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Penn State
FARM AND DAIRY

Business Seminar of the Week

EVALUATION TIME FOR YOUR FARM RECORDS

Virgil E. Crowley

1987 is now history and you are starting a new year. At this stage it is a year of promise and hope, with opportunities to improve both your business and quality of life. In order to take advantage of those opportunities you must be able to recognize them. You need to review your '87 records to help determine where the opportunities for improving your business exist.



Do your records provide you with that kind of information? If not, now would be the ideal time to set up a new record system or improve the one you have been using. What type of record system are you currently using a cash system, an accrual system, or a combination cash and accrual system? One of the latter two would be preferred. Regardless of which system is being used, the key is how you use the records you keep. If you are like most businesses and use records both for tax reporting and management decisions, then you may want to review your records to see if they are sufficiently complete. Are you really keeping a set of records, or only the financial

transactions of the business? An accounting system keeps track of the financial transactions, a record system keeps track of the financial transactions and the factors that affected them. For example, the grain farmer might simply record 10,000 bushels of No 2 corn sold on a specific date to company x for so much per bushel. The costs such as seed, fertilizer, fuel and labor required to produce the corn are also recorded. These are financial transactions and provide sufficient information for tax purposes. However, it is not enough information for management decisions. If the grain farmer in this example also had kept a field record which would show when the corn was planted, what varieties were planted, what the fertilizer applications were, notations concerning rainfall and temperature, the date harvested and yield per acre, then he would have a set of farm records. You could apply this same kind of detail to the livestock enterprise. For example, the dairyman only must record the amount of milk, dairy products and cull cows and calves sold. Again the costs of feed, labor, veterinary services, trucking, utilities and etc would be recorded. However, again the information provided is not enough for good management

decisions. What were the feed rations, how much was fed to each cow, what quality of hay and silage was fed? What were the average pounds of milk sold per cow, percentage calf crop and days each cow was in lactation? Knowing what our financial returns are usually isn't enough information. We need to know what the cash flow of the business is, and what rate of return is being earned on the assets in the business, and what the return to our equity is.

Are your records sufficiently complete to provide the information needed to calculate these factors? Also, today, most financial institutions place a great deal of emphasis on profitability. The calculation of true profitability requires either an accrual record system or a combination cash and accrual system. There is one additional task that the operator should manage in the recordkeeping area, regardless of what record system is used. That task is the development of an annual cash flow projection. Because the cash flow is so essential to the survival of the business, it is important for every farm operator to learn how to make a cash flow projection for the farm business. The cash flow projection is an

attempt to estimate as accurately as possible all cash that will be available to the farm business for the year, approximately during what periods of the year it will be received, and how much will be available in each period. The projection deals not only with cash that will be available, but also with how much cash will have to be paid out during the year. Again an attempt is made to estimate what month payments will be made and how much. Obviously a good set of records from past years is the best source of information for preparing a cash flow statement.

There is no question that developing a cash flow statement involves many uncertainties, but these uncertainties are no more difficult to deal with than are evaluation problems. A major factor that impacts return on assets and on owner's equity is the value placed on the assets. For example, what value is placed on the land, the livestock, machinery and equipment? The return on investment and return to owner's equity can be significantly influenced by the values placed on assets in the inventory. In all probability, cash flow projections carefully prepared can be as accurate as inventories. These areas of uncertainties are not likely to be eliminated, but that does not diminish the importance of records. It only emphasizes that record systems need to be evaluated frequently to determine if they are providing you with the information you need and want. With the changes in the tax law and increased emphasis on profitability there is no question but that the importance of records will increase in 1988. What better time to check yours than now?

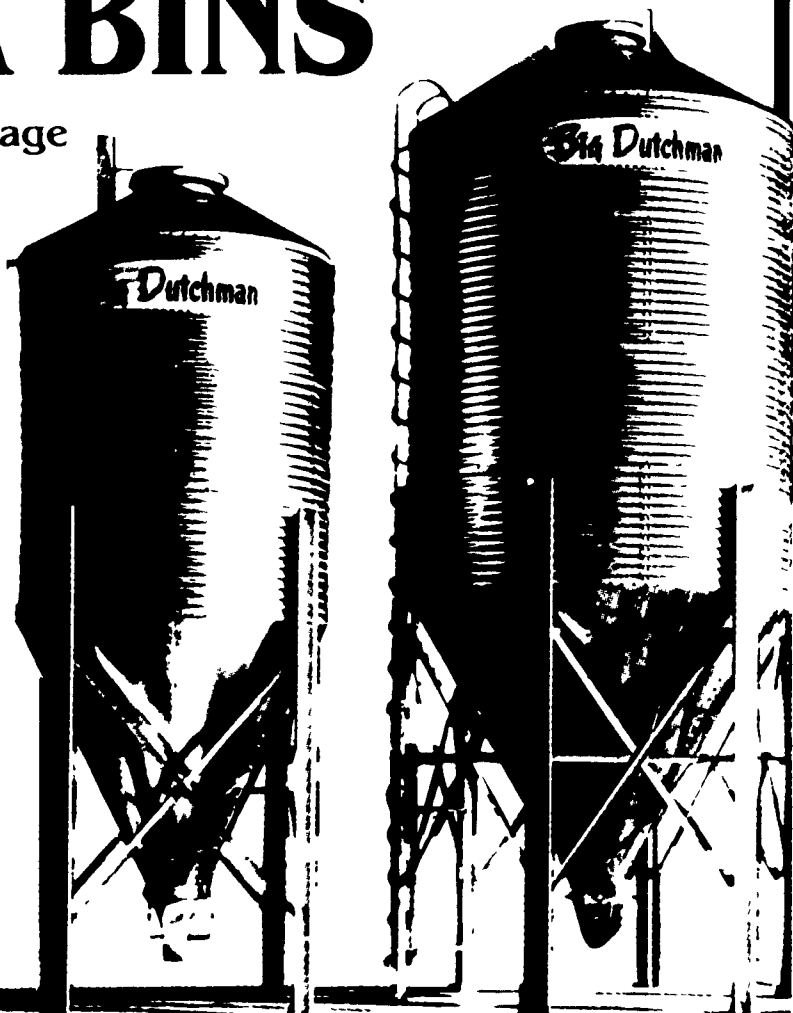
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