Best Practices for Farm Financial Management

Young Agrarians

Objectives

- Differentiate Financial Records from other Farm Records
- Outline the role of Bookkeeping for a farm operation
- Setting up a system of financial control on a farm
- Understand the importance of making time to record financial transactions
- Review the categories of Assets and Liabilities as part of a Chart of Accounts

Different Types of Farm Records

- Crop Records
- Livestock Records
- Machinery Records
- Labour Records
- Financial Records

Additional (Optional) Farm Records

- Aerial photographs
- Soil Map
- Field Map
- Farmstead map
- Climate Records

Bookkeeping

- The activity of keeping financial records of a business
- For records to be useful they must be:
  - Accurate
  - Relevant
  - Timely
  - Kept systematically

But I want to farm, not do paperwork!

- Paperwork is an essential part of farming
- All transactions generate paperwork
- Setting up systems early on will make farming easier in the long run
- You don't have to do it all alone . . . More about this later

Internal reasons for keeping records:

- To evaluate financial performance of the business over time
- To aid in planning
- To document business arrangements (partnership equity, leasing agreements, etc.)

External Reasons for Keeping Records:

- Canada Revenue Agency
- WorkSafe BC
- Lending Institutions
- Municipalities, Provincial Assessment
- Insurance companies
- Statistics Canada

Bookkeeping

- Bookkeeping can be done internally, but is easy to contract out.
- Bookkeeping is not accounting – this is an important distinction

Bookkeeping vs. Accounting

Bookkeeping (recording):
- Record financial transactions
- Post debits and credits
- Produce invoices
- Completing Payroll

Accounting (analyzing):
- Prepare adjusting entries
- Prepare company financial statements
- Analyzing costs of operations
- Completing income tax returns
- Helping the business owner understand the impact of financial decisions

Hire a Bookkeeper?

- Hiring a bookkeeper can:
  - Ensure accuracy of your financial records;
  - Ensure your records are maintained in a relevant manner;
  - Help you produce financial reports in a timely manner (and fast);
  - Help you establish systems and processes to maintain financial records;
- You focus on business management (work on your business)

This sounds expensive. You lost me.

- Sorry about that. Let's break things down.
- Let's say your annual revenue is $40,000.
- A Bookkeeper may cost up to $100/month
- That's 3% of your revenue: $1,200/year
- If you're organized, it could be less
- How long would it take you to do this work?
  - What would the value of your time be?

You are a manager

- Even if you are the only worker in your business, you still need to be a manger
- You manage tasks, information, decisions
- Before you hire someone to work for you, see what tasks you can contract out

Work on your business

- When you have time to work on your business, you are able to think strategically.
- Consider the time you devote to record-keeping
  - Could you better use this time to earn more money in your business?
  - Or have more free time for yourself?
  - Or feel more confident in your daily decision-making?

Opportunity costs

- By hiring a bookkeeper you present yourself with an **Opportunity Cost**
- By spending some money (the cost) you free up time for other tasks (the opportunity)
- A bookkeeper can do your financial records faster than you
- You can **manage** your business better than anyone else, providing you with a better financial return

Management and control

- Control is a primary function of management
- You require information to be able to monitor and direct plans as they are implemented
- Management needs to ensure there is a control system that:
  - Records Information
  - Analyzes information
- Set aside time weekly to organize and time to manage

Operate like a business

- Business office
  - Computer, printer, copier
  - Office supplies (files, paper, stapler, clips, tape, etc.)
  - Furniture (filing cabinet, desk, chair, etc.)
  - Mailing supplies
  - Date-book appointment planner
  - Calculator
  - "Paid" and "Posted" stamps
- Software tools for record keeping

Set up control systems

- Data Collection and Sorting
  - Ensure you have a business account separate from your personal expenses;
  - Use a business cheque book with check stubs;
  - Use a business deposit book with duplicate records;
  - Avoid cash transactions;
  - Keep every receipt (and photocopy them);
  - Keep vehicle logs in bound books.

Control Systems

- Bookkeeping options:
  - Quickbooks is an industry standard
    - Online (cloud based subscription)
    - Software purchase (stored on your computer)
  - Various online options:
    - Freshbooks
    - Sage
    - Wave
    - These generally make money by advertising to you, may not have the same functionality
  - A Bookkeeper will recommend a software option, may include it as part of services or offer a discounted price

Sales Records

- Set up systems to record your sales
  - Invoice all of your market sales
    - Deduct returns
  - Count your cash (and other payments) after each market and record on a cash report
  - Make regular bank deposits
  - Invoice all of your CSA deliveries

Set up Filing Systems

- Keep a filing system:
  - Current bills to be paid;
  - Paid bills and receipts to be filed.
- Each month transfer every bill, receipt and bank statement in a folder for the month your received them;
- Print hard copies of all invoices;
- Ensure you have photocopies of all receipts that are small and/or will fade over time.

Recording transactions

- Transactions are each allocated to an account;
- Accounts are listed in the business' Chart of Accounts

Accounts

- Assets (what the business owns)
- Liabilities (what the business owes)
- Owner's Equity (resources invested by the owner)
- Revenue (goods or services sold)
- Expenses (cost to purchase/produce goods or services)

Assets: Items owned by the business

- Bank Accounts
- Investments
- Crops inventory
- Accounts Receivable
- Breeding Livestock
- Machinery
- Buildings
- Land
- Quota

Liabilities: Debt owed by the business

- Operating loan
- Accounts payable
- Bank loan

Homework

- Here are some tasks to get you organized:
  1. Label 12 folders: January 2017, February 2017, etc. and place them in your filing cabinet
  2. Set aside 1 hour each week to work on your financial records – get into the habit now
  3. Ensure you have necessary office supplies on hand and a space to work
  4. List all of your assets
  5. List all of your liabilities
  6. If you don't have a business bank account, set up an appointment to open one.

Chart of Accounts

- A listing of all the accounts you use to record all your bookkeeping entries:
  – Assets
  – Liabilities
  – Owner's Equity
  – Revenue
  – Expenses

Chart of Accounts

- Accounts are used to record all business transactions;
- A Chart of Accounts identifies the five types of accounts and specific accounts within each type.
- Clarity in naming is important to avoid errors
  - e.g. Delivery income and Delivery expense are very similar sounding, but one is Revenue and the other is an Expense

Assets: Items owned by the business

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Liabilities: Debt owed by the business

- Operating loan
- Accounts payable
- Bank loan
- Advance payments on product (CSA shares)

Breaking down Assets and Liabilities

- Assets and Liabilities are broken down into 3 additional categories:
  - Current: Cash assets, consumables or convertible to cash in one year; Liabilities to be obligations to fulfill within the year
  - Intermediate: Assets to last between 1 and 10 years; Liabilities are debt against these assets
  - Long-term: Fixed Assets, generally limited to land and buildings; Liabilities are debt against these assets

Owner's Equity

- Owner's contributions
- Owner's withdrawals

Revenue: Value of goods/services sold

- Crop sales
- Livestock sales
- Commodity sales
- Custom work
- Machinery/tool rentals
- Program payments (e.g. AgriInvest)

Expenses: Costs to purchase inputs

- Seed
- Fertilizer and pesticides
- Feed
- Veterinary and medicine
- Fuel, oil
- Repairs on equipment and buildings
- Insurance
- Professional fees
- Dues and subscriptions

Chart of Accounts

- Bookkeeping software will generally offer you categories for a Chart of Accounts
- You may want to customize your Chart of Accounts
- A bookkeeper can help to set up your chart of accounts to ensure they reflect common categories for the sector and are useful for preparing reports and taxes.

Double-entry Bookkeeping

- Every transaction requires two accounts:
  - A debit and a credit must be entered for each transaction
  - When all debits and credits are equal, your books are in balance
  - When you use bookkeeping software (e.g. Quickbooks), the program does this for you

Two ways to do bookkeeping

- Cash Basis of Accounting
  - Method of accounting where revenue are recorded when cash is received and expenses are recognized when cash is paid
- Accrual Basis of Accounting
  - Revenues are recognized in period earned, regardless of when cash is received; expenses recognized in period when incurred regardless of when cash is paid

Cash or Accrual?

- Farmers have the option of using cash or accrual methods
- Cash method is very rarely used
- Accrual is standard (and generally recommended)
- Accrual generally allows for more accurate reflection of your operations
- Cash is more useful in commodity production

Accrual example

- Farmer Leigh delivers a $200 order to a restaurant customer on 4 June
- The restaurant doesn't pay the bill until 20 August
- The transaction still shows up as Revenue on financial statements for June
- Between delivery and payment, the transaction is recorded as an Accounts Receivable (Asset)

Example 1: Leigh buys a tractor

- Tractor costs $30,000
- Purchased on credit from the dealership
- $500 monthly payments
- This transaction has two immediate impacts:
  - Increases Assets (Leigh now owns a tractor)
  - Increases Liabilities (Leigh now carries a debt)

How is this recorded?

	Debit	Credit
Tractor (asset)	$30,000	
Loan (liability)		$30,000
Total	**$30,000**	**$30,000**

The Books are in balance because debits = credits

Example 2: Leigh sells CSA shares

- Leigh sells 50 CSA shares valued at $400 each
  - Boxes valued at $25/week for 16 weeks
- Customers pay in advance; Leigh received the payments this week

How is this recorded?

	Debit	Credit
Bank Account (Asset)	$40,000	
CSA Deposits (Liability)		$40,000
Total	**$40,000**	**$40,000**

- The books are in balance because debits = credits
- Why are CSA payments a Liability?
  - These are advance payments Leigh has received for product not yet delivered

Example 3: The Restaurant Sale

- Remember that sale Leigh did to the restaurant?
- $200 delivery, but payment wasn't received for over two months

How is this recorded?

	Debit	Credit
Sale to Restaurant (Revenue)		$200
Accounts Receivable (Asset)	$200	
Total	**$200**	**$200**

- A second entry is required when payment is received

How is the payment recorded?

	Debit	Credit
Bank Account (Asset)	$200	
Accounts Receivable (Asset)		$200
Total	**$200**	**$200**

Compiling transactions into Financial Statements

- All of these transactions are reflected in Financial Statements
- Many transactions can be condensed into a few lines

How can we think about Financial Statements?

- Let's consider them answers to general questions
- We'll start with the Balance Sheet:
  - What does a business own (assets)?
  - What does a business owe (liabilities)?
  - What is the difference between the two (equity)?

The Balance Sheet

- Financial Statement that shows the financial condition of the business at a particular point in time
- It's like a snapshot: The Balance Sheet has a single date on it
- Lists
  - Assets
  - Liabilities
  - Equity
- Assets = Liabilities + Equity

Leigh's 1st Balance Sheet (4 Feb)

Assets			
	Current Assets		
		Bank Account	$20,000
	Intermediate Assets		
		Tractor	$30,000
Total Assets			**$50,000**
Liabilities			
	Current Liabilities		
		CSA Deposits	$20,000
	Intermediate Liabilities		
		Tractor Loan	$30,000
Total Liabilities			**$50,000**
Equity			$0

Transactions in next 5 months include:

Expenses totaling $3,180

- Seed: $800
- Land lease: $1,000
- Fuel: $80
- Small tools: $200
- Insurance: $400
- Office expenses: $200
- Compost: $500

Also, payments on the tractor

- 5 months, $500/month = $2,500

Revenue

- Farmers market sales: $2,300 (cash received)
- Restaurant sale: $200 (billed, but not paid)
- 2 CSA deliveries:
  - 2 weeks X 50 Boxes X $25 = $2,500

Record the Expenses

	Debit	Credit
Bank Account (Asset)		$3,180
Seed (Expense)	$800	
Land Lease (Expense)	$1,000	
Fuel (Expense)	$80	
Small Tools (Expense)	$200	
Insurance (Expense)	$400	
Office Expense (Expense)	$200	
Compost (Expense)	$500	
Total	**$3,180**	**$3,180**

Record the tractor payments

	Debit	Credit
Bank Account (Asset)		$2,500
Tractor Loan (Liability)	$2,500	
Total	**$2,500**	**$2,500**

Record the Revenue

	Debit	Credit
Bank Account (Asset)	$2,300	
Market Sales (Revenue)		$2,300
CSA Payments (Liability)	$2,500	
CSA Sales (Revenue)		$2,500
Accounts Receivable (Asset)	$200	
Restaurant Sale (Revenue)		$200
Total	**$5,000**	**$5,000**

Leigh's 2nd Balance Sheet (30 June)

Assets			
	Current Assets		
		Bank Account	$16,620
		Accounts Receivable	$200
	Intermediate Assets		
		Tractor	$30,000
Total Assets			**$46,820**
Liabilities			
	Current Liabilities		
		CSA Deposits	$17,500
	Intermediate Liabilities		
		Tractor Loan	$27,500
Total Liabilities			**$45,000**
Equity			$1820

Balance Sheet

- Assets = Liabilities + Equity

The Income Statement

- What is the question?
  - How did the business perform over a period of time?
- Shows the profitability of the business

Income Statement (YTD 30 June)

Income		
	Vegetable Sales	$5,000
		$5,000
Expenses		
	Seed	$800
	Land Lease	$1,000
	Fuel	$80
	Small Tools	$200
	Insurance	$400
	Office Expense	$200
	Compost	$500
		$3,800
Net	Farm Income (Loss)	$1,200

Remainder of the year

- Completed the CSA program (value $17,500)
- Additional Farmers Market sales ($21,500)
- Additional Restaurant Sales ($3,750; $2,250 uncollected)
- Tractor Payments ($3,000)
- Additional expenses ($15,000)

Leigh's 3rd Balance Sheet (31 Dec)

Assets			
	Current Assets		
		Bank Account	$21,820
		Accounts Receivable	$2,250
	Intermediate Assets		
		Tractor	$30,000
Total Assets			**$54,070**
Liabilities			
	Current Liabilities		
		CSA Deposits	$0
	Intermediate Liabilities		
		Tractor Loan	$24,500
Total Liabilities			**$24,500**
Equity			$29,570

Income Statement (1 Jan – 31 Dec)

Income		
	Vegetable Sales	$47,750
		$47,750
Expenses		
	All Expenses	**$18,800**
Net	**Farm Income (Loss)**	**$28,950**

Adjust for Depreciation

- Tractor: 20%/year (Canada Revenue Agency)
  - Half in the first year (i.e. 10%)
  - $30,000 x 20% = $6,000
  - $6,000 / 2 = $3,000

	Debit	Credit
Tractor (Asset)		$3,000
Depreciation (Expense)	$3,000	
Total	**$3,000**	**$3,000**

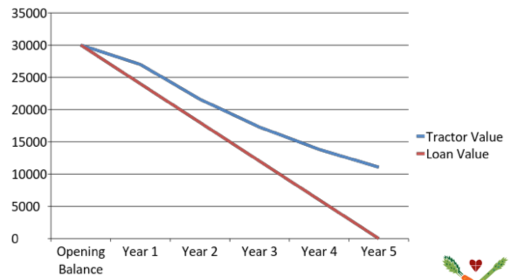
Income Statement (1 Jan – 31 Dec)

Income		
	Vegetable Sales	$47,750
		$47,750
Expenses		
	All Expenses	$18,800
	Depreciation	$3,000
		$21,800
Net	**Farm Income (Loss)**	**$25,950**

Leigh's 3rd Balance Sheet (31 Dec)

Assets			
	Current Assets		
		Bank Account	$21,820
		Accounts Receivable	$2,250
	Intermediate Assets		
		Tractor	$27,000
Total Assets			**$51,070**
Liabilities			
	Current Liabilities		
		CSA Deposits	$0
	Intermediate Liabilities		
		Tractor Loan	$24,500
Total Liabilities			**$24,500**
Equity			$26,570

Depreciating the Tractor



Depreciating the Tractor

Assets

- Each payment of $500 comes from the balance of the Bank Account
- Every year the value of the tractor depreciates by 20% (half in the first year)

Liabilities

- Each payment of $500 reduces the loan by $500

Expenses

- The depreciation is recorded as an Expense

This can pose a problem

- You may have a profitable business, but still have trouble making payments
- Depreciation amount is less than the actual amount of cash exiting your bank account
- You need to plan for this

Cash Flow Statement

- Answers the questions:
  - When does money come in?
  - When does money go out?
- Captures more than Income and Expenses
  - Will include loan payments
  - Actual bills paid and accounts received

Uses of Cash Flow Statement

- You can run a profitable business but still go broke
- Cash Flow Statement will show you where you need to fill gaps
- For example, in late June you may be running out of cash after using CSA deposits to pay expenses, but you don't have Farmers Market revenue yet

When is the best time to ask for money?

- When you don't need it!
- You don't have time to ask for a loan during the season
- You don't look very good to a lender asking for money when you're run out
- You can anticipate where you might need a loan to cover operating expenses before revenue starts to come in
- Ask for financing when you don't need it: set up a line of credit, just in case, before the season starts

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Why do a cash flow analysis?

- It can help you decide:
  - Whether you can afford a piece of equipment;
  - Whether you can expand.
- It can help you plan when to take a draw from your business . . . And avoid being broke at the start of the year
- Identify when in the season you become profitable . . . And how you can improve on that
- Show a lender your ability to re-pay a loan

When to do a cash flow analysis?

- Before you start farming – what will it take to get through the first year?
- Every year so that you can see how you are managing
- Any time you consider a major change:
  - Adding capacity (equipment or hired help)
  - Giving up a lease on land
  - Changing crop plan (mix or timing)
  - Picking up a new lease

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- You can anticipate where you might need a loan to cover operating expenses before revenue starts to come in
- Ask for financing when you don't need it: set up a line of credit, just in case, before the season starts

Steps to create a cash flow projection

- If you are a new farm operation:
  1. Research your likely expenses;
  2. Anticipate your sales based on your crop plan and realistic sales exstimates;
  3. Your labour needs and costs. Don't forget CPP, EI, vacation pay, WorkSafeBC premiums
- Speak to colleagues, find out what expenses they incur and unexpected expenses they had
- Make use of Enterprise Budgets (e.g. KPU)

Steps to create a cash flow projection

- If you have already been in operation:
  1. Monthly info from your records (files, spreadsheets, bookkeeping software, etc.)
  2. Identify the records telling you where money went (invoices, bank & credit card statements, etc.)
  3. Identify the records telling you where money came from (sales records, loans, etc.)
  4. Expanding? Do the same research a new farm would

Considerations for Cash Flow IN

- Categories for Cash Flow IN:
  - Operating Income
  - Cash from Borrowing
  - Contributions From Savings
- If you use the accrual basis for your books, considering your payment terms:
  - Cash on Delivery?
  - 30 Days?
  - Longer?

Considerations for Cash Flow IN

- Sales projections:
  - CSA income may arrive early in the season, but you have less cash flow in later in the season
  - Market sales may provide immediately cash in hand each market day (but unpredictable sales)
  - Restaurant, retail or wholesale clients may expect terms of 30-60 days after delivery
- How secure are your sales? CSA is secure (make sure you can produce); Restaurants can provide a guaranteed sale; Farmers Markets can be reliable … or not

Plan for your Cash Flow IN

- What do you need to do to collect on accounts?
  - How much time will this take?
- How can you boost sales?
  - Is there an additional marketing cost?
- Re-assess your prices annually
  - What do increases at the rate of inflation look like?
  - What do your prices look like compared to competition?

Plan for your Cash Flow IN

- Make sure your projections are reflected in your marketing plans
  - Don't plant crops you don't know if you can sell
  - Use historic sales data from markets
- Carefully plan for sales fluctuations
  - Demand up in Sept, but crops slow down?
  - Lower sales in August during holidays?
  - Sales up or down around Long Weekends?
  - Ask others farms or market managers for historic info.

Other planning considerations

- Can you put aside money for slow season?
- Can you make strategic investments to increase revenue in slow season?
- Note all payment terms on your invoices
  - COD, 14 days, 30 days, etc.
  - Interest rate on overdue accounts (2% monthly)

Considerations for Cash Flow OUT

- Categories for Cash Flow OUT:
  - Operating Expenses
  - Capital Expenses
  - Payments on debt/financing
  - Owner Draws
  - Savings
- Terms on accounts:
  - COD or do you have time to make payments?

Plan for Cash Flow OUT

- What are reasonable operating expenses?
- When are the expenses incurred?
- When do you need to make debt payments?

Evaluating Farm Investments

Rule of thumb for today:

- Very few people start big and succeed.
- Just like the plants in the soil, growth is incremental.

How to start?

- What are crucial pieces of infrastructure to starting a farm venture?

Essential considerations

- Water – for crop irrigation/washing or livestock
- Fencing – for crops or livestock
- Housing – greenhouses for crops, housing for livestock
- Cooling – for crops or livestock products

Investment Considerations

- How can you reduce outside labour?
- How can you improve the efficiency of your own labour?
- Do you have a plan for using a piece of equipment or a specific tool?
- Is there an Opportunity Cost to be considered?

Prioritizing equipment

- Borrow/Rent/Buy?
- Length of Use
- Priority Level
- Your Budget

Prioritizing Infrastructure

- DIY or Contractor?
- Useful Life
- Priority Level
- Your Budget

Quick lesson in depreciation

- What is the reduction in value of an item over time due to wear and tear?
- In your taxes you are able to depreciate items purchased for over $500 at a certain rate over time.
- You can aim to depreciate an item in your own plans over a shorter or longer period

The Rule of 5

- Operating profit should be 1/5 of gross sales
- Operating profit should be bale to pay off the capital expenditures in five years.
- Can you pay off your capital expenditures within five years of purchase?

How to use the Rule of 5

- Financing: Does a capital expense fit into your 5-year budget projections?
- Self-financing: Can you pay yourself back within 5 years of a purchase?

Cost-Benefit Analysis

- What is the cost of not making purchase?
- What alternatives exist?
- Predicted outcome over a relevant timeframe?
- Current cost and future cost potentials?