**Instructions for Generic Cash Income Statement, Balance Sheet and Ratios**

# Introduction

This document is a tool to help you track and analyze your farm's financial performance. Various farms and accounting firms have different ways of setting up their income statements. The intents of this approach are to organize it into logical, standardized categories of expenses that can then be used to calculate ratios. In turn, the ratios can be used across large groups of farms to provide performance benchmarks. The instructions are hopefully clear, but should you have questions, please contact Larry: larry@agrifoodtraining.com or Travis: traviswjansen@gmail.com.

# Income Statement

The income statement is organized in seven parts:

* Sales (Revenue)
* Cost of Goods Sold (COGS)
* Direct Operating Expenses (DOE)
* Operating Overheads (OH)
* Cost of Capital (COC)
* Interest Expense
* Other Income and Expenses

The following section explains these parts, their subcategories and what should be included in each.

## Sales

This is the value of sales of products from farming operations. The section has spaces for crop and livestock sales as well as other sources of farm income. It should not include government payments except for production insurance. It should not include gains or losses on sales of assets such as machinery or land, nor any form of non-farm income. These items go at the end of the income statement under "other income and expenses".

Inventory and receivables also go here to do the accrual adjustments. If you have product inventories (e.g. grain you'll sell or livestock on feed) carried over at the end of your fiscal year, their value should be included as revenue. The adjustment is done by subtracting the value of product inventories at the beginning of the year from the value at the end of the year. If this is positive, it's an increase in effective revenue, and a decrease if negative. Just enter the amounts with the appropriate signs and the spread sheet does the calculations.

Similarly, if you sold something before the end of your fiscal year, but have not collected payment, you have an account receivable. Receivables are not included in sales for your cash statement but should be for your accrual statement. As with inventories, the adjustment is made by subtracting beginning receivables from ending receivables. Again, enter the amounts with the appropriate signs.

**Non-Market Livestock:** Are livestock that provide ongoing products. Includes breeding stock, milking animals or animals that provide another renewable product (e.g. wool). Sales of cull animals from these herds would appear as sales.

**Market Livestock:** Livestock sold for their meat, fur, etc. Inventories should be valued at their current market value as livestock at the current stage of their life. For example, if you have 1100-pound cattle on feed at the end of your fiscal year, they should be valued at the current market price.

## Cost of Goods Sold (COGS)

This is the cost of inputs that go directly into producing your product. For crops these include seed, fertilizer and crop protection material. For livestock it is feed, feeder animals, veterinary fees, medicines, and breeding expenses. This category also includes costs such as crop insurance and marketing fees.

For either crop or livestock enterprises, if your farm has inventories of inputs at the end of the year that have been produced or paid for, then the change in inventory value should be included. If, for example, your farm purchased fertilizer, some of which was unused in the current year, then the cost of the unused inventory should be carried over to the next fiscal year when the fertilizer will be used. For livestock operations, there may be a similar example for feed or, very likely, a change in the value of breeding stock. In these cases, an increase in the value of inventory should be deducted from this year’s costs. Therefore, the entries into the spread sheet are, value of beginning inventory minus value of ending inventory. Again, placing the values and appropriate signs in the spreadsheet will give the proper result when the spreadsheet calculates the net values.

Similarly, if you have pre-paid expenses in the current year, these count as expense for your cash accounts, but should be attributed to next year in an accrual statement. These are entered in the same way as changes in input inventories. You may also have prepaids in your direct operating expenses. Lines are identified in both categories for these possibilities.

## Direct Operating Expenses (DOE):

These are costs of farm operations such as electricity, tools, repairs, operating labour, transportation costs, and custom work. The most common items are listed in the spread sheet, including changes in inventories and prepaids. We have adopted the practice of including any management salaries in the operating labour category instead of operating overheads because of the variety of ways owner-operators pay themselves.

Farmers sometimes expense machinery and equipment in this category instead of in Cost of Capital below. Please include only the annual cost of operating machinery and equipment in this category. Annual depreciation, leasing and/or rental expenses are capital costs. Entering them into this category will make your ratios inaccurate.

## Cost of Capital (COC)

The costs that come from owning/renting/leasing land, equipment, facilities etc. This includes depreciation/amortization, land rent, machinery or building leases or rental fees, and land clearing/tiling.

## Interest Expense

The cost of financing your operation. Includes interest on long-term debt, interest on operating loans or lines, and, if it can be separated out, interest included in lease payments. It is helpful to list each of the three separately because this information may be important in developing a financing strategy for your business.

## Other Income/Expenses

Revenue earned or expenses incurred that is not directly from the business – i.e. NOT from farming operations. Examples include interest income, rental house, solar panels, equity markets, gains or losses from sales of capital items, expenses for home renovations, etc.

## Principal Payments

Principal payments are not a part of the income statement. However, they are included on the income statement spreadsheet as this information is needed to calculate your debt-service ratio, found under the “Ratios” tab.

# Balance Sheet

The Balance Sheet lists your company's assets, liabilities and equity at a particular point in time. While the Income Statement shows a summary of the year’s performance, the Balance Sheet shows exactly where the farm’s finances are when the document is produced. Here are some helpful points that explain the different sections of the balance sheet:

* Current assets are assets that will be used within the current year, current liabilities are the obligations that are due within a year.
* Demand loans must legally be included in short term liabilities on your official statements despite them being long term in nature. For our purposes here, include only the current portion of demand loans as current liabilities to properly calculate your ratios. The remainder should go in long term liabilities.
* Similarly, include the current portion of your long-term debts as current liabilities, and the remainder as long term.
* Long term assets are those which have useful life beyond one year, including land, buildings and equipment or machinery.
* Long term liabilities are loans that will be paid out over more than a year. This includes mortgages, equipment loans and leases.
* Other assets are those which are not farm related. Some examples might be investments or shares in a co-op.
* Equity represents the net value of ownership in your business. This section may include owners’ initial investment in the business, any additional cash injections, and retained earnings.

# Ratios

All values in this sheet are calculated and require no input. A summary of the income statement and balance sheet can be found on the left. Further to the right there are five groups of financial ratios that measure the performance of your farm.

* **Margin Ratios:** Measure your farm’s operational earnings. Benchmark values for grain and oilseed farms are found in the top-right corner of each measure.
* **Cost Ratios:** Measure how much you spend relative to your sales. Benchmark values for grain and oilseed farms are found in the top-right corner of each measure.
* **Liquidity Ratios:** Measure your ability to pay off your current debts, i.e. your short-term financial risk.
* **Solvency Rations:** Measure your ability to pay off your long-term debt. Measures your general financial risk.
* **Profitability Ratios:** Measure your return on assets and equity.
* **Debt Service Coverage Ratio:** This ratio is important as it is what banks use to assess loans. The concept is straight forward: it is the ratio of how much money the business has to service your annual debt obligations (after paying operating expenses).

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