

*Breaking Barriers for Beginning
Farmers and Ranchers*
(NIFA-USDA #2010-49400-21729)



*Fundamental Record Keeping
and Financial Statements*

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Seminar Series

AgriLife Extension

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What is the purpose and use
of accounting records?

Purpose and Use of Records



1. Measure profit and assess financial condition
2. Provide data for business analysis
3. Assist in obtaining loans
4. Measure the profitability of individual enterprises
5. Assist in the analysis of new investments
6. Prepare income tax returns

Any other purpose or use?

- Demonstrating compliance with environmental regulations
- Establishing insurance needs
- Valuing the agribusiness
- Monitoring inventories
- Dividing landlord/tenant expenses
- Planning strategic and tactical decisions

1. Measure Profit and Assess Financial Condition

- These are among the most important reasons for keeping records.
- Profit is estimated by developing **an income statement**.
- The financial condition is shown on the **balance sheet**.

Income Statement Example



Cash Accounting

Grain revenue from cash sales	\$50,000
Total Revenue	\$50,000
Fertilizer	8,000
Seed, chemicals, fuel	25,000
Drying fuel	3,000
Total Expenses	\$36,000
Net Farm Income (Profit)	\$14,000

Balance Sheet Example



Assets		Liabilities	
Current Assets	\$100	Current Liabilities	\$60
Noncurrent Assets	<u>400</u>	Noncurrent Liabilities	<u>200</u>
		Total Liabilities	\$260
		Owner's Equity	<u>240</u>
Total Assets	\$500	Total Liabilities and Owner Equity	\$500

2. Provide Data for Business Analysis



- Use the information from the balance sheet and income statement to perform an in-depth analysis.
- Analysis of past decisions is useful for making current and future decisions.

3. Assist in Obtaining Loans

- Lenders require financial information about the farm business to assist them in their lending decisions.
- With the current financial and economic crisis, many agricultural lenders are requiring more and better records.
- Good records increase the odds of
 - Getting a loan approved
 - Receiving the full amount requested

4. Measure the Profitability of Individual Enterprises



- An income statement or a balance sheet may include several different enterprises
- It is possible that one or two of the enterprises are producing all or most of the profit and one or the other enterprises are losing money
- You can do separate income statements and balance sheets for each enterprise
- You can estimate unprofitable or least profitable enterprises

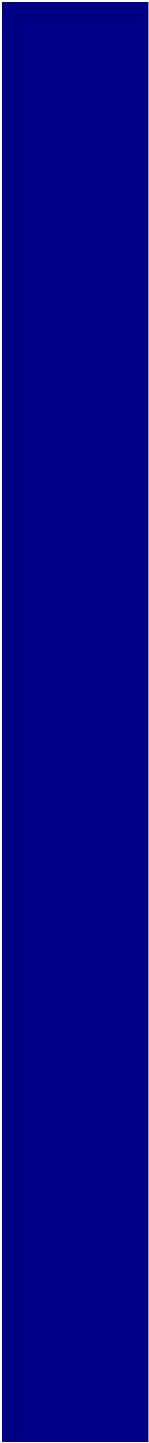
5. Assist in the Analysis of New Investments



- A large amount of information may be required to analyze and decide on a new investment
- Past records of the business can be excellent source of information
- Records of the business can be on the same or similar investments

6. Prepare Income Tax Returns

- Internal Revenue Service (IRS) regulations require keeping records for tax purposes.
- Tax records are often inadequate for management purposes.
- Sound record-keeping can also help reduce income tax obligations.
 - It may identify additional deductions and exemptions
 - It may provide better management of taxable income from year to year
 - It may help reduce income tax paid over time



What are my options in
choosing an accounting
system?

Options in Choosing an Accounting System

- a) What accounting period should be used?
- b) Should it be cash or accrual?
- c) Should it be single or double entry?
- d) Should it be basic or complete?

a) Accounting Period

- An **accounting period** is a period of time used to summarize revenue and expenses and estimate profit. It can be either a **calendar year** or a **fiscal year**.
- It is generally recommended that a firm's accounting period follow the production cycle of the major enterprises.

b) Cash vs. Accrual

- Under **cash basis accounting**, transactions are recorded only when cash is received or paid.
- The cash basis of accounting is not in accordance with generally accepted accounting principles (GAAP)
- Under **accrual basis accounting**, transactions are recorded in the periods in which the events occur, rather than in the periods in which the company receives or pays cash.
- The accrual basis of accounting is in accordance with GAAP.

c) Single vs. Double Entry Systems

- With single-entry, only one entry is made for each transaction.
- With double-entry, two entries are made for each transaction.

d) Basic vs. Complete

- The most basic accounting system is one that is very simple and uses cash accounting.
- A complete system would be computerized with capabilities for both cash and accrual accounting, and with the ability to track inventories, loans, and depreciation, and to handle payroll accounting and perform enterprise analysis.
- Between these extremes are many possibilities.

How Complete?

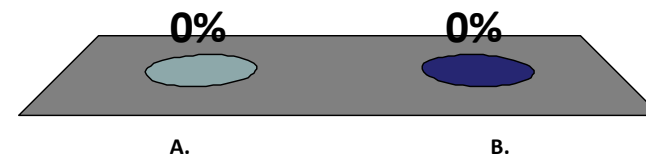
- How much accounting knowledge does the user have?
- How large and complex is the farm?
- How much and what kind of information is needed or desired for management decision making?

Quick Review

True or False?

An accounting period always has to be from January 1st to December 31st.

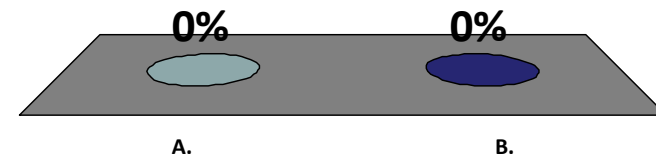
- A. True
- B. False



True or False?

Records have no use when trying to obtain a new loan.

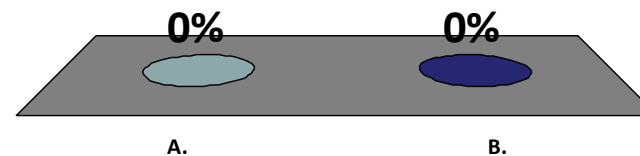
- A. True
- B. False



True or False?

In **cash accounting** transactions are recorded only when cash is received or paid.

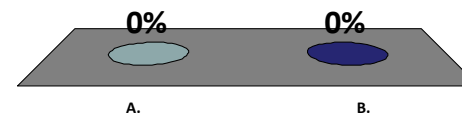
- A. True
- B. False



True or False?

In **cash accounting** transactions are recorded in the periods in which the events occur, rather than in the periods in which the company receives or pays cash.

- A. True
- B. False



Next...

- This presentation is going to focus on how to use single-entry cash accounting. That is, a basic accounting system.
- Before going on, let's review some basic accounting terminology.

Basic Accounting Terms



- Asset
 - Cash
 - Equipment
 - Land
 - Supplies
 - Inventory
 - Account receivable
- Liability
 - Accounts payable
 - Notes payable
 - Salaries payable
 - Interest Payable
- Owner's Equity
 - Expenses
 - Revenues
 - Owner's Drawing
 - Owner's Capital
- Debit
- Credit
- Revenue
- Expense
- Profit
- Loss

Asset

Assets are items of value, tangible or financial.

Assets are the resources owned by a business.

Examples include cash, equipment, machinery, land, bank accounts, buildings, grain, livestock, etc.

Liability

Liabilities are debts or other financial obligations that must be paid at some point in the future.

Examples include accounts payable, notes payable, salaries payable, interest payable, current portion of long-term debt, taxes payable, etc.

Owner's Equity

- The difference between business assets and business liabilities. It represents the net value of the business to the owner(s) of the business.
- Owner's equity is what remains after selling all assets and paying all liabilities. It's what belong to the owner(s) after all assets are sold and all liabilities are paid. It's the ownership claim on total assets.

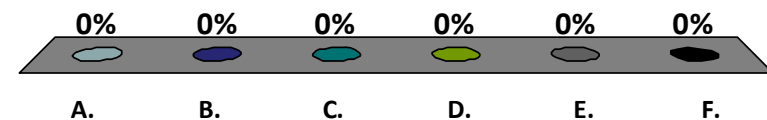
Accounts receivable Vs. Accounts payable



- **An account receivable** is revenue for a product that has been sold or a service provided but for which no payment has yet been received. An example would be custom work for a neighbor who has agreed to make payment at a future time.
- **An account payable** is an expense that has been incurred but not yet paid. Typical accounts payable are for items charged at farm supply stores where the purchaser is given 30 to 90 days to pay the amount due.

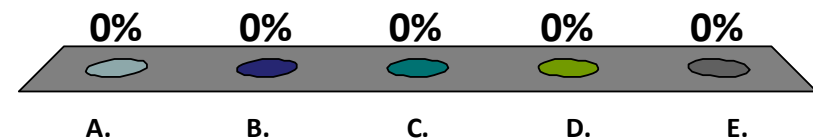
Which of the following is **NOT** an Asset?

- A. Milo on hand
- B. A tractor
- C. A dairy cow
- D. Microsoft's stocks
- E. An account payable
- F. All of the above



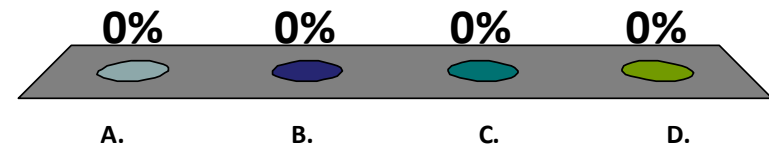
Which of the following IS a Liability?

- A. A barn
- B. Fences
- C. An account receivable
- D. A saving account
- E. The farm mortgage



What IS Owner's Equity?

- A. The sum of the value of all farm's debt
- B. The sum of the value of all farm items.
- C. The difference between (A) and (B) above.
- D. None of the above.



Inventory

- The physical quantity and financial value of products produced for sale that have not yet been sold. For example, crops, livestock, bales of hay.



Debit and Credit

- A **debit** is an accounting entry in the left-hand side of a double-entry ledger
- A **credit** is an accounting entry in the right-hand side of a double-entry ledger.

Revenues and Expenses



- A **revenue** is the value of products and services produced by a business during an accounting period. Revenue may be either cash or noncash.
- An **expense** is the cost or expenditure incurred in the production of revenue.

Profits and Losses

- There is a **profit** when revenues exceed expenses.
- There is a **loss** when expenses exceed revenues.

Example 1: Single-Entry Cash Accounting



- a) **November 2009:** Purchased and applied fertilizer, for the 2010 grain crop. Paid \$8,000 cash.
- b) **May 2010:** Purchased and paid \$25,000 cash for seed, chemicals, fuel, etc.
- c) **October 2010:** Purchased fuel for drying on account for \$3,000.
- d) **November 2010:** One half of grain sold for \$50,000 cash. The rest placed in storage and valued at \$50,000.
- e) **January 2011:** Paid \$3,000 cash for fuel bill used to dry grain.
- f) **May 2011:** Remaining 2010 grain sold for \$60,000 cash.

Example 1: Single-Entry Cash Accounting

- The following are accounts used by the farmer:

<u>Assets</u>	<u>Expenses</u>	<u>Revenues</u>
Cash	Seed, chemicals, fuel expense	Grain revenue
	Fertilizer expense	
	Drying fuel expense	

- Journalize the transactions using a single-entry cash accounting system and prepare the income statement for the year 2010.

Single-Entry Cash Accounting



a) Nov. 2009

b) May 2010

c) Oct. 2010

d) Nov. 2010

e) Jan. 2011

f) May 2011

Income Statement 2010



Cash Accounting

Grain revenue from cash sales

Total Revenue

Fertilizer

Seed, chemicals, fuel

Drying fuel

Total Expenses

Net Farm Income (Profit)

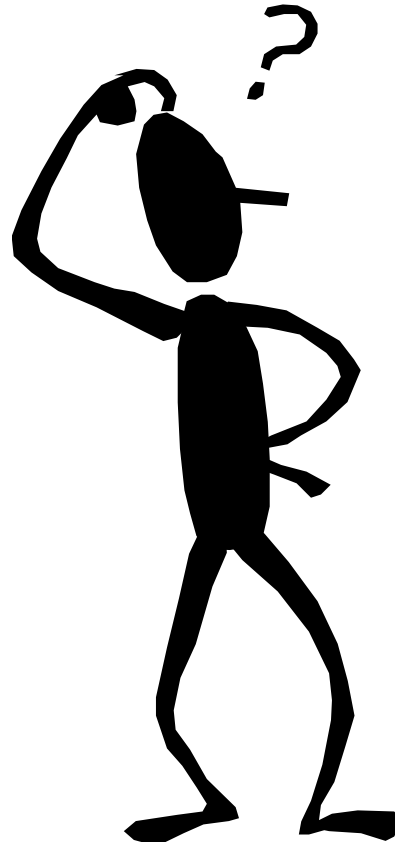
Summary

- This chapter discussed the importance, purpose, and use of records as a management tool.
- Records provide the information needed to measure how well a business is performing.
- They also provide information needed to make sound decisions in the future.

Confused?



Questions?



Next Seminar



Tuesday, November 22, 2011, 6:30 – 8:30 p.m.

Labor Management in Agribusiness

Professional Agricultural Workers Building
957 Connally Street, Sulphur Springs, TX 75482



Thanks!