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Keeping Good Ranch Records: Introduction to the Financial Statements

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Financial records can often be taken for granted on an agricultural enterprise. This is most likely to occur on the smaller operations where the agricultural enterprise is not the primary income source. However, good records could mean the difference in maintaining operations and facing dire financial crises. I will introduce key financial records for the beef cattle enterprise and highlight their uses in the operation of the enterprise.

There are three financial records that complement each other. They are the balance sheet, the income statement, and the cash flow statement. Each serves a distinct purpose for evaluating the performance of an operation. Three of these statements examine business performance over an entire period - for operations grossing over \$250,000, many analysts will recommend doing these statements on a quarterly basis. The balance sheet is the exception since it is only a "snapshot" of the business on a given day.

The balance sheet is used to reconcile three components of a business; assets, liabilities, and equity. When the balance sheet is indeed balanced then assets will be equal to the sum of liabilities and equity. This will be used to determine such financial ratios as the debt-to-equity, debt-to-assets, and current ratios. These ratios are important in assessing the firm's liquidity and solvency, or the ability to repay debts. The balance sheet is also important in assessing the returns on the investment in the operation.

The income statement includes all revenue earned and expenses incurred. It is very important to determine the method of accounting for income. This can be done either on an accrual (accounting) basis or a cash basis. Generally, the accrual basis provides a clear

sense of the profitability of an enterprise since it accounts for all earnings and expenses incurred over the time period regardless of cash flow. On the income statement, expenses will include such items as depreciation and appreciation which are not cash expenses. These items will not be on a cash flow statement because of this lack of cash movement.

Cash flows are an important issue on the ranch. Many times, the need for cash on hand can lead to unanticipated inventory liquidation - calves must be sold earlier than would be ideal. Careful financial planning and creative use of financial leveraging can help overcome this need. However, a cash flow statement is instrumental in managing this type of situation

The cash flow statement works in conjunction with the income statement, balance sheet, and statement of owner equity. While it may be easy to confuse the statement of cash flows with the income statement, I must stress that these are two very different statements. The statement of cash flows outlines exactly what cash has been received or remitted. It more specifically tracks the uses of the cash as it flows in and out of the enterprise. It consists of three sections; Cash Flows from Operations, Cash Flows from Investment Activities, and Cash Flows from Financial Activities.

The statement of cash flows allows us to examine the ability to repay debt since it tracks the most liquid of assets - cash. Understanding the weak points in the ranch's cash flows will allow for better management of the ranch business by allowing costs and revenues to be more accurately managed. This is most evident in times of expansion, capital seeking, and market strategy planning.

Once the set of cash flows is understood, the cash budget can be developed. The cash flow budget is a forecasted plan of cash flows as opposed to the historical record of the fore mentioned statements - this difference is only a matter of timing. The cash flow budget is a useful tool in planning the course of business over the coming period or set of periods. It serves as a guide post for business and marketing decisions. It can be used with the historical financial documents when obtaining financing and it can be used to compare alternative business plans.

There is a key point to understand in budgeting - not all budgets are the same. When a university develops a budget, it is usually of an economic style. It includes revenues, variable costs, and fixed costs. It will take into account all factors of production such as operator labor, a charge for land use, and other opportunity costs, and it is generally focused on one enterprise. These non-cash costs included in the economic budget are often confusing for a business operator. Therefore, the cash flow budget is the type used by businesses as a tool in their decision making process. A cash flow budget from a finance perspective accounts for the timing of inflows and outflows of cash. A cash flow budget will tend to look at the operation as a whole, but it can be divided among the various enterprises in the operation.

With accurate assessments of the financial statements, the ranch manager can identify potential areas for improving the net ranch income in much the same way understanding

EPDs and other animal performance measures can. Most significantly, accurate financial records are key to determining whether or not any given marketing strategy is right for you.

Risk is inherent in the nature of agricultural endeavors. However, returns don't necessarily compensate for the risk. This only makes careful management and planning of the finances of the ranching enterprise all the more important. For some examples of the financial statements mentioned in this article, visit <http://edis.ifas.ufl.edu> and look for EDIS documents FE008-FE012, FE153, and FE333 by Dr. P.J. van Blokland or ask your county extension agent for a printed copy of any of these documents.