



Penn State
FARM AND DAIRY
Business Seminar of the Week

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Many farmers take what records they have to their tax preparer or their accountant so their income tax returns can be prepared and filed. If they prepare their own tax returns they use the records for that purpose and then all too often, regardless of who prepared the tax returns, the farm records are filed away. "Filed away" often means they are put in some obscure place, and never looked at again unless the farm business is audited.



This is unfortunate because records have many uses and while they are essential for filing tax returns that should not be their only use, indeed it should not be the most important use.

The first and most important function of farm records should be to provide data for the farm operator to use in making management decisions. It is very difficult for a farmer to make good management decisions without accurate information about the past performance of the farm business. Good records will provide the information needed for nearly all farm management decisions.

You will note that I used the

term "good records." This is because farm management decisions must be based on both financial and production information. For example suppose the financial data for a farmer's corn enterprise showed that the variable cost of corn for 1986 was \$2 per bushel. If this is the only information that the farmer has it really doesn't give enough information for the farmer to make a good decision.

Sure it tells the farmer that he or she lost money on corn in 1986 and that it could have been purchased for less than it cost to grow it, however, it doesn't tell the farmer why it cost \$2 per bushel to grow corn. The farmer needs additional information: when was the corn planted, what variety was used, what and how much fertilizer was used per acre, had the soil been tested, how much rainfall was received and when, what was the yield potential of the corn fields, what herbicides were used and were they effective, were temperatures normal or excessively hot or cold, and was the crop affected by disease or insects. These are examples or information that tells the farmer why the per bushel variable costs for corn were \$2.

We have indicated two important uses for farm records, additional uses of farm records include the following: obtaining credit, planning and budgeting, resolving legal issues that affect the farm

business, and guide to determining farm policy alternatives.

Not many farm businesses are able to operate without ever having to use borrowed money. Thus credit is very important for most farm operations. Farm records are important to the lender for several reasons.

First and perhaps most important, records provide the data necessary to prepare a balance sheet, or what many of us call a net worth statement. This document lists all of the assets of the farm business and the claims that other people have against those assets -- the liabilities of the business. The lender can use the balance sheet to determine how much of the farm's assets are available to provide collateral (protection) for the loan the farmer is seeking. The balance sheet not only tells the lender how much protection is available for the loan, a series of balance sheets over a period of time also helps the lender determine the management ability of the farmer.

While the balance sheet is a key document that most lenders demand, additional information that many demand is the income and cash flow of the farm business. The income statement tells the lender if the farm generates enough income to pay family living costs and service debt. A cash flow statement tells the lender when the farm business would have cash available to make payments on a loan.

While we have emphasized the importance of records to the lender we need to recognize that these records are equally important to the farmer. They are the principal

source of information required to manage the farm's finances.

For example the cash flow statement not only tells the farmer when cash is available for debt payment, it also tells him or her what periods cash will not be available for paying bills. The balance sheet essentially tells the farmer how strong his or her financial position is. The larger the farmer's equity (that is the portion of the business the farmer owns) the better he or she is able to withstand disaster such as a crop failure, severe livestock losses, etc.

Planning and budgeting are important to the long run survival of the farm business. While budgeting is essential for long-range planning it is also a tool that can be effectively used to evaluate annual adjustments in the farm business. There are several different types of budgets and good records are a necessity for all of them.

One of the important things about budgeting is that it gives the farmer an approximation of how changes in the farm business will affect net income before actually investing money in land, buildings, and equipment. Planning is essentially the road map the farm operator develops as a guide to the goals that have been established and the budgets establish the boundaries for the map.

Usually people can readily see how records are essential to the things we have already discussed such as filing tax returns and borrowing money. However, they often fail to recognize the importance of records in legal matters. Yet, some of the most bitterly con-

tested legal battles emerge as the result of the breakup of a partnership. Regardless of the reasons for dissolving the partnership the dispute usually arises concerning the distribution of assets. A good set of records established at the beginning and maintained during the partnership would essentially settle any questions that might arise concerning distribution of the assets.

Records also provide a record of the value of farm business assets that might be destroyed or lost in a disaster such as flood or fire. They would be very important in the event that a question of amounts and value arose that resulted in legal action. Also good records would provide information concerning the use of herbicides and insecticides. Chemicals used improperly for either of these purposes could result in legal action from surrounding property owners.

Therefore records are important to document what materials were used, how much was used, when they were used and what the weather conditions were when they were applied.

Finally records are a source of information that is often sought by the USDA and people studying farm policy and how certain policies might impact farm production and farm prices. While farm policy never pleases all farmers and is often criticized by many, there is a strong possibility that policy may be based on faulty or inadequate information. Many farmers don't have sufficiently detailed records for policy decisions.

Clearly records are important for many purposes other than filing tax returns and they also provide the information necessary for tax management. Records supply the farm operator with the information needed to plan and manage the farm to reach family goals. They help prevent bitter arguments within partnerships and they provide the basis for obtaining and using credit to improve the net returns of the farm operation. Finally, they can provide information that will help policy makers develop a sound and equitable farm policy.

In the future remember that your records can be used for many purposes other than filing tax returns. They are the basic guide to a more prosperous farm operation.

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