Getting on Track:

Better Management through Basic Financial Statements

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Provide a welcoming to the last session, Session Five.

Again, the objectives of the course are:

- Describe the purpose and characteristics of a “cash flow statement”
- Describe the purpose and characteristics of a “balance sheet”
- Describe the purpose and characteristics of an “income statement”
- Describe the purpose and characteristics of a “statement of owner equity”
- Understand the challenges and benefits of the four financial statements
- Learn how to create financial statements for your own business

So far, we have discussed:

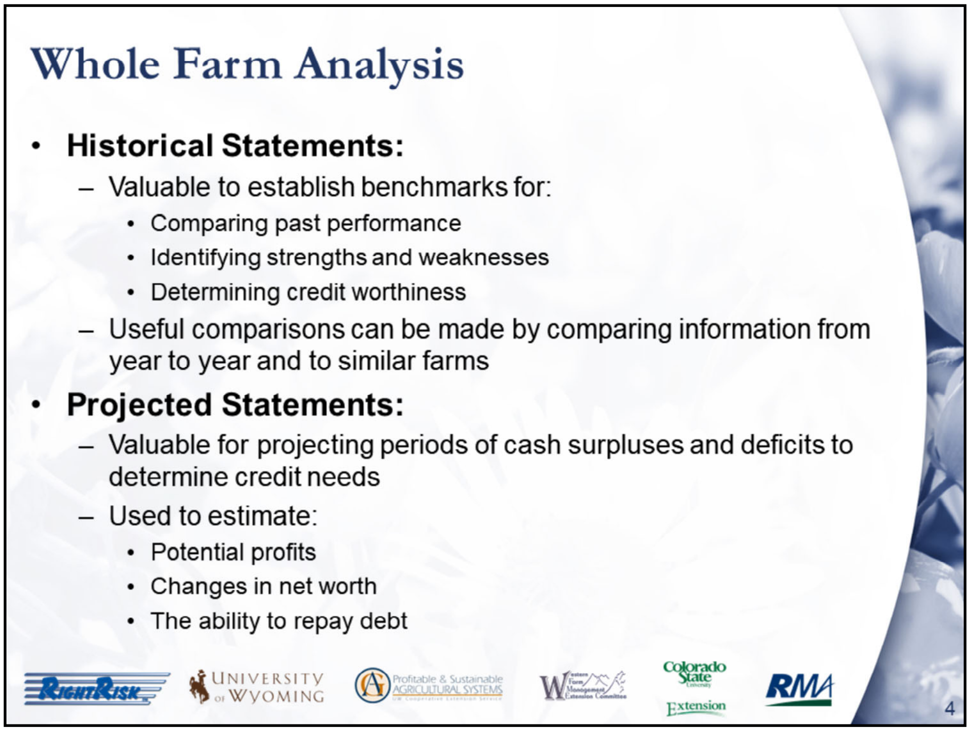
- Cash flow statements
- Balance sheets
- Income statements
- Statements of owner equity

This session will last 45 minutes and will cover:

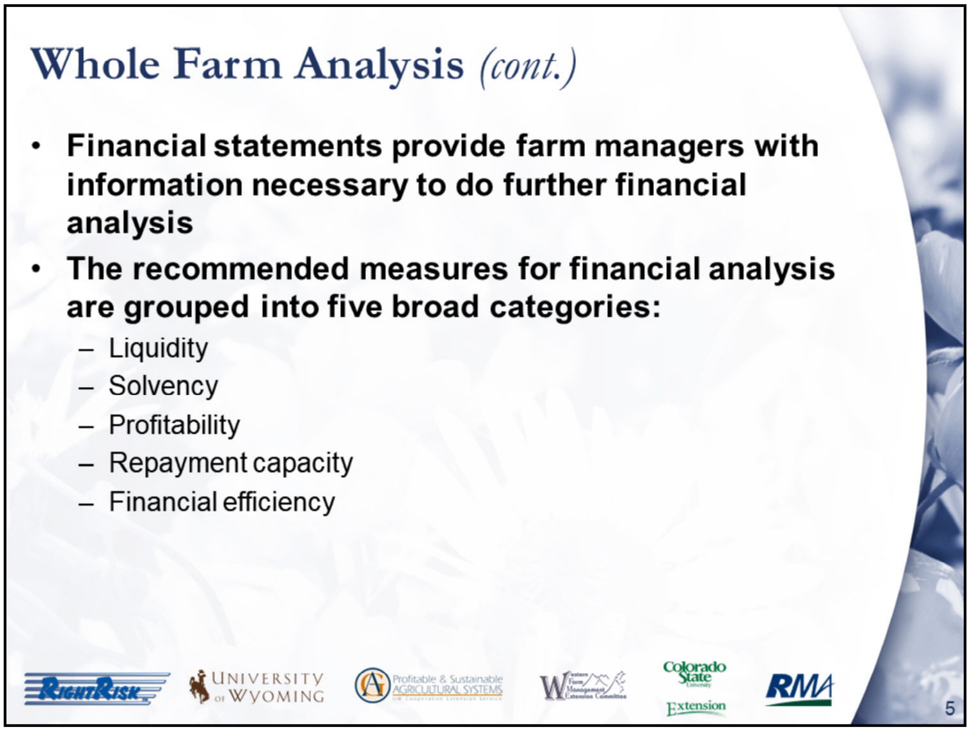
- Where to go from here
- Financial ratios
- Enterprise analysis
- Investment analysis
- Marketing analysis

The Getting on Track: Better Management through Financial Statements course provides the basics of agricultural financial statements. Once a good set of statements has been prepared, a farm manager has a wealth of power to do analysis.

This last session discusses the various kinds of analyses that can be done as well as additional resources available to help you better manage your farm.



Whole farm analysis uses both historical and projected financial statements to help farm managers make better management decisions. Review historical and projected financial statements.



Financial statements provide farm managers with information necessary to do further financial analysis. The recommended measures for financial analysis are grouped into five broad categories: liquidity, solvency, profitability, repayment capacity, and financial efficiency.

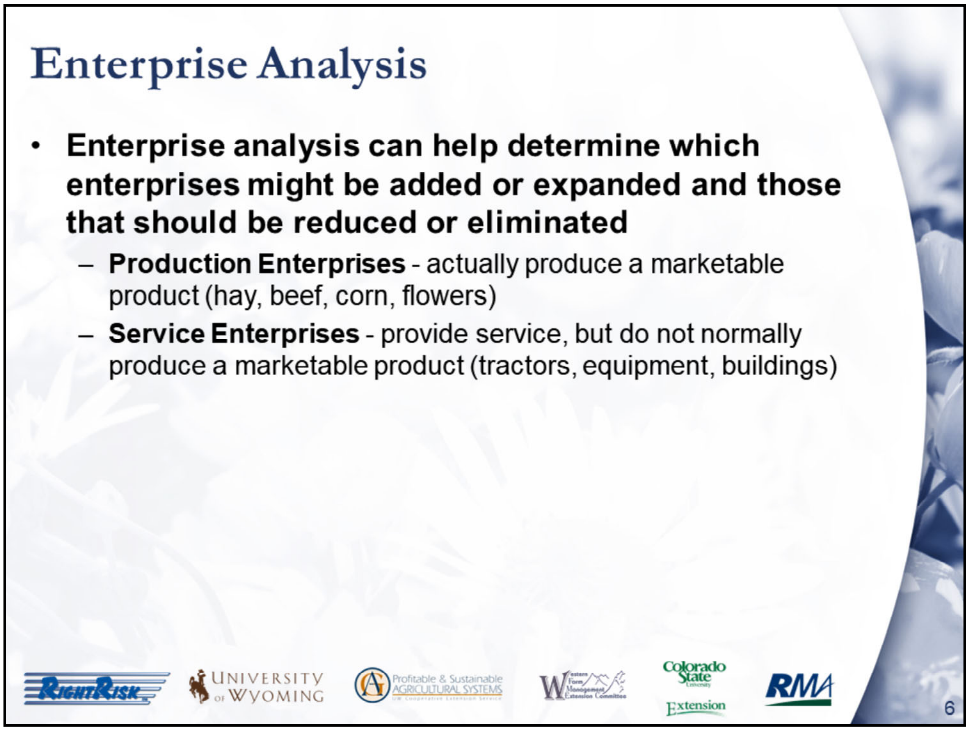
Financial ratios can be used to help evaluate the financial performance of the business. The U.S. "Farm Financial Task Force, 2" has recommended 16 measures and definitions.

- Liquidity measures the ability of the business to meet financial obligations as they come due without disrupting normal business operations
- Solvency measures the long run ability of the business to pay all obligations. It is an indication of the business’s ability to withstand risks by providing information about the farm’s ability to continue operating during and after financial adversity
- Profitability measures the ability of the business to use farm resources to generate returns from operations in excess of its costs over a period of time
- Repayment Capacity measures the ability to repay debt. It evaluates the capacity of the business to generate enough money to make debt payments and replace capital assets after meeting all other cash commitments
- Financial Efficiency measures how effectively the business uses the farm resources (farm assets, operating inputs, borrowed funds, manager time, etc.) to generate gross revenues and the effectiveness of production, purchasing, pricing, financing, and marketing decisions

Additional teaching point: Financial ratios are measures to indicate the financial position of a business and are usually used to compare one business to another. Some commonly used financial ratios include:

- Asset Turnover Ratio = gross revenues / average total assets

- Current Ratio = current assets / current liabilities
- Debt to Asset Ratio = total liabilities / total assets



One of the most basic and important management decisions is choosing the combination of production and service enterprises. These enterprises are the building blocks for a farm plan. Enterprise analysis can help determine which enterprises might be added or expanded and those that should be reduced or eliminated.

Income and expenses from the income statement can be allocated or distributed to individual enterprises to measure the profitability of each one.

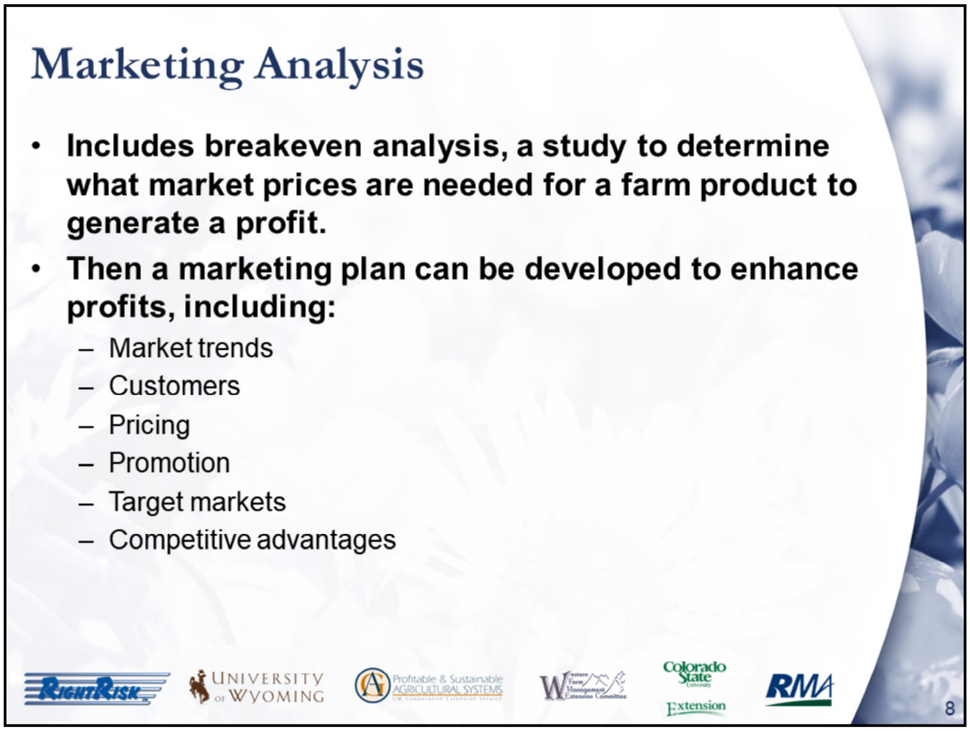
Additional teaching point: Enterprise Analysis is the physical and financial planning for a specific crop/livestock enterprise. It estimates the income and expenses for a set period of time under a set of production practices.

Investment analysis is another important management activity to consider. The evaluation of alternative investments and their impact on profitability and cash flow is crucial in the farm planning process.

A good investment must be both economically profitable and financially feasible.

Additional teaching points:

- Investment analysis: the evaluation of alternative investments and their impact on profitability and cash flow
- Principal is the amount of money borrowed from another person or business. It is a debt. Interest is calculated on the principal from the time it is borrowed until it is repaid. Principal payments are not an expense. An example of principal would be when a person borrows $50,000 to build grain storage. The $50,000 is the principal borrowed
- Interest is rent you pay for the use of someone else’s money



Marketing is another important management component farm managers should consider.

Before enterprises are selected, managers should conduct a breakeven analysis to determine what market prices are needed to generate profits. Then a marketing plan can be developed to evaluate different marketing opportunities and strategies that offer the highest potential to enhance profits. The marketing plan could include information about market trends, customers, pricing, promotion, target markets, and competitive advantages.

Additional teaching point: Marketing is a component of all business activities involved in the flow of goods and services to the consumer.

Other information may be needed as you begin to complete financial statements for your farm or ranch business. RightRisk has developed a number of courses to help people learn how to better manage their ag businesses. The RightRisk web site contains other courses and resources for new, beginning, and existing farmers and ranchers.

You have reached the end of the last session. Provide time for the class to ask questions and debrief what they have learned.