1,450	1,450
Marketable bonds & securities	14,160	25,050
Futures/Options account equity	–	–
Accounts receivable:		
Government program payments	11,885	11,885
Other	–	–
Notes & contracts receivable:		
Portion due within 12 months	–	–
Accrued interest earned	–	–
Feeder livestock & poultry:		

Kind	No.	Avg. Wt.	$/Unit	Value
Hogs	152	212	44	$14,179
"	149	174	49	12,704
"	154	130	58	11,612
"	160	92	58	8,538
"	162	54	85	7,436
"	167	20	85	2,839
Cattle	55	450	68	16,830
"	57	975	63	35,012

	Cost	Market Value
Feeder livestock & poultry	109,150	109,150

Crops and feed:

Item	Quantity	Unit	$/Unit	Value
Corn	29,500	bu	2.40	$70,800
S.B.	7,680	bu	6.05	46,464
Hay	56	ton	55	3,080
Silage	130	ton	20	2,600
Supp.	1	ton	300	300

	Cost	Market Value
Crops and feed	123,244	123,244
Prepaid expenses	1,366	1,366
Supplies	2,270	2,270
Investment in growing crops	1,218	1,218
Other current assets		
TOTAL CURRENT ASSETS	$ 270,233	$ 281,123

Non-current Assets		Cost	Market Value
Raised breeding livestock, not depreciated		$ 37,260	$ 51,858
Raised breeding livestock, depreciated		–	–
Purchased breeding livestock		//////////////	$ 2,441
Cost or basis	$ 7,880	//////////////	//////////////
minus Accumulated depr. (–)	4,437	3,443	//////////////
Machinery & equipment		//////////////	$ 137,500
Cost or basis	$ 231,522	//////////////	//////////////
minus Accumulated depr. (–)	168,520	63,002	//////////////
Capital leased assets		–	–
Investments in cooperatives		14,780	14,780
Investments in other entities		–	–
Notes & contracts receivable—portion due beyond 12 months		–	–
Real estate		//////////////	825,000
Cost or basis	$ 816,000	//////////////	//////////////
minus Accumulated depr. (–)	185,375	630,625	//////////////
Other non-current assets:			
TOTAL NON-CURRENT ASSETS		$ 749,110	$ 1,031,579

	Cost	Market Value
TOTAL BUSINESS ASSETS	$ 1,019,343	$ 1,312,702
Personal assets	//////////////	59,520
TOTAL ASSETS	$ 1,019,343	$ 1,372,222

LIABILITIES AND OWNER EQUITY

Current Liabilities		
Accounts payable:		
Labor	$ 154	
Repairs	560	
Storage		
Rent		
Feed & seed	$	
Fert. & chem.		
Fuel & oil	115	
Mach. hire		
Other		$ 829
Credit card balances (business accounts)		
Commodity Credit Corporation (CCC loans):		
Notes due within 12 months: (to whom, maturity, purpose)		
Farmland State Bank due March 1		71,009
Accrued interest on:		
Accounts payable & credit cards	$	
Notes due within 12 months	1,302	1,302
Accrued interest on all non-current liabilities		15,366
Principal due within 12 months on all non-current liabilities		28,225
Accrued tax liabilities:		
Property	$	
Real estate	3,950	
Employer payroll withholdings	586	4,536
Estimated accrued income & soc. sec. tax		2,464
Other current liabilities		
Deferred tax on current assets		83,296
TOTAL CURRENT LIABILITIES		$ 207,027

Non-current Liabilities	
(Principal portion due beyond 12 months)	
Notes	$ 33,844
Capital leases	
Sales/Land contracts	
Real estate mortgages	197,081
Other loans	79,391
Other non-current liabilities	
TOTAL NON-CURRENT LIABILITIES	$ 310,316

	Cost	Market Value
Total current and non-current liabilities	$ 517,343	$ 517,343
Deferred tax on non-current assets	//////////////	111,905
TOTAL BUSINESS LIABILITIES	$ 517,343	$ 629,248
Personal liabilities	//////////////	14,210
TOTAL LIABILITIES	$ 517,343	$ 643,458
OWNER EQUITY:		
Retained Earnings	$ 502,000	$ 502,000
Contributed Capital	–	–
Personal Net Worth	//////////////	45,310
Valuation Equity	//////////////	181,454
TOTAL OWNER EQUITY	$ 502,000	$ 728,764
TOTAL LIABILITIES and OWNER EQUITY	$ 1,019,343	$ 1,372,222

THE INCOME STATEMENT

Net income, or profit, is the single most important factor that determines whether your operation will be able to stay in business. The amount of net income generated from farm and non-farm sources is the key to properly evaluating current financial performance, past progress and future potential. Measuring net income accurately and thoroughly understanding the concepts behind it are extremely important. Only after completely understanding your net income can you analyze your performance and make the best management decisions for your operation.

Cash Basis Versus Accrual Basis Net Income

The income statement presented here converts data from the cash basis to an accrual basis. Cash basis accounting measures revenues only when received and expenses only when paid. Accrual basis accounting measures revenues in the year generated and expenses in the year incurred, even if revenues and expenses are not received or paid in the year incurred. The income statement can be utilized with nearly any existing record system that generates data for filing taxes on a cash basis, as long as accrual cost basis balance sheets are completed at the end of the year.

The practice of calculating net farm income on a cash basis still pervades the agricultural industry. The reason is simple. The IRS allows farmers and ranchers, except for very large operations, to file income tax returns on a cash basis.

Unfortunately, the taxable income on a cash basis too often is used as a measure of business performance. It may well create an erroneous impression about the operation. IRS rules are designed to determine how much income tax will be paid—with no intent that such a measure be used to evaluate financial performance. For a given year, this cash basis net income may differ dramatically from true net income and therefore is not an appropriate measure of business performance. An accrual analysis is required.

The calendar year is most often chosen in farming and ranching as the accounting period because it coincides with the tax year. Data already available for cash basis tax reporting can be used and adjusted to generate a meaningful accrual net income analysis.

Structure of Income Statement

In regard to the Williams Farm income statement, the upper two-thirds of the statement calculates net farm income, while the lower portion is used to calculate nonfarm income. At the bottom, these two are combined to give total income before taxes and extraordinary items. This income figure minus a provision for taxes and minus extraordinary items gives net income—the amount that should be used to reconcile the change in owner equity for the year being analyzed.

INCOME STATEMENT

IS

For a 12-month period Ending 12-31, 19X2

☒ Actual
☐ Projected

Name Williams Farm
Address Anywhere, U.S.A
Phone

REVENUE						
Feeder livestock and poultry:						
cash sales	$ 210,360	(1a)				
inventory change	± + 673	(1b)				
feeder livestock transferred to breeding herd	9850	(1c)	$ 220,883	(1)		
Crops and feed:						
cash sales	$ 92,541	(2a)				
inventory change	± + 267	(2b)	92,808	(2)		
Livestock and poultry products (milk, wool, eggs, etc.)—cash sales			—	(3)		
Custom work—cash received			—	(4)		
Government payments: cash—(a) 10,303 certificates—(b) 10,750			21,053	(5)		
Patronage dividends: cash—(a) ____ non-cash—(b) ____			—	(6)		
Change in accounts receivable			± <-136>	(7)		
Income from hedging transactions			± +200	(8)		
Other revenue: cash—(a) 2,200 non-cash—(b) ____			2,200	(9)		
GROSS REVENUE (add lines 1 through 9)					(10)	$ 337,008
minus Feeder livestock and poultry purchases			-$ —	(11)		
minus Feed purchased			- 33,105	(12)		
VALUE OF FARM PRODUCTION (line 10 minus lines 11 and 12)					(13)	$ 303,903
EXPENSES						
Cash operating expenses			$ 163,273	(14)		
Accrual expense adjustments: Unused assets	±$ + 454	(15a)				
Unpaid items	± + 413	(15b)	± + 867	(15)		
Depreciation: Breeding and dairy livestock	$ 1,514	(16a)				
Machinery and equipment	25,833	(16b)				
Buildings and improvements	15,000	(16c)	42,347	(16)		
Total operating expenses (add lines 14, 15, and 16)					(17)	- 206,487
Interest expense: Interest paid in cash or by loan renewal		(18a)	$ 49,373			
Change in accrued interest payable		(18b)	± <-2,845>		(18)	- 46,528
NET FARM INCOME FROM OPERATIONS (line 13 minus lines 17 and 18)					(19)	$ 50,888
Capital asset account adjustment and/or capital gains (losses) on sales of:						
Raised breeding & dairy livestock not capitalized and not depreciated		(20a)	±$ 2,520			
Breeding & dairy livestock fully capitalized and depreciated		(20b)	± 320			
Machinery, capital leased assets, real estate & other farm assets		(20c)	± 7,000		(20)	9,840
NET FARM INCOME (add line 19 plus line 20)					(21)	$ 60,728
NON-FARM INCOME (available to the business)						
Wages: Operator's wage off farm—(a) ____ spouse's wage off farm—(b) 5000			$ 5,000	(22)		
Interest, dividends, and capital gains distributions:						
Received in cash or credited to checking & savings accounts	$ 633	(23a)				
Earned and re-invested in bonds, securities & other investments	—	(23b)	633	(23)		
Change in accrued interest earned			± —	(24)		
Royalties and mineral lease income			—	(25)		
Gain (loss) on sales of non-farm assets			—	(26)		
Net income—other entities, farms, businesses & real estate			1,500	(27)		
Other: Cash—(a) ____ non-cash—(b) ____			—	(28)		
NON-FARM INCOME (add lines 22 through 28)					(29)	$ 7,133
NET INCOME						
TOTAL INCOME BEFORE INCOME TAXES AND EXTRAORDINARY ITEMS (line 21 plus line 29)					(30)	$ 67,861
Income and social security taxes:						
Amount of tax paid in cash	$ 17,200	(31a)				
Change in accrued tax & deferred tax on current assets	± +2,641	(31b)	-$ 19,841	(31)		
Extraordinary items (explain)			± —	(32)		
NET INCOME (line 30 minus line 31 plus/minus line 32)					(33)	$ 48,020

THE STATEMENT OF OWNER EQUITY

A key indicator of financial progress is the change in owner equity over time. The main purpose of the statement of owner equity is to reconcile the total owner equity reported at the beginning of a time period with that reported at the end of the period. To reconcile means to verify that the financial statements are in agreement or to make the statements agree; consistency among the statements is the goal.

It is also important to know the reasons behind an increase or decrease in owner equity. Those reasons may include changes in earnings, withdrawals, increases (decreases) in the market value of assets, or personal net worth change. The statement of owner equity links together beginning and ending balance sheets and the corresponding income statement. In doing this, it reconciles these statements and verifies their accuracy.

The idea of reconciling financial records is widely accepted and practiced daily by businesses and consumers. Balancing the amount of money recorded in a checkbook account to the bank account statement is a familiar process of reconciliation that is similar in concept to the statement of owner equity.

If the accounts do not agree, the errors must be found and an adjustment made to one or both of the accounts. This reconciliation process establishes confidence in the numbers reported and a greater understanding of the financial process.

STATEMENT OF OWNER EQUITY

SOE

Name Williams Farm

For 12-month period Ending 12-31, 19X2

Address Anywhere, U.S.A.

Phone

					Cost	Market Value
TOTAL OWNER EQUITY, Beginning of Period (beginning Balance Sheet, line 58)				(1)	$ 486,422	$ 681,240
Change in Contributed Capital and Retained Earnings:						
Net Income (loss) after taxes for the period (Income Statement, line 33)			$ ± 48,020	(2)		
Withdrawals of net income and retained earnings (cash or property) during the period:						
Withdrawals for family living expenses	$28,442	(3a)				
Withdrawals for investments into personal assets	9,000	(3b)	− 32,442	(3)		
Additions of capital (cash or property) to the business during the period:						
Gifts & inheritances received; additions to paid-in capital	$	(4a)				
Investments of personal assets into the business		(4b)	+	(4)		
Distributions of capital, dividends, or gifts made (cash or property) during the period			−	(5)		
TOTAL CHANGE IN CONTRIBUTED CAPITAL AND RETAINED EARNINGS (add lines 2 through 5)				(6)	± +15,578	± +15,578
Change in Personal Net Worth:						
Personal net worth, end of period (ending Balance Sheet, line 56)			$ + 45,310	(7)		
Personal net worth, beginning of period (beginning Balance Sheet, line 56)			− 40,465	(8)		
TOTAL CHANGE IN PERSONAL NET WORTH (line 7 minus line 8)				(9)	//////////	± +4,845
Change in Valuation Equity:						
Valuation equity, end of period (ending Balance Sheet, line 57)			$ + 181,464	(10)		
Valuation equity, beginning of period (beginning Balance Sheet, line 57)			− 154,353	(11)		
TOTAL CHANGE IN VALUATION EQUITY (line 10 minus line 11)				(12)	//////////	± 27,101
TOTAL OWNER EQUITY, End of Period (as calculated) (add lines 1, 6, 9, and 12)				(13)	$ 502,000	$ 728,764
TOTAL OWNER EQUITY, End of Period (as reported) (ending Balance Sheet, line 58)				(14)	$ 502,000	$ 728,764

THE STATEMENT OF CASH FLOWS

Cash flows sufficient to meet obligations when due are essential for a continuing business. How a business generates those cash flows is equally critical. The statement of cash flows focuses attention on how the cash flows have been generated. The statement has three segments: operating, investing, and financing activities.

Reconciling accrual net income to net cash income from operating activities provides insight into the linkage between profitability and cash flow feasibility.

When the statement of cash flows is used with the balance sheet, income statement, and statement of owner equity as a full set of financial statements, the actual cash flow lends itself to an assessment of profitability, liquidity, management, and financial risk. It also provides key information on financial projections.

STATEMENT OF CASH FLOWS

SCF

For a 12-month period Ending 12-31, 19X2

☒ Actual
☐ Projected

Name Williams Farm
Address Anywhere, U.S.A
Phone

CASH FLOWS FROM OPERATING ACTIVITIES:

Cash received from farm operations:						
Feeder livestock/poultry sales	$ 210,360	Crops/feed	$ 92,541			
Livestock & poultry products		Custom work				
Gov't payments, cash & certs	21,053	Patronage div.				
Hedging acc't withdrawals	4,200	Other revenue	2,200	+ $ 330,354	(1)	
Cash received from non-farm income and operations:						
Wages	$ 5,000	Interest, dividends (IS, line 23a)	$ 633			
Royalties		Other revenue				
Cash income from other entities, farms, businesses & real estate			4,200	+ 9,833	(2)	
Cash paid for farm operating activities:						
Feeder livestock/poultry	$	Feed purchases	$ 33,105			
Operating expenses	163,273	Interest expense	49,373			
Hedging acc't deposits			4,000	− 249,751	(3)	
Cash expenses paid in non-farm operations (other entities, farms, businesses)				− 700	(4)	
Income and social security taxes paid in cash				− 17,200	(5)	
Extraordinary items received or paid in cash				± —	(6)	
NET CASH INCOME (add lines 1 thru 6)					(7)	$ +72,536
Cash withdrawals for family living				− $ 28,442	(8)	
Cash withdrawals for investments into personal assets				− 4,000	(9)	
NET CASH PROVIDED BY OPERATING ACTIVITIES line 7 minus lines 8 and 9)					(10)	$ 40,094

CASH FLOWS FROM INVESTING ACTIVITIES:

Cash received from the sales of:			
Raised breeding & dairy livestock, not capitalized and not depreciated	+ $ 12,280	(11)	
Purchased and raised breeding & dairy livestock, capitalized and depreciated	+ —	(12)	
Machinery and equipment	+ 7,000	(13)	
Farm real estate; other farm assets	+ —	(14)	
Bonds and securities; investments in other entities; other non-farm assets	+ —	(15)	
Cash paid to purchase:			
Breeding & dairy livestock	− 1,300	(16)	
Machinery and equipment	− 28,000	(17)	
Farm real estate; other farm assets	− —	(18)	
Capital leased assets	− —	(19)	
Bonds and securities; investments in other entities; other non-farm assets	− —	(20)	
NET CASH PROVIDED BY INVESTING ACTIVITIES (add lines 11 thru 20)		(21)	$ <-10,020>

Statement of Cash Flows Continued:

CASH FLOWS FROM FINANCING ACTIVITIES:			
Operating and CCC loans received (including interest paid by loan renewal)	+ $ 13,031	(22)	
Term debt financing—loans received	+ 21,000	(23)	
Cash received from gifts, inheritances, and paid-in capital	+	(24)	
Personal investments of cash added into business assets	+	(25)	
Operating debt principal payments (including repayment of CCC loans for redeemed grain)	− 45,500	(26)	
Term debt principal payments: Scheduled payments	− 23,335	(27)	
Unscheduled payments	−	(28)	
Principal portion of payments on capital leases	−	(29)	
Cash distributions of dividends, capital, or gifts	−	(30)	
NET CASH PROVIDED BY FINANCING ACTIVITIES (add lines 22 thru 30)		(31)	$ <-34,804>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS (add lines 10, 21, and 31)		(32)	$ <-4,730>
Cash and cash equivalents reported on the beginning-of-year Balance Sheet: (BS, lines 1, 2, and PIK certificates listed as part of line 3) $ 2,180 + 8,820 + 11,420		(33)	$ 22,420
Cash and cash equivalents, as calculated, at the end of year (line 32 plus line 33)		(34)	17,690

For cash reconciliation purposes, compare line 34 to the end-of-year cash and cash equivalents reported on line 35 below:

Cash and cash equivalents reported on the end-of-year Balance Sheet: (BS, lines 1, 2, and PIK certificates listed as part of line 3): $ 5,490 + 1,450 + 10,750 (35) $ 17,690

(SCF, Part 2) RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES

NET INCOME		(a)	$ 48,020
ADJUSTMENTS that reconcile Net Income to Net Cash Provided By Operating Activities:			
REVENUE ITEMS (accrual and non-cash adjustments):			
Change in feeder livestock & poultry inventory plus transfers	±$ +10,523	(b)	
Change in crops and feed inventory	± + 267	(c)	
Non-cash patronage dividends	–	(d)	
Change in farm accounts receivable	± -136	(e)	
Change in hedging account equity	± –	(f)	
Other non-cash farm revenue	–	(g)	
Interest, dividends and capital gains earned and re-invested	–	(h)	
Change in accrued interest earned	± –	(i)	
Other non-cash, non-farm income	–	(j)	
Capital adjustment and gain (loss) on sales of: Breeding livestock and machinery	± +9,840	(k)	
Non-farm assets	±	(l)	
TOTAL REVENUE ADJUSTMENTS (add lines b thru l)	± +20,494	(m)	
Enter the total from line (m) but REVERSE THE SIGN (i.e., if line m is positive, enter the amount here, on line n, as a negative figure; if line m is negative, enter the amount here, on line n, as a positive figure)		(n)	$ -20,494
EXPENSE ITEMS (accrual and non-cash adjustments):			
Expense adjustments for unused assets and unpaid items	±$ +867	(o)	
Depreciation	42,347	(p)	
Change in accrued interest payable	± -2,845	(q)	
Adjustment for noncash expenses on other entities, farms, businesses & real estate	2,000	(r)	
Change in accrued tax and deferred tax on current assets	± +2,641	(s)	
TOTAL EXPENSE ADJUSTMENTS (Add lines o thru s)		(t)	$ 45,010
minus CASH WITHDRAWALS FOR FAMILY LIVING (from line 8 on the front side of this form)		(u)	− 28,442
minus CASH WITHDRAWALS FOR INVESTMENT INTO PERSONAL ASSETS (from line 9 on the front side of this form)		(v)	− 4,000
NET CASH PROVIDED BY OPERATING ACTIVITIES (add lines a, n, t, u, and v) (Should agree with line 10 on the front side of this form.)		(w)	$ 40,094

FINANCIAL PERFORMANCE RATIOS

The financial statements that have been discussed contain much of the information needed to make business decisions. But once this information is available, how can it be used to analyze a farm or ranch business to determine its strengths or weaknesses? The following financial performance ratios are the recommendations of the Farm Financial Standards Task Force. These measures include evaluating liquidity, solvency, profitability, financial efficiency, and repayment capacity of the business.

The primary objective of these performance measures is to help improve management and lender decision-making. Good financial management is a lot like good health management. By conducting regular checkups on financial condition and performance, and by taking timely action based on adequate and accurate information, decision-makers are more likely to treat causes rather than symptoms of problems.

Liquidity is a measure of the dollars that are available to purchase inputs and inventory items after the sale of current farm assets and the payment of all current liabilities.

1. Current ratio = total current farm assets ÷ total current farm liabilities

2. Working capital = total current farm assets – total current farm liabilities

Solvency evaluates what would happen if all assets were sold and converted to cash and all liabilities were paid.

3. Debt to asset ratio = total farm liabilities ÷ total farm assets

4. Equity to asset ratio = total farm equity ÷ total farm assets

5. Debt to equity ratio = total farm liabilities ÷ total farm equity

Profitability measures are the most crucial in evaluating the level of success of a farming operation. The following are key indicators in evaluating net farm income.

6. Rate of return on farm assets = (NFIFO* + farm interest expense – value of operator and unpaid family labor and management) ÷ average total farm assets**

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*Net Farm Income From Operations = net farm income excluding gains and losses from disposal of farm capital assets.

**(Beginning Balance Sheet Total Assets + Ending Balance sheet Total Assets) ÷ 2.

7. Rate of return on farm equity = (NFIFO) = value of operator and unpaid family labor and management) ÷ average total farm equity*

8. Operating profit margin ratio = (NFIFO + farm interest expense – value of operator and unpaid family labor and management) ÷ gross revenue

9. Net Farm Income

Financial efficiency includes five ratios for evaluation, profitability, operating efficiency, competitiveness, and level of profits retained in the business.

10. Asset turnover ratio = gross revenue ÷ average total farm assets

11. Operating expense ratio = operating expenses (excluding interest and depreciation) ÷ gross revenue**

12. Depreciation expense ratio = depreciation expense ÷ gross revenue

13. Interest expense ratio = interest expense ÷ gross revenue

14. NFIFO ratio = NFIFO ÷ gross revenue

Repayment capacity includes two ratios, the first providing a measure for the borrower to cover all term debt and capital lease payments and the second to measure the capital replacement and term debt repayment margin.

15. Term debt and capital lease coverage ratio = [(NFIFO + total nonfarm income + depreciation expense + interest on term debts + interest on capital leases) – total income tax expense – withdrawals for family living] ÷ annual scheduled principal and interest payments on term debts and capital leases.

16. Capital replacement and term debt repayment margin = [(NFIFO + total nonfarm income + depreciation expense) – total income tax expense – withdrawals for family living] – payments on prior period unpaid operating debt – principal payments on current portions of term debts – principal payments on current portions of capital leases – total annual payment on personal debt.

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*(Beginning Owner Equity – Personal Net Worth + Ending Balance Sheet Owner Equity –Ending Balance Sheet Personal Net Worth) ÷ 2.

**Gross revenues or value of farm/ranch production.

BEING PREPARED FOR YOUR LENDER

What should you as a borrower do to be prepared in approaching a lender? If you can respond to the 12 questions listed below and provide support for your answers, you will have gone a long way toward being adequately prepared.

1. How much money are you going to need?
2. What is the money going to be used for?
3. How will the loan affect your financial position?
4. How will you secure the loan?
5. How will you repay the loan?
6. When will the money be needed and when will it be repaid?
7. Are your projections reasonable and supported by documented historical information?
8. How will alternative possible outcomes affect your repayment ability?
9. How will you repay the loan if the first repayment plan fails?
10. How much can you afford to lose and still maintain a viable operation?
11. What risk management measures have been or are to be implemented?
12. What have been the trends in the business's key financial position and performance indicators?

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