



Getting on Track:
*Better Management through
Basic Financial Statements*

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Provide a welcoming to Session Four.

Again, the objectives of the course are:

- Describe the purpose and characteristics of a “cash flow statement”
- Describe the purpose and characteristics of a “balance sheet”
- Describe the purpose and characteristics of an “income statement”
- Describe the purpose and characteristics of a “statement of owner equity”
- Understand the challenges and benefits of the four financial statements
- Learn how to create financial statements for your own business

So far, we have discussed:

- Cash flow statements
- Balance sheets
- Income statements

This session will last 45 minutes and will cover:

- Statement of Owner Equity
- Beginning Net Worth
- Net Farm Income
- Contributions to the Business
- Distributions from the Business
- Valuation Changes

- Ending Net Worth

Using our Financial Statements

Using financial statements has helped Jack and Joanie grow their business significantly over the past five years.



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Jack and Joanie have continued keeping cash flow statements, balance sheets, and income statements for their farm business.

Using these statements has helped them to grow the business significantly over the last five years.

This year, when they prepared their balance sheet, Joanie noticed something odd.

What is a Statement of Owner Equity?

- **A financial statement that analyzes how a farmer's net worth, or owner equity, changed between two balance sheets**
- **Changes in net worth can be used by a number of factors, including:**
 - Earning and spending money
 - Paying taxes
 - Inheriting or receiving gifts and giving gifts
 - Having debt forgiven
 - Changes in asset value



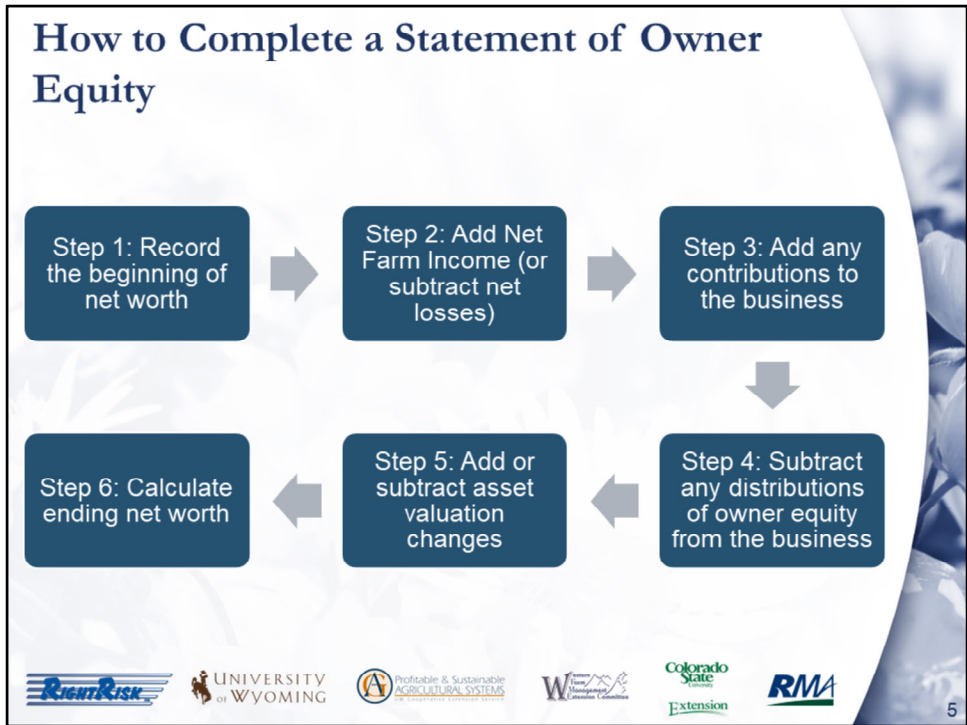
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Dad recommends that Jack and Joanie create another financial statement, called a Statement of Owner Equity.

A Statement of Owner Equity is a financial statement that analyzes how a farmer's net worth, or owner equity, changed between two balance sheets.

Changes in net worth can be caused by a number of factors. Simply comparing net worth from one reporting period to another will not indicate which events caused a change.

Additional teaching point: Owner equity, also known as net worth, is a measure of the basic monetary value of a business or an individual. It is figured by subtracting the total dollar amount of all liabilities from the total value of all assets.



Completing a Statement of Owner Equity is a six-step process. Most of the values for this statement will be found on your balance sheet and income statement.

Additional teaching moment: Print off Jack and Joanie’s balance sheet and income statement from the past year (on the CD called “Jack and Joanie’s Financial Statements”). The class will use them to complete a Statement of Owner Equity. Also, print the Statement of Owner Equity template for them to complete as they view Jack and Joanie’s example.

Step 1: Record the Beginning Net Worth

Statement of Owner Equity	
Beginning Net Worth	X
Net Farm Income	X
Contributions to the Business	X
Distributions from the Business	X
Asset Valuation Changes	X
Ending Net Worth	XX



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Dad tells Joanie to begin by recording the beginning net worth from the current balance sheet.

Additional teaching moment: Lead class to find the beginning net worth on the current balance sheet and record the data on the statement of owner equity.

Step 2: Record Net Farm Income

Statement of Owner Equity	
Beginning Net Worth	X
Net Farm Income	X
Contributions to the Business	X
Distributions from the Business	X
Asset Valuation Changes	X
Ending Net Worth	XX



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In Step 2, you will adjust the beginning net worth for income or losses generated by the business during the year. To do this, record net farm income or net losses listed on the Income Statement and add it to the beginning net worth.

Additional teaching moment: Lead class to find the net farm income on the income statement and record the data on the statement of owner equity.

Step 3: Adjust for any Contributions to the Business

- **Add the value of:**
 - Contributions by the owner
 - Gifts to the business
 - Other contributions to the business

Statement of Owner Equity	
Beginning Net Worth	X
Net Farm Income	X
Contributions to the Business	X
Distributions from the Business	X
Asset Valuation Changes	X
Ending Net Worth	XX



In Step 3, you will add the value of any contributions made to the business by the owners or others. These may include cash contributions and other gifts.

This past year Jack and Joanie did not receive any gifts nor have any debts forgiven. They also did not give any gifts to the business. There is nothing to record in this section.

Had Jack and Joanie created a Statement of Owner Equity the year that Aunt Sylvia died, they would have recorded the debt for their land and house that was forgiven in her will in this section.

Step 4: Adjust for Distributions from the Business

Statement of Owner Equity	
Beginning Net Worth	X
Net Farm Income	X
Contributions to the Business	X
Distributions from the Business	X
Asset Valuation Changes	X
Ending Net Worth	XX



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In Step 4, adjustments are made to account for any distributions of owner equity from the business.

This year Jack and Joanie withdrew \$5,000 from the business to pre-pay college tuition for their children. This needs to be recorded as a distribution from owner equity.

Remember that distributions from the business must be subtracted from the Net Farm income, so they should be entered as a negative value.

Additional teaching moment: Lead class to record the data on the statement of owner equity.

Step 5: Calculate Valuation Changes

- **Over time, the value of some assets change (i.e., real estate)**
 - Increases in equity can make the operation look more profitable
 - Decreases in equity can make the operation look less profitable

Statement of Owner Equity	
Beginning Net Worth	X
Net Farm Income	X
Contributions to the Business	X
Distributions from the Business	X
Asset Valuation Changes	X
Ending Net Worth	XX



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In Step 5, adjustments are made for any change in value of the business's capital assets during the last year.

Over time, the value of some assets change. The primary example is real estate. Real estate values are occasionally adjusted on balance sheets to record the affects of inflationary pressures.

It is critical to understand how these valuation changes can distort owner equity when these adjustments are not made correctly.

If you feel that the value of your assets has changed significantly, seek the help of a financial advisor to assist you with this adjustment.

After reviewing Jack and Joanie's asset valuations, Dad said that they did not change significantly enough to warrant any adjustment.

Dad says that this adjustment is only necessary in rare situations such as settling an estate.

Step 6: Ending Net Worth

Statement of Owner Equity	
Beginning Net Worth	X
Net Farm Income	X
Contributions to the Business	X
Distributions from the Business	X
Asset Valuation Changes	X
Ending Net Worth	XX



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Totaling the results from Steps 1 through 5 gives you the ending business net worth.

Additional teaching moment: Allow time for the class to calculate the Ending Net Worth. Print off the sample Statement of Owner Equity on the CD to compare.

Ask the class:

- Did Jack and Joanie's net farm income add to or subtract from their net worth? (Add to)
- Did Jack and Joanie's personal withdrawals add to or subtract from their net worth? (Subtract from)
- Did Jack and Joanie's net worth increase or decrease from the beginning of the year to the end of the year? (Increase)

Challenges and Benefits

- **Challenges:**
 - Accurately measuring non-farm withdrawals
 - Putting appropriate values on assets



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Creating a Statement of Owner Equity presents both challenges and benefits to a business. Review the challenges listed on the slide.

Challenges and Benefits *(cont.)*

- **Benefits:**
 - Measures the change in owner equity over a period of time
 - Identifies why net worth changed during the period



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Creating a Statement of Owner Equity presents both challenges and benefits to a business. Review the benefits listed on the slide.

Quiz Time!

Which of the following are uses for a Statement of Owner Equity?

1. Determine the profitability of the business
2. Compare net worth from one period of time to another
3. Identify what events caused a change in net worth
4. Determine how much of a business' assets are owned by the business owner



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The next few slides contain quiz questions for the class. Allow for responses.

Answer:

2 and 3

Quiz Time!

Place the steps to create a Statement of Equity in the proper order:

- Add contributions to the business
- Add or subtract asset valuation changes
- Add Net Farm Income
- Subtract distributions of owner equity from the business
- Calculate ending net worth
- Record beginning net worth



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The next few slides contain quiz questions for the class. Allow for responses.

Answer:

The bullets are listed in this step order: 3, 5, 2, 4, 6, 1

Homework

- **Create a Statement of Owner Equity for your business**



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You have finished Session Four!

Review the Homework on the screen, providing instruction for how the class can find the Statement of Owner Equity Template and Instructions on the CD.

Allow for review debrief and any additional questions.