Agriculture & Business Management Notes ...

Colorado State University Extension

Record Keeping/Accounting

Quick Notes...

1. Records should be kept first for management purposes.
2. Good records are also necessary for taxes, credit acquisition, lease arrangements, government programs, and insurance claims.

There are several reasons to keep a good set of farm/ranch records, and a pre-requisite to their establishment is a clear understanding of the accounting entity and the accounting period. In addition, the accounting method (cash vs. accrual) and accounting system (single vs. double entry) must be selected. Finally, the components of the record system are identified and briefly explained.

Use and Purpose of Farm/Ranch Records
Several important reasons to keep accurate and complete farm/ranch records exist, including management purposes, tax purposes, credit, crop and livestock leases, participation in government programs, and all crop insurance products.

Farm/ranch management includes three activities: planning, implementation, and control. Farm/ranch managers cannot plan an efficient operation, nor can they determine if their decisions were appropriate and successful unless a good set of records are kept. Management of the farm/ranch is the first reason to keep a good set of records.

Determining your state and federal income tax liability requires accurate income and expense records. A stronger case can be made against farm/ranch land overvaluation by the county assessor if your argument is based upon an accurate set of farm/ranch records. Tax reasons are frequently listed as the principal reason to keep a set of farm/ranch records.

A third frequently given reason to keep good records is for credit purposes. Lenders require information regarding your equity, expected profitability, and cashflow before they will consider, let alone approve, a loan request.

Over half of US farm/ranch land is now rented or leased. Crop/livestock share leases require appropriate and reliable records. Analysis of cash share leases also require accuracy to determine if the lease is profitable. Thus, lease arrangements are a fourth important reason to maintain a good set of farm/ranch records.

Participation in government programs, including all crop insurance programs, require documentation provided by a good set of farm/ranch records. Deficiency payments are based upon proven farm yields as are crop insurance premiums and payments.

Key Definitions

Two definitions are critical in the establishment of a record keeping system: accounting entity and accounting period. The accounting entity specifies which activities and accounts are to be included in the system. If the accounting entity is defined as only the farm/ranch, then family accounts are not included in the system. Depending upon the situation there may be one record system for the farm/ranch, a second for a seed business, and a third for the family accounts.

The accounting period refers to the length of time and the starting and ending dates for which the success (profit) of the operation is determined. A Weld County irrigated farm would probably use a one year accounting period running from January 1 through December 31. A dryland wheat operation in Washington County would find a one year accounting period from September 1 through August 31 to be more appropriate. The production cycle of the principal enterprises is usually used to determine the accounting period.

Farmers/ranchers usually use a single entry system of accounting. Transactions are entered once and allocated to the appropriate account or accounts under the single entry system. In the double entry system each transaction is entered two times; first in the journal or book of original entry, and second in the ledger accounts which are used to monitor financial accounts.

The cash method of accounting only considers cash receipts and expenses (and depreciation). Inventory changes and other adjustments are not considered under the cash method. The cash method is typically used by farmers/ranchers for income tax computation because of the flexibility it provides in shifting income and expenses between tax years. The accrual method of accounting incorporates both cash and non-cash transactions and includes depreciation, inventory changes, and other adjustments. For management purposes farmers/ranchers should consider the accrual method.

Components of the Farm/Ranch Records System

The farm/ranch records system will include: 1) the asset and liability accounts, 2) the receipt and expense accounts, 3) capital accounts, 4) credit accounts, and 5) production and statistical records.

The asset accounts contain the physical and financial inventory of all assets (items of value) whereas the <u>liability accounts</u> show the inventory of financial claims of others against the accounting entity. The <u>receipt accounts</u> contain the financial flows into the accounting entity whereas the <u>expense accounts</u> show the financial flows from the accounting entity.

The capital accounts contain the purchases of assets with a life greater than the accounting period (e.g. machinery). Depreciation, the annual allocation of the cost of an asset with a life greater than one year is part of the capital accounts. The credit account records principal and interest payments and the establishment of new loans.

Production and statistical records include crop yields, calving percentages, weaning weights, input (fertilizer, pesticide, seed) rates, weather and irrigation data, feed records, and labor records. These data are useful in the analysis of the farm/ranch operations.

Summary and Evaluation Statements

The Net Worth, Net Farm Income, and Cashflow Statements are the three principal summary statements used to analyze the farm/ranch. The Net Worth Statement summarizes the assets and liabilities of the farm/ranch. The net worth or owners equity of the operation (the value of the owner's share of the farm/ranch) is determined by subtracting the total liabilities from the total assets of the accounting entity.

The Net Farm Income Statement summarizes the cash and non-cash expenses of the farm/ranch. The net farm income is a measure of the profitability or success of the farm/ranch and is the dollar return to the resources provided by the farmer/rancher including land, labor, capital, and management.

The Cashflow Statement summarizes the cash position of the farm/ranch. With the cashflow statement we can estimate the dollars of credit (line of credit) needed, total interest and principal payments, and when dollars will need to be borrowed and when they are expected to be repaid.

References: James, Sydney C. and Everett Stoneberg. 1986. Farm Accounting and Business Analysis. Third Edition. Iowa State University Press. Ames.

Kay, Ronald D. and William M. Edwards. 1994. Farm Management. Third Edition. McGraw-Hill, Inc. New York.

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