Financial Statements and the Business Plan

Presented by: Colleen Osterhout and Katie Moran
What is a Balance Sheet?

- A balance sheet shows the value of the items owned (assets) and all debts owed (liabilities). The difference between these is Net Worth or Equity.

- Shows a snapshot in time (i.e. 12/31/2010)
Assets

- What you “own”
- Organized on a balance sheet in the order of ease of conversion to cash
- Typically broken down into 3 categories
  - Current Assets
  - Intermediate Assets
  - Long Term Assets
Current Assets

- Easily converted to cash in less than 1 year

- Examples:
  - Cash, checking and savings accounts
  - Accounts Receivable
  - Feed/Supplies
  - Products and livestock raised for resale
Intermediate Assets

- Can be liquidated but requires more time to sell at a fair price

- Examples:
  - Breeding Livestock
  - Machinery, Equipment and Vehicles
  - Coop Stock
Long Term Assets

- In most cases these assets could not be liquidated without the business being terminated

- Examples
  - Land and Buildings
Liabilities

- What you “owe”
- Categorized by the term of the loan, not life of the asset
- Classified into 3 categories
  - Current Liabilities
  - Intermediate Liabilities
  - Long Term Liabilities
Current Liabilities

- Obligations that are likely to be repaid within 1 year

- Examples
  - Accounts Payable
  - Operating Loans
  - Current Portion of Intermediate and Long Term Liabilities
Intermediate Liabilities

- Obligations that are repaid within 2-7 years
- Loans for the purchase of
  - Machinery, Equipment and Vehicles
  - Breeding Livestock
- Leases
Long Term Liabilities

- Obligations with repayment terms longer than 7 years
- Most commonly Real Estate Mortgages
Why is it called a balance sheet?

- Because it must balance!
- Assets = Liabilities + New Worth
Types of Balance Sheets

- Market Value: Current Value of the asset if it were to be sold
- Book Value: Cost of the Asset - Accumulated Depreciation

Which one is used more in farm operations?
- Market Value
What increases Net Worth?

- Profitable Production
  - Increases in Inventory
  - Accounts Receivable
  - If item is sold, increase in checking and savings accounts or decrease of debt

- Increase in Price of Asset

- Infusion of Cash from Other Source - Gifts and Inheritance

- Forgiveness of Liability
What decreases Net Worth?

- Non-Profitable Production
  - Decrease in inventory, accounts receivable, cash or savings, increase in debt

- Decrease in Price of Assets

- Depreciation

- Family Draws

- Lost Capital
Analyzing a Balance Sheet

- Refer to Handout
What is an income statement?

- The goal of an income statement is to determine the profitability of your business
  - Profitability = value of farm production (receipts) – cost of farm production (expenses)

- Can be prepared on “Cash Basis” or “Accrual Basis”
Cash Basis Income Statement

- Cash Receipts – Cash Expenses = Net Cash Farm Income
- Entries are made when cash actually trades hands
- Ignores accounts receivable/payable, inventory changes and sometimes depreciation
Accrual Income Statement

- Accrual is more Accurate

- In addition to cash income and expenses, an accrual income statement takes into account accounts receivable and payable and inventory changes
### SCHEDULE F  
**Profit or Loss From Farming**

**Form 1040**

**Department of the Treasury**
**Internal Revenue Service**

**.pdf**

**2010**

**Attachment**
**Sequence No. 14**

**Name of proprietor**

**Social security number (SSN)**

### A. Principal product. Describe in one or two words your principal crop or activity for the current tax year.

### C. Accounting method:

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<th>Cash</th>
<th>Accrual</th>
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### E. Did you "materially participate" in the operation of this business during 2010? If "No," see instructions for limit on passive losses.

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### Part I. Farm Income—Cash Method. Complete Parts I and II (Accrual method. Complete Parts II and III, and Part I, line 11.) Do not include sales of livestock held for draft, breeding, sport, or dairy purposes. Report these sales on Form 4797.

1. Sales of livestock and other items you bought for resale

2. Cost or other basis of livestock and other items reported on line 1

3. Subtract line 2 from line 1

4. Sales of livestock, produce, grains, and other products you raised

5a. Cooperative distribution (Form 1120-PAS)

5b. Taxable amount

5a. Agricultural program payments (see instructions)

6a. Taxable amount

7. Commodity Credit Corporation (CCC) loans (see instructions):

7a. CCC loans reported under election

7b. Taxable amount

8. Crop insurance proceeds and federal crop disaster payments (see instructions):

8a. Amount received in 2010

8b. Taxable amount

9. Custom hire (machine work) income

10. Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)

11. Gross income. Add amounts in the right column for lines 3 through 10. If you use the accrual method to figure your income, enter the amount from Part II, line 51.

### Part II. Farm Expenses—Cash and Accrual Method. Do not include personal or living expenses such as taxes, insurance, or repairs on your home.

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12. Car and truck expenses (see instructions). Also attach Form 4926

13. Chemicals

14. Convoy expenses (see instructions)

15. Custom hire (machine work)

16. Depreciation and section 179 expense deduction not claimed elsewhere (see instructions)

17. Employee benefit programs other than on line 25

18. Feed

19. Fertilizers and lime

20. Freight and trucking

21. Gasoline, fuel, and oil

22. Insurance (other than health)

23. Interest:

24. Labor (including employment costs)

35. Total expenses. Add lines 12 through 34. If line 34 is negative, see instructions.

36. Net farm profit or (loss). Subtract line 35 from line 11. Partnerships, see instructions.

37. If you have a loss, you must check the box that describes your investment in this activity and whether you received any applicable subsidy (see instructions).

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<th>Yes</th>
<th>No</th>
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37a. All investment is at risk and you did not receive a subsidy.

37b. Some investment is at risk or you received a subsidy.

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 11341H  
Schedule F (Form 1040) 2010
Analyzing the Income Statement

- Refer to Handout
Trend Analysis

- A Trend ties the Balance Sheet into the Income Statement

- It also includes:
  - Non-Farm Income
  - Debt Service
  - Family Living
  - Income Taxes

- Represents the discretionary funds of the operation and borrower combined
Trend Analysis

- See Example Handout
  - Cash and Accrual
Summary

- Balance Sheet
- Income Statement
- Trend Analysis
Monthly Cash Flow Budget

- Why is it necessary?
  - Takes into account the seasonality of your business operating cycle.
  - Assists to determine timing and $ amount of operating infusion.
  - Provides for an opportunity to fine tune your budget for the upcoming season.
  - Provides an opportunity to prioritize capital purchases and identify potential funding sources.

PLUS
Monthly Cash Flow Budget

BANKERS LOVE THEM
Monthly Cash Flow Budget

- Components From Top to Bottom
  - Step 1: Basic Five Line Income Statement
    Gross Sales
    Less COGS
    Equals Gross Margin
    Less Overhead Costs
    Equals Net Margin

  COGS = wholesale cost on items purchased for resale or variable input costs
  (feed, bedding, trucking, production labor)
  Overhead Costs = DIRTI 5 (depreciation, interest, repairs, taxes, insurance)

- Step 2: Add in Net Non Farm Income (after tax)
Monthly Cash Flow Budget

- **Step 3**: Take out Family Living Expense

- **Step 4**: Itemize Monthly Debt Payments
  - Operating Lines (Interest Only)
    - Could be supplier credit or credit cards
  - Capital Debt Payments (Vehicles/Equipment)
  - Mortgage Payments (Real Estate)
Monthly Cash Flow Budget

- **Step 5:** What is Monthly Cash Required?
  - Is it positive or negative?
  - If negative, where fund the short fall?

- **Step 6:** Determine any other capital needs
  - How funded and when?
Business Plan

- Set the Mission, Values, and Goals:
  - Mission: Reason for existence—what the operation will do
  - Vision: Some desired future state
  - Goals: Measurable desired future state an operation attempts to realize
Business Plan

- Structure of the Company:
  - What type of entity?
  - Who is in charge?
  - Who is responsible for what tasks?

- SWOT Analysis
  - Strengths
  - Weaknesses
  - Opportunities
  - Threats

- Marketing Plan
Business Plan

- Financial Analysis
  - Start Up Costs
  - 3 yrs of balance sheet and cash flow projections
  - Sources of funding and required repayment

- What are your “doors out”?
  - Sell a building lot
  - Borrow from family members
  - Get a part/full time job off the farm
  - Liquidation of farm assets
Business Plan

- Hints and Tips:
  - Build in extra for start up costs
  - Be realistic—a loss the first year is ok
  - Know the industry averages
  - Have others review your plan
Thank You!

Questions?