

Financial Performance: How Am I Doing?

Assessing the financial condition of a farm business requires information from a balance sheet and an income statement. Most farm business managers have a balance sheet, particularly if they borrow money, because this document is a standard requirement of the credit transaction. Some farm business managers will have quite complete income statements based on an accrual accounting system, but many will only have a Schedule F tax return to provide evidence of their income-generating capacity. Even with this limited information, you can complete a relatively accurate financial analysis including the key performance measures identified in Table 2.

You can use Worksheet 1 (p. 12) in this section to organize the appropriate input information. A key virtue of this worksheet is that most farm business managers should already have most of the required data, once they have filed their income tax return. This worksheet will help you obtain the best estimates possible of key financial performance ratios with a limited amount of readily available data.

In order for the worksheets provided in this section to generate accurate, accrual-adjusted financial measures, the beginning and ending balance sheet dates should fall within a few days of the beginning and ending dates, respectively, for a farmer's taxable year. For example, March 1 balance sheets would produce unreliable measures when combined with a calendar year Schedule F.

Worksheet 1 identifies where specifically to look for the necessary information in the federal income tax return and what type of information to input from beginning and ending year balance sheets. Worksheet 2 (p. 13) guides you through a series of specific computations using the data from Worksheet 1. The computations required by Worksheet 2 produce values for the key financial measures outlined in Table 2. Once these measures have been computed, you can transfer the high-profit benchmarks from Table 2 to the benchmark column on Worksheet 2. Finally, you should compare the values for each of the financial measures to the corresponding benchmark in order to assess the financial performance and financial position of your farm.

Indications of financial strength will depend on the measure being considered. In some cases, a measure with a value greater than the benchmark will indicate financial strength. In other cases, a value smaller than the benchmark will indicate financial strength. The chart above indicates which measures fall into which categories.

Indicators of Financial Strength

Values Larger Than Benchmark

Return on assets
Return on equity
Operating profit margin
Current ratio
Asset turnover ratio
Revenue per full-time laborer
Net farm income ratio

Values Smaller Than Benchmark

Debt-to-asset ratio
Operating expense ratio
Depreciation expense ratio
Interest expense ratio

Worksheet 1. Input Information

Schedule F Data

Taxable Year:

Cost of livestock sold (Schedule F, line 2)	(a)	_____
Gross income (Schedule F, line 11)	(b)	_____
Depreciation (Schedule F, line 16)	(c)	_____
Mortgage interest (Schedule F, line 23a)	(d)	_____
Other interest paid (Schedule F, line 23b)	(e)	_____
Total expenses (Schedule F, line 35)	(f)	_____

Balance Sheet

Beginning

Ending

Balance sheet date			
Cash	(g)	(l)	_____
Total current farm assets	(h)	(m)	_____
Total current farm liabilities	(i)	(n)	_____
Accrued interest	(j)	(o)	_____
Farm accounts payable and accrued exp.	(k)	(p)	_____
Total farm assets		(q)	_____
Total farm liabilities		(r)	_____
Owner's equity		(s)	_____

Miscellaneous Data

Breeding stock sales (Form 4797)	(t)	_____
Number of operators and employees (annual full-time equiv.)	(u)	_____
Family living expense (all families supported by the farm) ¹	(v)	_____

Net Farm Income

Gross revenues [a+b+t+(m-l) – (h-g)]	(w)	_____
Interest expense [d+e+(o-j)]	(x)	_____
Other expenses [a+f-(d+e)+(p-k)]	(y)	_____
Net farm income [w-x-y]	(z)	_____

¹ This number is used to approximate the value of unpaid family and operator labor. University of Illinois research indicates that 1997 total living expenses for 1-2 member families is \$39,332; 3-5 member families is \$47,950; and 6+ member families is \$47,083. Do not include a value here if the operator and family members are paid a reasonable wage by the business and those wages are already included in the value on line f.

Worksheet 2. Financial Performance Measures

Profitability	Your Farm	Benchmark ¹	Strong (+) / Weak (-) ² (circle one)
1. Return on Assets [(z+x-v)÷q] x 100	_____ %	_____ %	+ -
2. Return on Equity [(z-v)÷s] x 100	_____ %	_____ %	+ -
3. Operating Profit Margin [(z+x-v)÷w] x 100	_____ %	_____ %	+ -
Liquidity			
4. Current Ratio [m÷n]	_____	_____	+ -
Solvency			
5. Debt-to-Asset Ratio [r÷q] x 100	_____ %	_____ %	+ -
Financial Efficiency			
6. Asset Turnover Ratio [w÷q] x 100	_____ %	_____ %	+ -
7. Revenue per Full-Time Laborer [w÷u]	_____	_____	+ -
8. Operating Expense Ratio [(y-c)÷w] x 100	_____ %	_____ %	+ -
9. Depreciation Expense Ratio [c÷w] x 100	_____ %	_____ %	+ -
10. Interest Expense Ratio [x÷w] x 100	_____ %	_____ %	+ -
11. Net Farm Income Ratio [z÷w] x 100	_____ %	_____ %	+ -

¹ See Table 2 for benchmarks.

² A strong indicator for items 1, 2, 3, 4, 6, 7, and 11 would be a value for your farm that is greater than the benchmark. A strong indicator for items 5, 8, 9, and 10 would be a value for your farm that is less than the benchmark.

In the last column of Worksheet 2, circle the plus or minus, as appropriate, to assess the financial strengths and weaknesses of your farm relative to the benchmark farms.

Worksheets 1 and 2 provide a beginning point for conducting a financial evaluation of your farm. Using more of the information from the balance sheets and Schedule F, you can conduct a more detailed financial analysis. The FINAN program in FINPACK* would be one way of conducting a more detailed analysis. The FINAN program will provide more information about cash flows and repayment capacity. It also provides a good initial point for the development of a detailed annual or multi-year cash flow projection. If an evaluation of financial performance is conducted annually, FINAN provides a method of organizing data for a trend analysis.

* *FINPACK is farm financial planning and analysis software developed by the Center for Farm Financial Management at the University of Minnesota. The software contains four components: 1) Balance Sheet Development; 2) Long-Range Budgeting; 3) Single and Multi-Year Cash Flow Projections, FINFLO; and 4) Financial Analysis, FINAN. A farmer version of the program costs \$395 and can be obtained by contacting the Center for Farm Financial Management at 1-800-234-1111 or can be downloaded from the center's Website at <<http://www.cffm.umn.edu/>>.*