

Farm Record-Keeping



value-added & alternative agriculture

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OVERVIEW

Record-keeping is an important and necessary aspect of operating even the smallest farming enterprise. Producers maintain records for several reasons: to provide proof of income and expenses to the Internal Revenue Service and NC Department of Revenue; to use as a decision-making tool; to demonstrate compliance with environmental regulations; to obtain and maintain financing.

Efficient and profitable farm operations depend upon thorough and accurate record-keeping. Producers may prefer to maintain hand-written records using a ledger book or similar record-keeping tool, or they may take advantage of inexpensive bookkeeping software available to small business. Regardless of the methodology used, the best system is the one in which all expenses and income are recorded in a timely and accurate manner.

TRANSACTIONS TO RECORD

A good record-keeping system contains each of the following pieces:

- A business-checking account that keeps the business and personal transactions (and funds) separate
- A monthly income and expense ledger
- An inventory ledger, where appropriate, that is used to count inventory items and value the business
- A depreciation schedule for any purchased equipment that is eligible for depreciation (see IRS rules)
- Pro forma statements – a balance sheet to determine net worth; an income statement to determine net profit or loss; a cash flow statement to track the flow of funds

RECORD-KEEPING METHODS

Most farms operate on the cash method of accounting. This means that the enterprise records all income earned and deducts all expenses in the year in which they are paid. Most farms operate on a calendar year basis, from January 1 to December 31. Enterprises have the option of declaring a fiscal year, but this must be reported to the IRS and the NC Department of Revenue prior to the first tax filing.

The accrual method is more typically used by organizations that extend credit and/or capitalize purchases. The accrual method reports income earned and expenses deducted or capitalized in the year in which they occur, although it may not be the same year in which the income is received or the expense paid. For businesses that do offer credit or maintain inventories, the accrual method offers a more accurate picture of the net profitability of the enterprise.

PRODUCTION AND FINANCIAL RECORDS

Producers need to maintain two sets of farm records: one that tracks production levels and one that records financial transactions.

Production records keep track of the enterprise's inputs and outputs: crop yields, plant populations, livestock born and lost.

Financial records track operating expenses, equipment, feed and seed purchases, fertility expense, wages and salaries, depreciation expense and interest and loan payments.

Farm entrepreneurs need both sets of records to make good decisions about the health and future of the enterprise.

With accurate and timely record-keeping, the entrepreneur has sufficient information to assess the following:

- Where income was produced
- Strengths and weaknesses of the farm business
- Returns on labor and management
- Trends in net worth
- Production efficiencies

Adequate access to cash to reduce the enterprise's need for borrowing is an essential aspect of building and maintaining a successful enterprise.

An income statement measures the net farm income or loss. The equation for an income statement is:

$$\text{Revenue} - \text{Expenses} = \text{Profit (loss)}$$

Seasonal farm enterprises typically show a net loss in the early part of the season, when production expenses are incurred before any revenue is generated. One important reason to maintain good financial records is for the enterprise to track how many months it takes before income is earned, and what are the typical expense patterns that the enterprise experiences.

A cash flow statement records the sources and uses of funds. It is the tool by which entrepreneurs can determine whether or not they have sufficient funds to pay their monthly bills. Over time, the enterprise should gain experience in how cash flows through the operation to determine the need to save money during low income months to cover fixed expenses, and how to manage expenses during more active months in order to maximize revenues.

FINANCIAL STATEMENT BASICS

Daily financial transactions and records are ultimately summarized in three "pro forma" statements. The balance sheet, as mentioned earlier, determines the enterprise's net worth. A balance sheet is set up based on the equation:

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

Assets are cash, receivables and equipment. Liabilities are debts – both those that are due within the next 30 days and longer-term debt, such as operating loans and mortgages.

The difference between assets and liabilities measures the enterprise's net worth. One important point to remember is that a positive net worth on paper may not translate into liquidity – the term that is used to define how much cash (or ready access to cash) and enterprise may have.

RESOURCES

For a more detailed discussion of record-keeping basics, visit:

<http://www.utextension.utk.edu/publications/pbfiles/pb1540.pdf>

Record Keeping in Farm Management

<http://agbiopubs.sdstate.edu/articles/ExEx5054.pdf>

The Internal Revenue Service provides a free CD on basic business record-keeping.

Visit <http://www.irs.gov/businesses/index.html> to request the CD.

Small Business and Self-Employed One Stop Resource

<http://www.irs.gov/businesses/small/index.html>

The Value-Added and Alternative Agriculture Start-up Tool Kit



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