COMPLIMENTARY TEACHING MATERIALS

Farm Business Management: The Fundamentals of Good Practice

Peter L. Nuthall

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Chapter 8

Farm Finances, Financial Accounts and Records in General

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LEARNING OBJECTIVES

Discover the broad reasons for keeping records.

Realize that record keeping, and the analysis of records, is an investment no different from any other, but more tangible, projects. For each record, or analysis, it must be assessed whether the return from the effort covers the costs. The return from more and more record keeping will likely decline, as in a production function, and eventually become negative.

Understand the difference between data and decision information.

Learn how to review and critique a farmer's current record-keeping practices.

Turning to farm financing, understand the different forms and sources of farm funds borrowing.

Discover the structure and form of annual financial accounts.

Learn about double-entry bookkeeping and its single-entry counterpart.

Obtain a knowledge of the structure and functions of typical computer-based financial recording and budgeting systems.

Develop an understanding of the processes involved in farm accounts analysis.

Keeping Records

Records are needed to:

- provide data and information to analyse proposed new farm systems;
- control current operations;
- comply with the law and regulations: financial accounts; tax matters; labour matters; environmental factors;
- enjoy the farm operations and bask in physical, environmental and financial outcomes.

Best system for any one farm is unique because the farmer and farm are both unique. Must suit the farmer and her/his abilities and personality.

Assessing Record Requirements

Allow for costs and benefits in deciding record requirements.

Record keeping has a cost, i.e. the time and equipment involved.

Returns from records include better decisions; greater satisfaction; complying with the law and regulations; saving in penalties.

Data and information: data on its own is of little use, so need to process data to create decision information (e.g. sum and collate rainfall records into suitable decision form).

Review Current Recording System

Constantly review current systems to seek improvements.

Summarize current procedure by listing what records are kept and their form.

Consider each record and review how the information is used. What decisions are made from each? Are the records useful now, or in future?

Consider current decisions that do NOT have helpful records. Should they be added?

Areas of requirements: personal records (e.g. insurance); farm records (e.g. technical, legal); farm physical records (e.g. rainfall, yields, field information, animals); farm financial records (e.g. debt, cash flows, transactions, tax).

Farm Financing

Most farmers borrow funds for initial purchase and/or development and/or operations (working capital). Sources are:

- Mortgages: long-term borrowing. Fixed term and conditions and/or variable term and conditions, varying level of security over assets (first mortgage, second mortgage, etc.).
- Short term (usually working capital) from banks of varying kinds and supply companies (extended debt), e.g. general farm supplies group.
- Family and similar loans: various conditions and arrangements.
- Non-family sources of funds: equity partners (share profits); shareholders (stock holders, receive dividends).

Books of Account (Financial and Sometimes Physical)

Often required for government tax purposes, but also important for management.

Balance sheet: Shows the net financial position at a fixed point in time, assets and liabilities (loans) leading to net worth (the difference). Values are usually based on original purchase cost.

Profit and loss: Presents income and expenses for, usually, a 12-month period. Not all items are cash (e.g. depreciation estimates, stock value changes). Difference between income and expenses is profit (usually taxable).

Supporting accounts: Feed into profit and loss account, e.g. stock sales and purchases with adjustments for beginning and end value changes.

Appropriation account: Provides information on how the profit was utilized, e.g. living expenses. The difference between the profit and its uses provides a growth in net assets and is transferred to the balance sheet.

Book-keeping Methods

Financial

- **Single-entry system**. Record every transaction in only one account type, e.g. fertilizer in the fertilizer account.
- **Double-entry system** (as in most modern computer systems). Record every transaction twice: once in the relevant type account (e.g. animal health, fertilizer) and once in the balance sheet account it affects (e.g. bank account, short-term debt from supply group). Advantages: allows check on accuracy when compare with what bank sends, and maintains up-to-date balance sheet accounts.

Physical

Field recording. Hand notes, electronic devices, rising plate meters (field dry matter), etc.

Computer-based Accounting Records and Financial Forecasts

Most western farmers keep their own records on farm computers (and analyse them as appropriate).

Every transaction and its associated physical quantities (e.g. tonnes of fertilizer) is entered at least monthly.

Enables both tax and management reports. Common examples are:

- enterprise accounts (actual gross margins);
- budgets and budget actual comparisons (at least monthly);
- farm as well as personal income and expenditure;
- searching and listing facilities (did I pay that account?);
- tax reports (value added and others);
- physical reports (e.g. stock reconciliation, product on hand).

Farm Size

Records help decide on appropriate farm size when combined with other farm records.

Researchers often analyse records to find out an optimal size for a farm.

Increasing size can lead to efficiencies (e.g. specialist staff, sufficient staff to cover absentees).

Too large a size can lead to inefficiencies (e.g. disease spreads in large mobs of animals, lack of control).

Size that is optimal varies from farm to farm because of their qualities and uniqueness.

Economies of size where efficiencies occur as increase size of some operations and economies of scale where get gains from increasing all factors in proportion.

All farms need to expand production because of the constant cost–price squeeze.

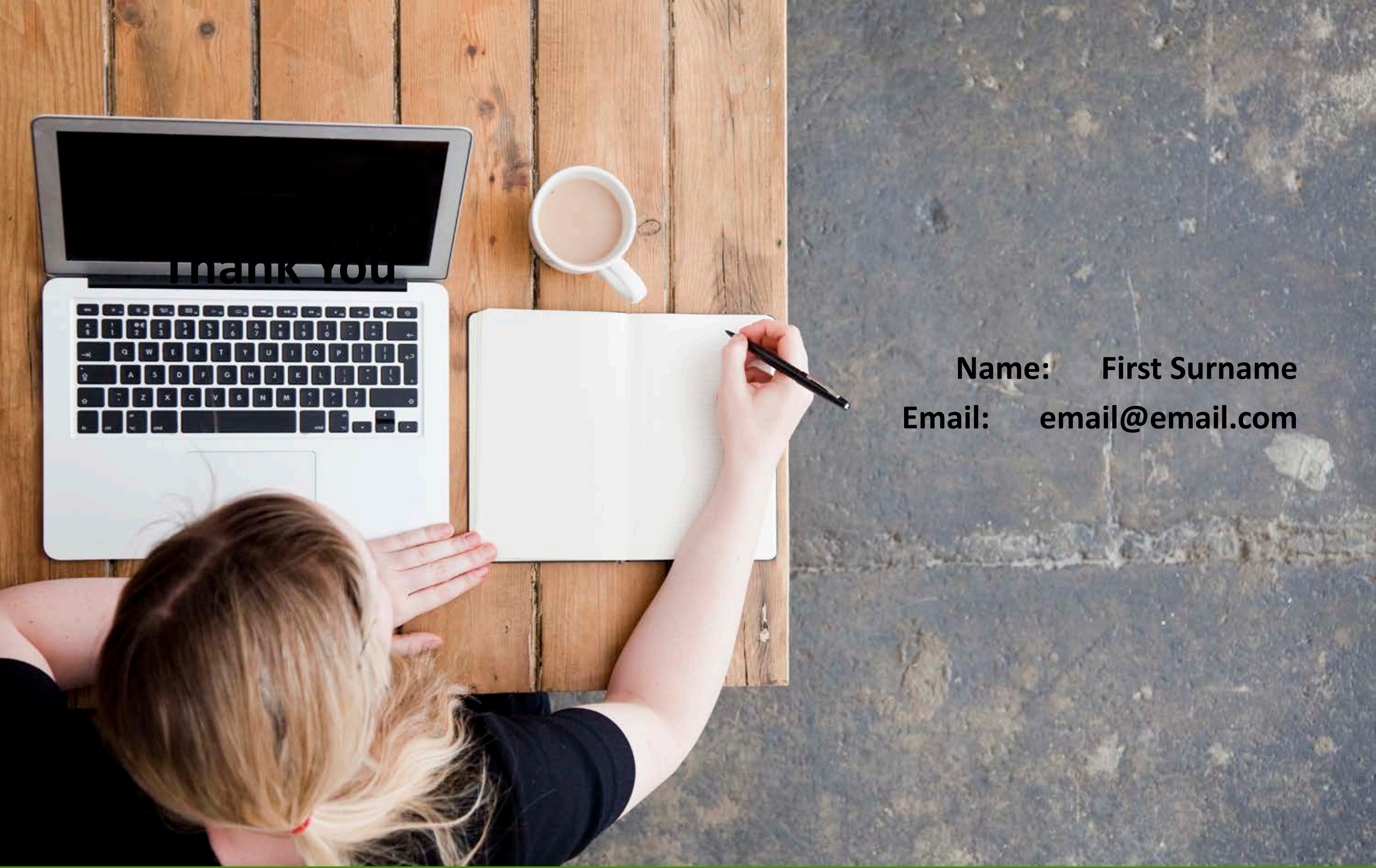
Accounts Analysis

Accounts are usually prepared to meet tax laws and do not normally comply with management requirements (e.g. use historic costs).

Adjust accounts for management purposes: use for assessing relative profitability, benchmarking and providing decision variables (e.g. actual gross margins).

Adjustments required:

- Re-value assets to keep up to date: is net worth changing?
- Modify profit and loss to reflect true profit.
- Include non-paid resources (e.g. family labour, farmer's wages).
- Exclude household expenses.
- Exclude development expenditure.
- Adjust stock values to give true value change.
- Remove debt costs if wish to compare with other farms.



Thank You

Name: First Surname

Email: email@email.com