



## What Farm Women Need to Know About Finances

Objective of this lesson for Annie's Project:

- #1 To motivate farm women to accept the responsibility to keep good financial records
- #2 To educate farm women about constructing balance sheets, cash flows, and income statements.
- #3 To educate farm women how to understand the kinds of financial information found in balance sheets, cash flows and income statements.
- #4 To empower women to make reasonable judgments about finances and business.

Resources:

FAST Tools spreadsheets, Simple Balance Sheet, Ratio Analysis, Income Statement, Cash Flow.

### Objective #1

#### Keep good financial records

It's too hard!

What do I know about farming?

I don't know what to do with a balance sheet.

All I need to know about cash flow is that there is enough to cover my bills at the end of the month.

I'm not an accountant.

Schedule F is hard enough for me.

My husband doesn't think I need to worry about the books. It's his responsibility.

I already have a full time job plus family responsibilities. There are not enough hours.

Does any of this sound familiar? I strongly suspect that it does. Let's look at responses to each question or comment above:

#### It's too hard!

Nothing worthwhile is ever easy. Lots of folks have gotten over the "it's-too-hard" hurdle and discovered a sense of control where before there was none.

#### What do I know about farming?

Take a famous line out of the movie *Gone With The Wind* "I don't know nothing 'bout birthing babies." The woman's lack of knowledge didn't stop the human population from 'happening.' You are not going to take away the need for somebody to keep records and retrieve information because "you don't know nothin' about farming." Learn by doing and expect a few mistakes. Select your mentor who will help you when you have a question. Most farmers have discovered there are no permanent mistakes. We all learn and grow from mistakes. So too shall you.

**I don't know what to do with a balance sheet.**

Stick around. That's what this program is all about. You'll learn.

**All I need to know about cash flow is that there is enough to cover my bills at the end of the month.**

See, you got the right idea. Now picture yourself maybe in a month where cash is a little tight. Instead of dreading the shortfall, manage it. Have your lender prepared to cover your cash shortages with lines of credits or sweep accounts in times of cash shortages.

**I'm not an accountant.**

That's right. (Some of you farm wives just may be accountants, so ignore this one.) You and 98% of farmers are productionists with the need for someone else to watch the books. That means you could be working with professionals who do know how to be accountants and you'll need to learn how to work with them.

**Schedule F is hard enough for me.**

For most of you, this is the reason you keep books. My goal here is to expand your need for records beyond tax reporting. How about being able to know if a son or daughter can join the business, or if someone needs off-farm employment? Estate planning requires a ton of financial information, which, at the time it has to be retrieved, is stressful enough. Have it done ahead of time in anticipation of needing financial information at a later date.

**My husband doesn't think I need to worry about the books. It's his responsibility.**

It may be your family's decision that financial record keeping is his job, but it is still your responsibility to know what his records say. Some men feel more in control paying the bills themselves. Some are hesitant to ask a spouse to put balance sheets and cash flows together when they themselves are not comfortable with the documents. Some men simply do not trust the women they married to keep adequate records. Trust is earned over time. (If reasons to keep women in the dark about farm finances get into immoral or illegal areas, then you'll need to know about that too. Do not bury your head in the sand for the sake of complacency.)

**I already have a full time job plus family responsibilities. There are not enough hours.**

Having experienced this one I have to agree. Unless record keeping is a priority item, it's just another thing to do on a list already too long. Let me just offer encouragement that as one matures, so does one's priorities. Remain open to the idea that one day, you'll be good at keeping farm records.

Now that we've spent time on excuses, let's move on to action!

Keeping financial records for farming operations is a very big responsibility and a suitable role for women who want to be active and informed business partners. For the uninitiated, farm financial record keeping can be intimidating. Where does one start with this kind of task?

Big responsibilities are best developed over a long period of time and in small increments.

Let's start with your **business environment**. First and foremost, get yourself into a position to want to keep records and pay bills. So many have a negative attitude towards this part of business that one wonders if this is normal. Keeping records and paying bills is a very important part of any business and if approached with the proper attitude, skills and business environment, the task is quite rewarding.

Get set up to manage money.

Organize office space. (Kitchen or dining table doesn't count)

- a. Computer & Printer/fax/copier
- b. Financial software and spreadsheets or data base
- c. Phone and Internet to gather information and to communicate
- d. Filing space to stay organized and expedite retrieval.
- e. Work space to organize projects (or piles)

Discipline yourself to make time to do business. Every farm operation needs the following financial documents. The times suggested to manage each document is a reasonable estimate on the author's part.

Balance sheet (Take one day to construct, analyze and keep on file.)

Cash Flow (Take one day to construct and visit monthly to check accuracy of your projections.)

Income Statement (Take one day to make adjustments from schedule F activity.)

Every farm has weekly, if not daily, business transactions. Do not let these pile up! It goes back to the first point. If you are in a position to efficiently deal with short daily or weekly financial duties, you are more like to get them done and off your desk.

Here is a list of what regular financial duties may entail:

- Paying bills and payroll.
- Writing correspondence.
- Scheduling when money comes in and when money goes out
- Reviewing debt obligations.
- Paying debt
- Depositing money.
- Allocating money to investments, operating accounts, checking accounts, etc.
- Reconcile checkbook (important way to find errors)

If you can think of a few more, add them to the list above.

That's the business environment; now lets work on the big picture.

**Objective #2**  
**Constructing Balance Sheets, Cash Flows and Income Statements.**

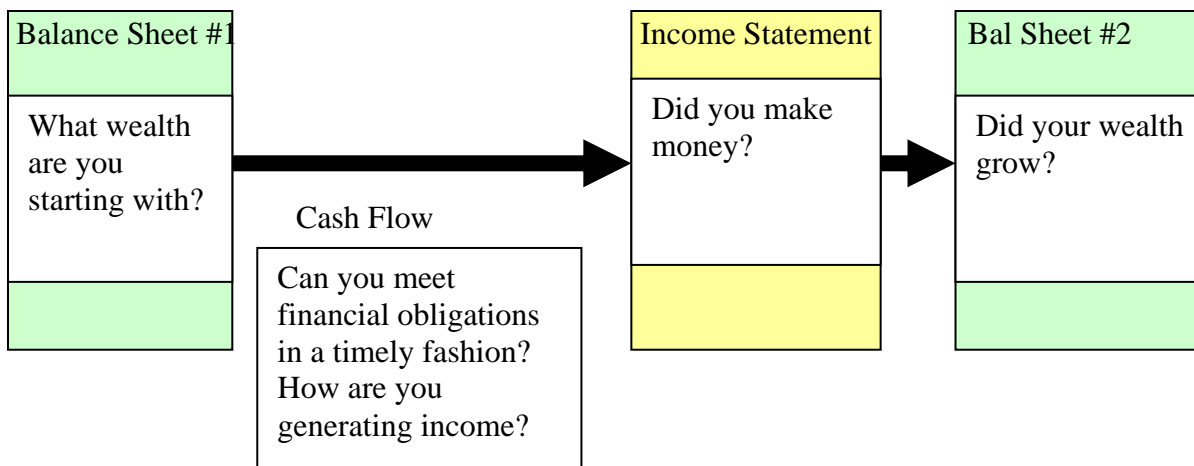
There are three kinds of financial records that farm women can master.

The first one is the balance sheet.

The second one is the cash flow.

The third one is the income statement (NOT income tax)

These three components of financial records work together to reveal valuable information for decision making.



Keep this visual in mind as we begin to train farm women to create these financial documents.


The combination of financial tools will allow you to make judgments in five areas of financial analysis:

1. Liquidity
2. Solvency
3. Profitability
4. Repayment Capacity
5. Financial Efficiency

Liquidity—having enough cash to meet financial obligations in a timely manner.

Solvency—having enough assets to meet all financial obligations today.

Profitability—money left over after paying cash operating expenses, and machinery and land investments.

A green oval with a black border containing the text "Annie's Project" in a black serif font.

*Annie's Project*

Repayment Capacity—having enough money to repay debt after paying necessary expenses.

Financial Efficiency—using your cash resources wisely to generate wealth.

## Balance Sheet Construction for Farm Women

Putting a Balance sheet together overwhelms some folks. This exercise is to help you do two things:

1. Learn the components of a balance sheet.
2. Raise your level of confidence to be able to complete and use a balance sheet.

The tool you will use is from your FAST CD. Look under “FAST Spreadsheet Tools”

Under the Financial Analysis section you will see “Simple Balance Sheet” Click on it.

You are about to prepare a balance sheet for “Sample Farm.” The date of preparation is December 31, 2003. Notice the date--December 31. NOT “*when the bank ask for it!*”

The balance sheet is a tool for you! The balance sheet is the financial snapshot of your business taken about the same time every year. Think about the pictures you may take of your family every Christmas. If the only picture you had to look at of your family is from 1987, you are not going to get a lot of information about your family. But if you lined up every picture you took of your family around Christmas over a period of years, you can see changes—children growing up, new faces appearing, old ones disappearing, etc.

The balance sheet works the same way. One balance sheet by itself from three years ago doesn't give you much information. But a series of balance sheets all prepared about the same time, gives you lots of information. This tool lets you see growth, or spots *potential* trouble. Balance sheets give you information that decision makers use to help them make good decisions.

No one is going to tell you to do this job. You have to take responsibility to do it. Your first decision is that you are going to take this responsibility. Your first task is to do it.

Lesson #1 How a balance sheet looks:

There are two basic ways that information is presented on a balance sheet.

The first way divides information into ASSETS on the top part of the page and puts LIABILITIES on the bottom half. Many commercial financial software packages use this format.

The second way, and more commonly used method, divides the page into four sections. This is the method we will use.

Balance Sheet As of \_\_\_\_\_ Business \_\_\_\_\_ Personal \_\_\_\_\_ Consolidated \_\_\_\_\_

CURRENT ASSETS	CURRENT LIABILITIES
NON-CURRENT ASSETS	NON-CURRENT
Total Assets	Total
Liabilities	Total Assets minus Total Liabilities = Net Worth or Owner Equity

Signature and Date \_\_\_\_\_

Things to note:



#1 The balance sheet represents ONE day of your financial condition. Record it as accurately as possible. Note the date "Balance Sheet As Of \_\_\_\_\_." Pick your date and stay with it year after year. After all, this is *your* set of records.

#2 Note the three choices of "Business, Personal, or Consolidated." Most balance sheets for farmers are consolidated, meaning that personal and business information is supplied on the same balance sheet. Here is another choice you get to make. Do you want the balance sheet to reflect only the business? When you are the owner and operator and investor of a business it is difficult to separate the personal from the business. It can be done. You decide. We recommend that you use "consolidated."

#3 Note that ASSETS are listed on the left side of the page; LIABILITIES are on the right. CURRENT ASSETS and LIABILITIES are on the top, NON-CURRENT ASSETS and LIABILITIES are on the bottom.

ASSETS are all the tangibles that you own and have value. LIABILITIES are all your debts.

CURRENT covers from the day of balance sheet preparation and the next 365 days.

NON-CURRENT is everything that lasts or continues beyond 365 days.

#4 Net worth is the result of *very simple* arithmetic. Total assets minus total liabilities equals net worth.

#5 Sign what you prepare. If a lender prepares a balance sheet *for* you, take it home and look it over before signing. Your name on this important document means something.

Better yet, YOU put your own information into a balance sheet and sign it. If or when a lender or other business partner needs to look at your balance sheet you are ready for this request. Most lenders will want a balance sheet no older than 6 months; some will want it less than 3 months old. Remain open to the idea that lenders have their rules and preferences for how financial information should be presented to them.

It's time to practice! [USE **SIMPLE BALANCE SHEET ON FAST TOOLS**]

Let the spreadsheet do your work. Your first real balance sheet will take a little time to construct. Estimated time: 8 hours (one day) if you've never done this. This example will take 50 minutes.

Where blanks are shaded, you can type in your information. When blanks are white, you will need to use the schedules built in behind the spreadsheet. Information will then transfer into the balance sheet. This helps you organize a lot of information easily and with the least amount of errors.

Here is the farm we are going to use: 1,100 acres of corn, soybeans and wheat, with home, buildings and grain storage facilities. Sample farmers are in their late forties, early 50's.

We'll start on the asset side of the balance sheet.

- Cash on hand (checking accounts and cash)--\$10,000
- Cash in savings and CDs--\$50,000
  
- Crops in storage on December 31, 2002
  - Corn—50,000 bushels @ \$2
  - Soybeans—5000 bushels @ \$5.00
  - Wheat—nothing in storage
  
- 500 gallons of diesel fuel are in the tank @ \$1.20 per gallon
  
- There are 100 acres of wheat growing in the fields @ \$40 per acre.

Note that everything to this point is useable or saleable in the next 365 days. That makes this stuff **CURRENT ASSETS**.

Now for the NON-CURRENT ASSETS. These are the things that last beyond the year. These items can grow in value (appreciate) or lose value (depreciate.)

- Machinery is worth \$250,000 if sold today. According to the depreciation schedule the value is \$275,000. The first figure is called **Market Value**; the second figure is called **Cost Value**.
- Retirement accounts = \$90,000
- Cash value of life insurance is \$8,000
- All acres are owned currently valued at \$2,500 per acre. Original value is \$1,200 per acre.
- Buildings and a grain storage facility are valued at \$150,000
- Home place is valued at \$78,000. Initially it was appraised at \$50,000.

A word about valuing assets. When valuing current assets, you can check saving account and checking account balance s and check market prices. Be consistent with the dates and location of where you are checking prices. For growing crops, look at actual expenses incurred to this point to determine value.

Valuing machinery is not an exact science, but most farmers have a good feel for the value of their equipment by virtue of attending farm auctions and checking prices of used and new equipment. Most of you keep track of depreciation for tax reasons. You can use this number in the “cost” column. Use your best defensible judgment of what equipment would bring on a sale to fill in the “market value” column.

The same goes for land values. Annual appraisals are not necessary, but at least one professional appraisal or actual sale or purchase of land is helpful in estimating reasonable and defensible land values.

Now for the LIABILITY side of your balance sheet.

This side of the page is a little more involved especially if you have lots of different notes and loans. If farmers lose track of something, this is it—the debt loads a farmer carries can mount up without his or her knowing it.

This part of your balance sheet can be completed more quickly if you organize your information.

Here are the types of debt:

Current debt.

Unsecured

Unpaid bills, accounts payable, credit cards and money from family and friends.

(No collateral involved, just annoying phone calls and a ruined credit rating if you can't get bill paid in a timely manner.)

Secured

Operating notes, and lines of credit.

(Collateral involved, usually the crop or livestock for which the money is borrowed.)

Non-current debt.

Secured

Real Estate loans and contracts, machinery notes, old operating notes.  
(Collateral involved, usually land and machinery.)

Back to the spreadsheet:

Begin with accounts payable, blue box schedule 6.

For our example enter \$1000 in the "other" category. In the real world you will carefully record everyone you owe money to for regular bills as of the date you are preparing your balance sheet. These debts are unsecured. Even if you keep bills paid up, it is best to put something in this category, because everybody owes something to somebody at any one time.

Notes Payable in one year: Operating note for \$25,000 payable 12/1. 8% annual interest

Land real estate loan balance \$185,000 due on Feb 1, interest rate is 7%. Annual payment.

Eight more years to payoff.

Current portion of this debt is: \$18,300 (list in the current liability section under term

debt due in next 12 months.) The rest of the debt, \$166,700 will be under non-current liabilities.

Accrued interest is \$11,871 ( $7/12 \times 11 \times \$185,000$ )

That's it! You have created a balance sheet.

Now we'll look at results.

Your spouse has you sign a balance sheet that will go on file with the lender. Do you look at it before signing? Probably not. Why not? Probably because you wouldn't know where to start if you did look at it. We are going to end that. Balance sheet analysis for your purpose is not complicated if you know **WHAT** you are looking at and **WHY** you are looking at it.

[USE **BENCHMARK RATIO ANALYSIS ON FAST TOOLS**]

Remember that we said the combination of financial tools would allow you to make judgments in five areas of financial analysis:

1. Liquidity (Use the balance sheet to help determine this)
2. Solvency (Use the balance sheet to help determine this)
3. Profitability (Use the income statement to help determine this)
4. Repayment Capacity (Use the income statement to help determine this)
5. Financial Efficiency (Use the income statement to help determine this)

For this exercise I have three balance sheets for your inspection. You'll look at all three balance sheets using the same pattern, and then make some judgments for me. This will be quick and easy when you get the pattern.

The first thing to look at is **liquidity**. What is liquidity? It's your ability to meet current obligations as they come due. Why do you want to look at liquidity? It will tell you if you can meet your scheduled obligations or if there will be a money crunch.

One measure of liquidity is **working capital**. Working capital is money and assets to meet obligations and begin the purchase of future inputs.

You find working capital on the balance sheet by subtracting current debt from current assets.

The number needs to be positive. The bigger the better. Negative numbers need to be investigated immediately.

Working capital by itself should generate a few questions for you. Ask how this compares to current debt and value of farm production.

The **current ratio** helps to answer the question about current debt compared to working capital. Divide current debt by current assets to get the current ratio.

Example:

Current debt = \$50

Current assets = \$100

Working capital is \$50. (ca – cd)

Current ratio is 2 (ca/cd) (For every dollar of current debt there is \$2 of current assets ready to meet obligations)

Since the value of farm production comes from the income statement and we are only looking at a balance sheet for now, we'll leave that ratio for later. (I said this was going to be quick)

Now let's look at solvency. Solvency measures your ability to meet all obligations today. The best indicator of solvency is the **debt to asset ratio**.

Again, simple division gets you this ratio.

Divide **total debt** (lower right hand corner of balance sheet) by **total assets** (lower left hand corner of balance sheet.) The bigger this ratio, the bigger your troubles.

A couple of examples:

Total debt = \$50

Total assets = \$500

Debt to asset ratio = .10 or 10% ( $50/500 = .10$ ) O.K.

Total debt = \$500

Total assets = \$600

Debt to asset ratio = .83 or 83% ( $500/600 = .83$ ) Very bad (unless you have a very productive dairy operation.)

For operations that own land and assets, any number less than .40 or 40% is usually pretty solid. If your ratio is over 40%, watch for financial stress. A bad year could create hardships very quickly. (You can keep that from happening with revenue insurance, but that is another program.)

That's it for ratios to look at before signing.

You may want to examine land values and machinery values. If something sounds high or low ask about it.

Now that you have a financial picture of your life, it's time to start the videotape of day-to-day activities. That is considered the cash flow.

Cash flow looks at money coming in and going out and the timing of each.  
In an ideal world:

- cash comes in just before cash needs to go out.
- the source of the cash going out is from sales of commodities produced on the farm.
- the money coming in from sales of commodities is more than the money scheduled for payments of debts, operating expenses, family living and taxes.

[USE FAST TOOLS CASH FLOW SPREADSHEET]

Your income statement reveals profitability. This is different than your income tax, which is a record for paying taxes. To minimize taxes, you minimize income. This is perfectly legal. Do not however, use income tax records to determine profitability. Use your income statement.

Your income statement starts with your cash accounting and makes adjustments for inventory changes and asset changes.

Sound intimidating until you use the FAST tool for adjusting income statements. When women use this spreadsheet, they are surprised by how painless the process really is. You'll start with your schedule F information from your tax return and plug in inventory and asset information.

[USE FAST TOOLS CASH TO ACCRUAL INCOME APPROXIMATION]

Depreciation of farm equipment and buildings is a task that intimidates farm women.  
How do I . . . ?  
What if I . . . ?  
Why do I . . . ?

Depreciation in the formal sense is called cost accounting. For assets that have value longer than one production cycle, there must be a way to allocate the expense (investment) in that item for a production cycle.

IRS has specific rules, like "mid-year convention" "quarterly convention" MACRS, straight line depreciation, double declining balance, etc.

Your balance sheet reflects your world. The two numbers do not have to match exactly.

[USE FAST TOOLS MACRS CALCULATOR]