

## FAQ 9

### What Are the Most Necessary Farm Records, and How Do I Interpret and Use Them?

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Farm recordkeeping is more than just keeping track of what crop was planted in what field. It is a concept applicable to the entire farm operation. Livestock producers keep herd management and production records adapted to each individual species. Anyone who applies restricted use pesticides is required by law to keep application records. However, those same pesticide application records can also include important pest pressure information, crop yields, and seed varieties planted. Over the long haul, farm records can be a valuable management tool and help the farm operator/manager make informed decisions. Farm records can also assist the producer when he/she presents his/her 'story' to the lender or even the general public. Complete records make a complete story.

Purdue Extension publications EC-712, ID-237, EC-671, and EC-616 provide valuable information on farm records. EC-712 also discusses how to interpret financial performance ratios from farm records and provides benchmarks as a measuring tool. Both EC-671 and EC-712 are great publications for understanding what records to use in determining your financial position (EC-671) and how to interpret what those records tell you (EC-712).

#### **Excerpt from *The Projected Cash Flow Statement* (EC-616)**

A projected cash flow statement is described as a listing of all expected cash inflows and outflows for the coming year. The statement can be prepared for whatever time period is most useful to you; quarterly, monthly, and even weekly if desired. This information enables you to communicate borrowing needs to your lender and to establish a repayment schedule. In addition, the information can be used to identify possible investment opportunities during the planning period.... cash flow planning ... will be a major concern for lenders and borrowers. A projected cash flow statement will greatly aid attempts to plan cash inflows and outflows for a farm business. Often the statement provides only a rough estimate of the cash position for the business, since marketing plans, prices, production levels, and even expenses often differ from what is projected. However, even though a projected cash flow is but a rough estimate—if compared to no estimate—it is a great help in planning ahead.

### Resources for Record Keeping

Resources	Sources
<i>Measuring &amp; Analyzing Farm Financial Performance</i> (EC-712). Purdue Extension.	<a href="http://www.agecon.purdue.edu/extensio/fbm21/Ec712entry.htm">http://www.agecon.purdue.edu/extensio/fbm21/Ec712entry.htm</a>
<i>The Projected Cash Flow Statement</i> (EC-616). Purdue Extension.	<a href="http://www.ces.purdue.edu/extmedia/EC/EC-616.html">http://www.ces.purdue.edu/extmedia/EC/EC-616.html</a>
<i>Checking Your Farm Business Management Skills</i> (ID-237). Purdue Extension.	<a href="http://www.ces.purdue.edu/extmedia/ID/ID-237.pdf">http://www.ces.purdue.edu/extmedia/ID/ID-237.pdf</a>
<i>Utilizing Record Keeping Tools for Management and Profit</i> (EC-671)	Copy included. Deleted Purdue Extension publication. Not available at MDC.
Illinois Farm Business Farm Management Association Farm Business Results	<a href="http://fbfm.ace.uiuc.edu/results.htm">http://fbfm.ace.uiuc.edu/results.htm</a>

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## **What Kind of Records Do I Need to Provide Information for Making Farm Management Decisions? How Do I Keep Those Records? How Do I Use the Information?**

How do you plan to use the information? Wrestling with that question is a logical starting point when designing a farm record system. The types of uses typically associated with farm records are: 1) tax compliance and reporting, 2) financial reporting and analysis, 3) management analysis and control, and 4) budgeting and financial forecasting/projections. The intended use should dictate what types of records are maintained. The specific information requirements associated with a particular use should dictate what information is accumulated in those records.

Too many farmers still use records exclusively for tax compliance and tax reporting. Records have so much wasted potential when they are only used for tax compliance.

### **Cash Record Keeping for Tax Compliance and Reporting**

Records kept to support tax reporting are too often some form of checkbook register or single entry account book. Recording checks written and receipts deposited is the primary focus of these simple tax records. The record keeping procedures used with these records oftentimes leave them very vulnerable to being incomplete and inaccurate. There are important steps that can be taken to attempt to ensure the completeness and accuracy of such records. Examples include:

1. A central clearing account should be used for the farm business. All farm receipts should initially be deposited in this account, even if they are later transferred to other checking/savings accounts. All farm expenses should originate from this account.
2. Use a separate record book for each checking account. Monthly totals from each record book should be reconciled to the corresponding farm checking account balance.
3. Keep a file for the sole purpose of accumulating evidence of non-cash transactions. For example, evidence of non-cash transactions includes the paperwork that accompanies a patronage refund and the financing statement that accompanies dealer financing of an equipment purchase.
4. Never take cash for spending money out of receipts deposited at the bank.

The net cash farm income reported on a tax return is generally not a good indicator of the actual earnings of a farm business. Net income must be measured on the accrual basis in order to produce a valid and useful measure of net farm income. Accrual measurement recognizes income when earned rather than when cash is received. It also recognizes expenses when they contribute to the production of earnings rather than when cash is paid. A process of making accrual adjustments can be used to convert net cash farm income to a meaningful measure of periodic income. This process involves adjusting cash receipts and expenditures by the net change during the year for certain current farm asset and liability accounts including grain in inventory and accounts payable at the farm store. Purdue Extension publication EC-712, *Measuring and Analyzing Farm Financial Performance*, provides worksheets for guiding a producer through the accrual adjustment process.

IRS publication 225, *Farmer's Tax Guide*, elaborates more on specific kinds of records farmers must keep for tax compliance purposes.

### **Financial Record Keeping and Financial Reporting**

General-purpose financial statements are the end product of financial record keeping and reporting activities. The four types of general-purpose financial statements are the balance sheet, the income statement, the statement of cash flows and the statement of changes in owners' equity. Financial statement analysis techniques should be used to evaluate the financial information summarized by these statements. The purposes of financial statement analysis are 1) to identify the financial strengths and weaknesses of the farm, 2) to determine whether the farm has made financial progress, and 3) and to determine how financial performance might be improved.

One way to do financial analysis is called ratio analysis. Ratio analysis involves computing the relationship between selected dollar amounts that appear in the financial statements. For example, the current ratio is computed by dividing current assets by current liabilities and is a near term indicator of the farm's capacity to pay current liabilities as they become due. Ratios are oftentimes easier to interpret than absolute measures and easier to compare across farms or time. Another analysis technique is called trend analysis. Financial statement amounts and ratios are compared to the same measures from previous accounting periods. Another analysis technique is called benchmarking or comparative analysis. Dollar amounts and ratios gleaned from the farm financial statements are compared directly with performance data from comparable farms.

*Financial Guidelines For Agricultural Producers, Recommendations of the Farm Financial Standards Council*, is an excellent source of information on both of the aforementioned topics. It is available at the following Web site: [www.ffsc.org](http://www.ffsc.org)

### **Management Record Keeping and Management Analysis**

Financial accounting is generally limited to recording dollars and to accumulating information needed for the general-purpose financial statements. Uniformity in financial reporting is important. The accounting standards that lead to increased uniformity in financial reporting heavily influence the design of financial accounting and reporting systems. Managerial accounting, on the other hand, is driven solely by the information needs of the farm manager. Much of the most useful information may involve physical amounts rather than dollar amounts. This information doesn't necessarily have to be recorded in the farm financial records. It may be kept in a separate record. Whatever works for the individual farmer is the deciding factor.

Accuracy is just as important in management record keeping as in tax and financial record keeping. If the management information isn't accurate, it may do more harm than if you didn't have it at all. With physical quantities, check sheets are recommended as a tool for testing the equality of the sources and uses of quantities and thereby testing the accuracy of quantity information. The sources/ amount to account for should equal or at least closely approximate the uses/ amount accounted for.

Quantity sources typically include beginning inventory quantity, quantity purchased, quantity produced and quantity transferred in from other production enterprises/production centers. Uses typically include quantity sold, quantity fed if feed or grain, quantity spoiled or death loss in livestock, quantity transferred out to other enterprises/production centers, and ending inventory quantity. Inventory change is a critical element if quantities are to coincide with accrual adjusted financial measures.

Completeness is another matter entirely. A farmer could wear himself out keeping track of every type of information that might remotely be useful for management analysis purposes. The appropriate criteria for how much and what management information to record are: 1) Does the benefit of recording and using the information sufficiently exceed the cost to make it worthwhile? 2) If the information is collected, will it be used to influence farm decision-making? As you try to apply these criteria, it may be helpful to think about what information is likely to change how you operate the farm.

Information that will change how you operate and lead to improved yields would seem to produce a net benefit. Unfortunately, we generally don't have the luxury of knowing that the information will pay off. But, it is a good idea to have a plan in mind about how the management information will be used before investing large amounts of time and money collecting that information. Management records are only useful when they are used.

It pays to invest time and effort in determining what management analysis record information will be beneficial. Start by looking for recommendations. Good places to look for recommendations about the most important non-financial records to keep include Extension publications, the popular farm press, and commodity organizations.

### **Forecasts and Projections (Budgeting)**

The importance of budgeting, in its many forms, has increased as the financial stakes associated with farming have increased. In particular, cash flow forecasts and projections are increasingly a prerequisite when obtaining financing for operating and for new farm investments. Historical records are an extremely valuable source of information for this type of budgeting. They likely provide the only reasonable basis for making some estimates of expected revenues and expenses, as well as a basis for assessing the reasonableness of many other estimates.

In addition, cash flow forecasts are an extremely useful tool for management decision-making. Consider for example, a farm that forecast net cash available (a surplus) for the year at \$24,000. The budget for the year has been right on the mark through the end of June, including the \$40,000 from wheat sales that is still in the farm checking account. But, now the farmer needs to trade tractors; an investment that he hadn't anticipated when he prepared the cash flow budget for the year. The tractor will cost him his old tractor plus \$35,000. He is considering paying the \$35,000 cash difference outright rather than financing the tractor, since he has the cash to do it. What will executing that plan do to his forecast cash surplus for the year? In our example, the annual cash flow forecast shows that most of the \$35,000 he is considering paying out now will be needed later in the year and isn't really as available as it appears to be.

### **Computerizing the Farm Records**

A computer is a powerful tool for any farm that is serious about using farm records for financial accounting, management, and budgeting. The Ag Software Directory on the Internet ([www1.agric.gov.ab.ca/departement/deptdpcs.nsf/all/econ4118](http://www1.agric.gov.ab.ca/departement/deptdpcs.nsf/all/econ4118)) is a good place to look for commercially available computerized record keeping and decision-making tools for farm use.

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