UW Growing Beginning Farmers & Ranchers

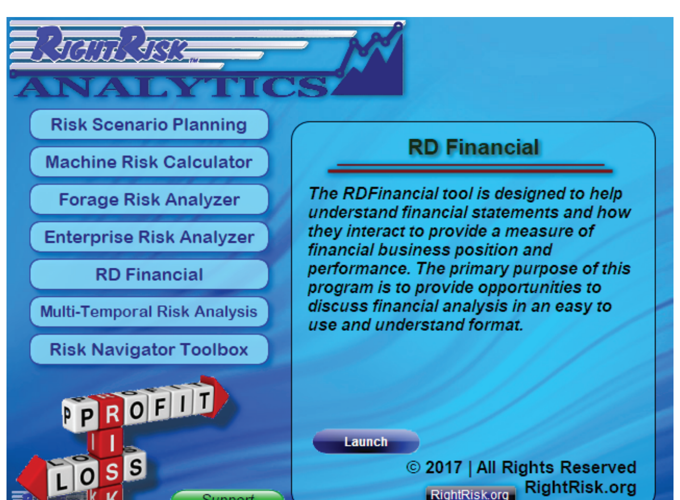
Getting Started in Ag: Financial Planning for the Coming Year

Visit Farmanswers.org/library for information on a variety of financial planning topics, many geared toward new and beginning producers. The library contains more than 300 articles on financial topics alone.

Visit RightRisk.org for additional financial planning resources and tools, as well as online courses, such as the "Getting on Track" series, which specifically addresses record-keeping, financial statements, financial analysis and more. RightRisk.org also offers the RD Financial Tool, developed to help producers evaluate their financial statements, and many other resources for new and beginning producers.

IT'S A NEW YEAR: WHERE DO I START?

This time of year is often when those involved in production agriculture begin making plans for the coming production season. Financial planning is a critical component of these plans, regardless of the size of your business. While you likely have plenty of chores and other daily activities that require your attention, it is important to set aside time for detailed financial planning.



In today's environment of supply chain challenges, inflation, rising interest rates and price volatility, it is imperative to plan accordingly. It is important, from a risk management standpoint, to develop a complete review of your financial health. This information can help you plan for uncertainty and allow you to take advantage of potential opportunities. Understanding your current financial position and budgeting for the coming year allows you to better measure your business's financial position and overall performance, address potential issues and make changes to succeed.

GATHER YOUR RECORDS

Before you can accurately plan for next year, you need to understand how last year went. It is important to keep good records—both production records and records of all receipts and disbursements. Save all receipts including, but not limited to, sales tickets, paid invoices, checking records and credit statements. These records should be sorted by enterprise or type, depending on the nature of your business.

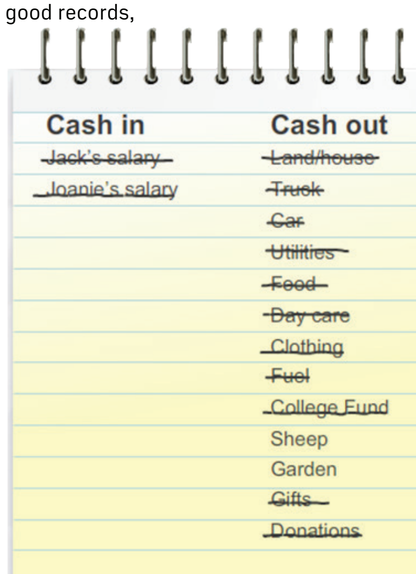
In addition to keeping good records, maintain a journal of all income and expenses. Journals can be paper or digital; many different apps and software programs, both free and paid, are available to help track transactions.

Once the data is collected, a profit and loss statement can be put together, either on a monthly or yearly basis. If your business includes more than one enterprise, it is important to divide or allocate the income and expense items by each enterprise as appropriate. Individual enterprise analysis can help you identify where both profit centers and areas of improvement exist within your business.

BUILD YOUR FINANCIAL STATEMENTS

There are four main financial statements crucial to analyzing your business and planning the way forward: cash flow, income statement, balance sheet and owner equity. The cash-flow statement describes the farm business's sources and uses of cash, as well as a monthly summary of those cash inflows and outflows. The first cash-flow statement should be a historical document, using actual data from your most recent financial records. From there you can construct a cash flow projection or budget for the coming year.

Formulating a projected cash-flow is especially important if you are borrowing money needed to operate. This projection allows you to anticipate when cash deficits might occur and how they will be addressed. The first step is to list all potential cash inflows and outflows in total, then assign them to appropriate months. It is important to be as comprehensive as possible when listing expenses, as it will cut down on surprises in the form of cost overruns later on.



Getting started with a cash flow statement.

Construction of the balance sheet is the next step. This statement outlines the owner's assets and liabilities and the subsequent net worth (asset values minus liabilities). The balance sheet is a useful tool for lenders as well as business owners, providing estimated values at a certain point in time as well as a measure of business performance over time. For instance, a series of balance sheets can show whether net worth has improved over a three-year period. Assets and liabilities are designated as current (due or sellable in the coming year) or non-current/long term (due beyond one year).

Using the information from the cash flow and balance sheet, it possible to formulate an income statement. An accrual-based income statement is the only true measure of profitability for a business. This statement accounts for all cash and non-cash (accrual) income and expenses.

Cash accounting measures income and expenses that are based on cash transactions, ignoring inventory and other non-cash changes. Accrual-basis accounting matches revenue from the production period to actual expenses associated with producing that revenue. This provides an accurate picture of business performance over the period, not just a description of changes in cash. Production agriculture often involves inconsistent revenue streams and expenses, so even if you choose to use cash accounting for tax purposes, it is important to develop an accrual-based income statement for management decision-making.

Finally, a statement of owner equity (net worth) shows how a business's overall financial position may have changed over a year. This statement can help identify the financial events that led to a change in equity position as well as what steps can be taken to address any negative impacts.

BUDGETING

You can begin to develop budgets for the coming year once you have a handle on your business's financial information. As discussed above, if you have more than one enterprise involved in your operation, such as crops and livestock, it is important to use enterprise budgets to evaluate financial performance. You can better understand the contribution of each enterprise to the profitability of the entire business by estimating net revenue for each. When building these budgets, make sure the financial information used is as accurate and up to date as possible.

Partial budgeting is another tool that can be used to consider the potential benefits and costs from a proposed change to an enterprise or the business as a whole. These changes might include expansion, machinery/equipment purchase, a new marketing strategy, or choosing to custom hire instead of owning equipment. For more information, see the Risk Scenario Planning tool available at RightRisk.org/Analytics.

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