Why Do We Need Good Records?

Session 1
It Starts with Why

START WITH WHY

HOW GREAT LEADERS INSPIRE EVERYONE TO TAKE ACTION

SIMON SINEK

WHAT

HOW

WHY
Why I Do What I Do

▪ What I Do: Tax Management, Accounting & Financial Analysis for Farmers

▪ How I Do it: With accuracy, timeliness, and with specialized knowledge in farming

▪ Why I Do It: To improve the profitability of Nebraska’s farms and ranches through better financial management

▪ What do you do?

▪ How do you do what you do?

▪ Why do you do what you do?
Why Do You Farm/Ranch?

It all comes back to financial management.

Putting “Fires” out takes away from the important things:

- Harvest
- Planting
- Calving
- Employees
Cash vs. Accrual Accounting
Cash Basis Records

- The income **recognized** during the year and all of the expenses **paid**
- Tells us very **little** about earnings of the business

\[
\text{Gross Cash Farm Income} - \text{Gross Cash Farm Expenses} - \text{Depreciation} = \text{Net Cash Farm Income}
\]

Example 1: Joe

What is his cash basis income?
Gross Income:
- Corn Sales $50,000
- Soybean Sales + $25,000
- Misc. Farm Income + $5,000
Total Gross Income (A) = $80,000

Gross Expenses:
- Seed $20,000
- Chemicals + $15,000
- Fuel + $8,000
- Depreciation + $15,000
- Other Farm Expenses + $12,000
Total Gross Expenses (B) = $70,000

Cash Basis Income (A-B) = $10,000

Example 2: John

What is his cash basis income for 2018?
### Gross Income:

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wheat Sales</td>
<td>$0</td>
</tr>
<tr>
<td>Cattle Sales</td>
<td>$262,500</td>
</tr>
<tr>
<td>Cattle Cost of Sales</td>
<td>($150,000)</td>
</tr>
</tbody>
</table>

**Total Gross Income (A)** $112,500

### Gross Expenses:

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Feed</td>
<td>$25,000</td>
</tr>
<tr>
<td>Chemicals</td>
<td>$17,500</td>
</tr>
<tr>
<td>Fertilizer</td>
<td>$15,000</td>
</tr>
<tr>
<td>Vet</td>
<td>$1,500</td>
</tr>
<tr>
<td>Trucking</td>
<td>$1,500</td>
</tr>
<tr>
<td>Cash Rent</td>
<td>$25,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>$50,000</td>
</tr>
<tr>
<td>Other Farm Expenses</td>
<td>$50,000</td>
</tr>
</tbody>
</table>

**Total Gross Expenses (B)** $185,500

**Cash Basis Income (A-B)** ($73,000)

### Accrual Basis Records

- Measures the **true profitability** of the farm
- Income **earned** during the year and expenses **incurred**
Think About the Differences

<table>
<thead>
<tr>
<th>Cash</th>
<th>Accrual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Received</td>
<td>Income Earned</td>
</tr>
<tr>
<td>Expenses Paid</td>
<td>Expenses Incurred</td>
</tr>
</tbody>
</table>

Accrual Basis Records

- When would you earn income that wasn’t recognized?
  - You earn income by growing a crop in 2017, but your don’t recognize it until you sell it in 2018
Accrual Basis Records

▪ When would you incur an expense that you didn’t pay?
  – If you use seed to plant your crop but you don’t pay for it until the following year, you have incurred an expense you haven’t paid

Accrual Basis Records

▪ When do you earn the income from the sale of the corn?

▪ You earn income throughout each stage but you can’t recognize it until you sell it.
Example 1:
Joe's cash basis income was $10,000.

Gross Income (A) $80,000
Gross Expenses (B) - $70,000
Cash Basis Income (A-B) $10,000

Example 1:
His balance sheets show the following changes to his assets.

<table>
<thead>
<tr>
<th>Inventories</th>
<th>Beginning</th>
<th>Ending</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corn</td>
<td>$34,000</td>
<td>$42,500</td>
<td>$8,500</td>
</tr>
<tr>
<td>Beans</td>
<td>$12,575</td>
<td>$14,000</td>
<td>$1,425</td>
</tr>
<tr>
<td>Prepaid Fertilizer</td>
<td>$24,000</td>
<td>$0</td>
<td>($24,000)</td>
</tr>
<tr>
<td>Growing Wheat</td>
<td>$0</td>
<td>$3,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>Total Inventory</td>
<td>$70,575</td>
<td>$59,500</td>
<td>($11,075)</td>
</tr>
</tbody>
</table>

Net Cash Income $10,000
Inventory Change + ($11,075)
Net Accrual Income ($1,075)
Example 2:
John had a cash basis loss of $73,000.

<table>
<thead>
<tr>
<th></th>
<th>Beginning</th>
<th>Ending</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wheat</td>
<td>$0</td>
<td>$180,000</td>
<td>$180,000</td>
</tr>
<tr>
<td>Prepaid Seed</td>
<td>$0</td>
<td>$14,000</td>
<td>$14,000</td>
</tr>
<tr>
<td>Accrued Interest</td>
<td>$9,475</td>
<td>$12,050</td>
<td>$(2,575)</td>
</tr>
<tr>
<td><strong>Total Change</strong></td>
<td><strong>$9,475</strong></td>
<td><strong>$12,050</strong></td>
<td><strong>($2,575)</strong></td>
</tr>
</tbody>
</table>

Net Cash Income   ($73,000)
Total Accrual Adjustments + $191,425
Net Accrual Income $118,425
My Dad’s Rules

1. Sort the edge pieces from the middle pieces
2. Put the edge pieces together
3. Fill in the middle
   - May need to sort by color, shape, etc. to get started.
4. Hide a piece so you get to put in the last piece!
Cash Basis Records

- Like the edge of the puzzle, cash basis records give us:
  - Clear defined edges, less pieces of information to process at once, and it's easier

- Cash basis accounting is the **foundation** for good records

Who wants to guess what the puzzle is now?
Accrual Basis Records

- Why do we need accrual records?
  - No one REQUIRES it

- **Accrual records** will give you the confidence to make good decisions
What Do You Need to
Keep Good Records

Session 2
The Cornerstone

- Webster’s Dictionary defines a cornerstone as “a basic element or a foundation”
- Traditionally, this is the first stone set in the construction of a building
  - If not set correctly, it could throw off the whole building

Your Records = Your Cornerstone

- Tough decisions are easier with data
- Tax prep is no longer a total nightmare
- No surprises at renewal
- Sleep easier
What Are Good Records

- More than a record keeping program
  - No computer program will automatically make you a good record keeper.

- More than a reconciled set of books
  - Good records HAVE to start as being reconciled to the bank
  - Must also be meaningful

- Must include production records

Good Records

- Good records are more than the system you use to organize the data

- Having good records is a matter of having all of the data you need gathered so that you can use it in making good management decisions
Bank Statements

- Have copies for each month for EVERY bank account you have  
  - Have copies of the checks attached in a legible format

<table>
<thead>
<tr>
<th>If Payment is By:</th>
<th>Then the statement must show:</th>
</tr>
</thead>
</table>
| Check                           | **Check number**  
|                                  | Amount  
|                                  | **Payee’s name**  
|                                  | Date the check amount was posted to the account by the financial institution |
| Electronic Funds Transfer       | Amount transferred  
|                                  | **Payee’s name**  
|                                  | Date the transfer was posted to the account by the financial institution |
| Credit Card                     | **Amount charged**  
|                                  | Payee’s name  
|                                  | **Transaction date** |
Check Stubs for ALL Income

- Helps distinguish the tax treatment of the income
- Keep all check stubs and supporting information
  - Bushels or head/pounds sold

Receipts for ALL Expenses

- In order to allow a deduction, receipts must show
  - The specific product
  - The quantity of the product
  - The price of each product

- Without receipts or invoices, IRS has the authority to outright **disallow** that expense

- This information is very helpful when allocating your expenses, so we can get the true cost of production
Receipts for ALL Expenses

- For capital purchases, you should keep:
  - Purchase and sales invoices
  - Real estate closing documents
  - Any associated loan documents
- These documents should be kept for as long as you have the asset

Loan Transaction Statements

- These accounts are just as important to verifying accuracy as the bank statements
- Without a reconciliation to the loan balances, you may be missing an interest deduction, calculating ratios wrong, or simply under or overstating net worth
Hedging Statements

▪ If you are using a commodity marketing account, it’s important that you learn how to read the statements so you know how to determine the gain/loss

▪ The year-end 1099-B should be part of your tax preparation documents, but the monthly statements are important to have as a part of your records

Non-Farm Investment Statements

▪ You may receive updates on your investment accounts monthly, quarterly or annually

▪ It is an important part of your balance sheet to make sure these accounts are included
Production and Feed Records

▪ If you don’t know how many **bushels** were produced on a field, we can’t calculate a **cost** per bushel

▪ If you don’t know how much gluten you fed your feeder cattle, how will we be able to calculate a **rate of gain**?

▪ This information is important for benchmarking against your past, and also against your peers

Year-End Inventories

▪ To have good accrual records, we need be able to measure what you have at both the beginning and end of the year

▪ This includes:
  – Accounts Receivable
    ▪ Income items you were owed at the end of the year but did not **receive**
  – Prepaid Expenses
    ▪ Expenses that you have paid for but that won’t be **used** until the next production year
Year-End Inventories

– Crop Inventory
  ▪ You should include all crops that you haven’t taken money for yet

– Livestock Inventory
  ▪ You need to separate feeding livestock and breeding livestock, but both are important.

– Accounts Payable
  ▪ We also need to know if you have any outstanding bills to be paid

Organization

▪ Organize these items in a manner that makes sense to you

▪ It should be organized in a manner that you can quickly and easily retrieve what you need and also be able to repeat the system throughout the year
Balancing Your Books

Session 3

Balancing Your Books

- The very first thing I listed in “What do You Need to Keep Good Records?” is your bank statements and it’s first for a reason

- Most “horror stories” start with books that are not balanced.
Unbalanced Books

▪ Just “the important stuff”

▪ Tax reports

▪ Computer reconciliation – The easy button

Discussion Question

▪ Think about a time when you’ve found a bank error. If you’re willing, share the story.
Discussion Questions

Are they taxable or deductible in this tax year or the next?

▪ You receive a grain check in November (this tax year) but you deposit it in the bank on January 2nd (next tax year).

- Taxable This Year
- Taxable Next Year

Discussion Questions

Are they or taxable or deductible in this tax year or the next?

▪ You deliver grain to the elevator in October to fill a Fall Delivery contract. Instead of receiving payment, you sign a deferred payment contract that states it is an installment agreement asking for your money on January 2nd.

- Taxable This Year
- Taxable Next Year
Discussion Questions

Are they or taxable or deductible in this tax year or the next?

▪ You write a check on December 30th for rent and put it in the mail that day. Your landlord receives it January 4th.
  – For You?
    ▪ Deductible This Year
    ▪ Deductible Next Year

Discussion Questions

Are they or taxable or deductible in this tax year or the next?

▪ You write a check on December 30th for rent and put it in the mail that day. Your landlord receives it January 4th.
  – For Your Landlord?
    ▪ Taxable This Year
    ▪ Taxable Next Year
Discussion Questions

Are they or taxable or deductible in this tax year or the next?

- You write a check on December 30th for rent and deliver it to your landlord that day.
  - For You?
    - Deductible This Year
    - Deductible Next Year

- You write a check on December 30th for rent and deliver it to your landlord that day.
  - For Your Landlord?
    - Taxable This Year
    - Taxable Next Year
Reconciling Your Bank Statement

Ending Balance Shown on Statement

Add Outstanding Deposits Not Shown on Statement
+ ___________

Subtract Total Outstanding Checks
- ___________

Equals Adjusted Ending Balance
= ___________

Terms

▪ Outstanding Deposits
  – Deposits that are **recorded** in your books but have not come through the statement yet

▪ Outstanding Checks
  – Checks that you have **written** but the bank has not **received** yet
Tips for Reconciliation

- Double check your opening and closing bank balances and make sure they match the bank.
- Check to see if your discrepancy is divisible by 9.
- Check to see if you entered a check as a deposit or a deposit as a check.
- Double check for automatic transactions.
- Get out a highlighter.
- Get fresh eyes.
Balancing Loans

- It’s important to **reconcile** your loans (if you have them) as well
- Goals of reconciling loans
  - Making sure we have an accurate **interest** and **principal**
  - Making sure there are no bank errors

Constructive Receipt

- Constructive Receipt is the term used to describe when **income** becomes **taxable** income
- Can significantly impact the tax rate paid if you do not follow these rules
Constructive Receipt Rules

▪ You must include income when you “actually or constructively receive” the money
  – This means when you have access to it
  – If you receive a check on December 30\textsuperscript{th}, but don’t take it to the bank until January 2\textsuperscript{nd}, you had access to the money so it should be included in December’s books.

Constructive Receipt Rules

▪ You must include income when you “actually or constructively receive” the money
  – If the co-op writes and mails you a check on December 31\textsuperscript{st} and you don’t receive it until January, you did not have access to the money, so you did not constructively receive the money until January.
Constructive Receipt Rules

▪ If you authorize someone to be your agent and receive income for you, you are considered to have received it when your agent receives it
  – If you have your calves listed with a sale barn, you have authorized the sale barn as your agent. When the sale barn collects the money for your calves, you have constructive receipt of the money.

Constructive Receipt Rules

▪ If you authorize someone to be your agent and receive income for you, you are considered to have received it when your agent receives it
  – If you send an employee to pick up a check, you have constructive receipt when the check is picked up.
Constructive Receipt Rules

▪ You must recognize income even if you receive property or services in exchange
  – If you give someone grain in exchange for feeding your cattle, you have income of grain sales and an expense of custom work.

▪ The income received would be taxable when the good or service was rendered

Constructive Receipt Rules

▪ You can sell items under a Deferred Payment Contract and defer the income to the year following sale
  – Many purchasers will establish a deferred payment contract where you deliver and sell your items and they will not issue you a check until the following tax year.
  ▪ You cannot have the option to choose to take the check before that time in order for it to be a bona fide contract. If that contract is established, you do not have constructive receipt until you receive your check.
Constructive Receipt Rules

- If a debt is paid directly by another person or is canceled, it is income
  - If your dad pays $10,000 down on your operating note instead of giving you a wage, it is income to you on the day he made the payment.
  - If your lender requires all income received to be used to reduce your debt, it is still income even though it doesn’t touch your checking account.

Getting Good Tax Records

Session 4
Getting Good Tax Records

▪ One of the toughest transitions is often understanding the difference between balanced records and meaningful records
▪ Balancing your books is just the beginning
▪ You could just have an organized mess
▪ We need to make sure your balanced records fit together and make sense

Discussion Question

▪ Go through Bob and Judy's reports provided and find the 10 mistakes.
Principal Advance in Income

Before:

<p>| | | | | | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>334</td>
<td>GEN 1</td>
<td>11/5/17</td>
<td>D</td>
<td>100</td>
<td>FSB Operating</td>
<td>5,000.00</td>
<td></td>
<td></td>
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<tr>
<td>334</td>
<td>GEN 6</td>
<td>11/12/17</td>
<td>D</td>
<td>100</td>
<td>Tina Barrett Wages</td>
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<td></td>
<td></td>
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<tr>
<td>334</td>
<td>GEN 7</td>
<td>11/27/17</td>
<td>D</td>
<td>100</td>
<td>Paul Jones Sale of tools</td>
<td>200.00</td>
<td></td>
<td></td>
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<tr>
<td>334</td>
<td>GEN 19</td>
<td>11/27/17</td>
<td>D</td>
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<tr>
<td>334</td>
<td>GEN 19</td>
<td>11/27/17</td>
<td>D</td>
<td>100</td>
<td>Jan Farmer Refund for Window Repair</td>
<td>3,180.12</td>
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<td></td>
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<tr>
<td>SUBTOTAL Misc. Farm Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>15,997.22</td>
</tr>
</tbody>
</table>

Principal Advance in Income

- Principal advancements are **not taxable**
- Principal payments are **not deductible**
- Exception
  - Commodity Credit Loan through FSA
Principal Advance in Income

Corrected:

<table>
<thead>
<tr>
<th>Code</th>
<th>Ent</th>
<th>C/D #</th>
<th>Date</th>
<th>T Bnk</th>
<th>Vendor</th>
<th>Description</th>
<th>Units</th>
<th>Weight</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>222</td>
<td>GEN 1</td>
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<td>FSB Operating</td>
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<td>222</td>
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<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
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<td>77,000.00</td>
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No Interest Split on Term Note

Before:

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<tr>
<th>257</th>
<th>GEN 8</th>
<th></th>
<th>11/18/17</th>
<th>E 100</th>
<th>JDF Combine</th>
<th>Combine P &amp; I Payment</th>
<th></th>
<th></th>
<th>(26,768.28)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>SUBTOTAL Equipment Loan</td>
<td></td>
<td></td>
<td>(26,768.28)</td>
</tr>
</tbody>
</table>
No Interest Split on Term Note

- This mistake should be caught when balancing your loans
- Your principal balance would be off, which would throw off your balance sheet and ratios
- You would have missed an **interest deduction**

### Corrected:

<table>
<thead>
<tr>
<th>Code</th>
<th>Ent</th>
<th>C/D #</th>
<th>Date</th>
<th>T/Bnk</th>
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<th>Amount</th>
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</thead>
<tbody>
<tr>
<td>257</td>
<td>GEN</td>
<td>8</td>
<td>11/18/17</td>
<td>E 100</td>
<td>JDF Combine</td>
<td>Combine Princ. Payment</td>
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<td>(22,205.50)</td>
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<td><strong>SUBTOTAL</strong> Equipment Loan</td>
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<td><strong>SUBTOTAL</strong> Interest</td>
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</table>
Purchase of Feeder Livestock in Cost of Sales in November

**Before:**

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<thead>
<tr>
<th>GEN</th>
<th>9</th>
<th>11/22/17</th>
<th>E</th>
<th>100</th>
<th>57 Livestock</th>
<th>Purchase of 30 Steers</th>
<th>30</th>
<th>24568</th>
<th>(57,862.21)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>SUBTOTAL Cost of Sales - Cattle</td>
<td>30</td>
<td>24068</td>
<td>(57,902.21)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>AVERAGE PRICE PER UNIT &amp; WEIGHT</td>
<td>(1.92874)</td>
<td>(2.36)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- You are not allowed to deduct the cost of an item purchased for resale until you **sell it**
  - Applies to anything you purchase with the intent to sell
- If you Purchase feeder cattle in November and sell them in April, you have a deduction in April
Purchase of Feeder Livestock in Cost of Sales in November

Corrected:

<table>
<thead>
<tr>
<th>Code</th>
<th>Bnk</th>
<th>Date</th>
<th>Bnk</th>
<th>Vendor</th>
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<tbody>
<tr>
<td>190</td>
<td>GEN</td>
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<td>100</td>
<td>57 Livestock</td>
<td>30</td>
<td>24668</td>
<td>57,862.21</td>
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<tr>
<td></td>
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<td></td>
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<td>SUBTOTAL Market Cattle Purchased</td>
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Co-op Bill with “Fertilizer, Chemicals, Fuel and Car Repair” in Memo

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Co-op Bill with “Fertilizer, Chemicals, Fuel and Car Repair” in Memo

- Correctly allocate expenses
- Farmers have a special tax rule that allows them to deduct up to 75% of their vehicle use without record
  - The safest way to ensure deductions is to keep mileage logs
- By putting personal expenses in your farm expenses, we can’t get a good measurement on farm costs if all your costs are comingled

Co-op Bill with “Fertilizer, Chemicals, Fuel and Car Repair” in Memo

Corrected:

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Sale of Cow/Calf Pairs in Breeding Livestock Sales

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<td>607 Livestock</td>
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Sale of Cow/Calf Pairs in Breeding Livestock Sales

- Purchased breeding livestock must be **depreciated**
- The purchase of feeding livestock is a **cost of goods sold** item
- When you’re selling pairs, you have the sale of a depreciated item and the sale of an inventory item
  - The sale of the cow is subject to ordinary income tax
  - The sale of the calf is schedule F income
Potential taxes on $50,000 of livestock sales depending on what type of livestock and how long you held the animals.

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<thead>
<tr>
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<th>ST Capital Gains</th>
<th>LT Capital Gains</th>
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<tr>
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<td>Purchased Breeding</td>
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<td>Raised or Purchased Feeding</td>
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<tr>
<td>$50,000</td>
<td>15%</td>
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Sale of Cow/Calf Pairs in Breeding Livestock Sales

Corrected:
Down Payment of $15,000 on Tractor Purchase in Supplies

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<td>Bomgaars Supplies</td>
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<td>11/8/17</td>
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<td>Walmart Light Fixture</td>
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<td>11/9/17</td>
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<td>Bomgaars Shop Supplies</td>
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<td>Bomgaars Propane Heater</td>
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<td>Bomgaars Supplies</td>
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<td>Bomgaars Batteries</td>
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<td>Bomgaars Gravel</td>
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<td>11/9/17</td>
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<td>Bomgaars Impact Tool</td>
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<td>11/24/17</td>
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<td>Bomgaars farm supplies</td>
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<td>11/30/17</td>
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**SUBTOTAL Supplies & Tools** | **18,551.92**

---

Down Payment of $15,000 on Tractor Purchase in Supplies

- The tractor needs to be categorized as a **depreciable** asset
- Need the correct purchase price recorded as an asset and the associated liability recorded in the books
- With a land purchase, other assets included should be **split off** from the total purchase price
Down Payment of $15,000 on Tractor Purchase in Supplies

**Corrected:**

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<tr>
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Co-op Equity Deposit of Cash Only With Memo “Cash $1,550, Equity $1,550”

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<td>Cash $1550, Equity $1550</td>
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Co-op Equity Deposit of Cash Only With Memo “Cash $1,550, Equity $1,550”

- The entire dividend declared is **taxable**
- Adjust the entry to account for the equity and record an asset for the equity
- Qualified Dividends
  - Required to be paid out
  - Taxable when declared
- Non-Qualified Dividends
  - Not required to be paid out
  - Taxable if and when paid out

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Co-op Equity Deposit of Cash Only With Memo “Cash $1,550, Equity $1,550”

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Wages Received in Other Farm Income

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<td>Frontier Refund</td>
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<td>Jan Farmer Refund for Window Repair</td>
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<td><strong>SUBTOTAL Misc. Farm Income</strong></td>
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Wages Received in Other Farm Income

- Separating **personal** income from **farm** income is just as important as separating expenses.
- If we include a net check in farm income and count the W-2, we have doubled up income on the tax return.
Wages Received in Other Farm Income

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SUBTOTAL Wages & Salaries 4,500.12

Utilities All in Farm, None in Personal

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SUBTOTAL Utilities / Farm 694.04
Utilities All in Farm, None in Personal

- There is no right or wrong split, it depends on the family and operation
- Basics to look for
  - You can never deduct the cost of the first landline phone
  - Cell phones don’t have the history to have court cases to rely on so we need to make a reasonable split
  - Electricity, gas, etc. don’t have specific rules we have to follow, but reasonableness will go a long way

Utilities All in Farm, None in Personal

Corrected:

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<td>SUBTOTAL Utilities / Farm</td>
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<td></td>
<td></td>
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</tr>
<tr>
<td>922</td>
<td>GEN 4</td>
<td>11/28/17</td>
<td>E 100</td>
<td>Great Plains Com</td>
<td>Landline</td>
<td>67.54</td>
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<td>922</td>
<td>GEN 1</td>
<td>12/31/17</td>
<td>J</td>
<td>Allocated Util</td>
<td>40% Utilities to Personal</td>
<td>(250.60)</td>
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<td></td>
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<td></td>
<td>SUBTOTAL Personal Utilities</td>
<td>(183.06)</td>
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</tbody>
</table>
Crop Insurance Payment Net of Premium With Memo “Indemnity $100,000, Check $40,000"

**Before:**

<p>| | | | | | | |</p>
<table>
<thead>
<tr>
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<tbody>
<tr>
<td>340</td>
<td>GEN 8</td>
<td>1/28/17</td>
<td>D 100</td>
<td>Rain and Hail</td>
<td>Indemnity 100K, check 40K</td>
<td>40,000.00</td>
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<tr>
<td></td>
<td></td>
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<td></td>
<td>40,000.00</td>
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<td></td>
<td></td>
<td>SUBTOTAL Crop Ins Income</td>
<td>40,000.00</td>
</tr>
</tbody>
</table>

- Impacts cost per acre
- Need to **increase** income to reflect the true payment
- Need to **increase** expenses to reflect the true costs
Crop Insurance Payment Net of Premium With Memo “Indemnity $100,000, Check $40,000"

Corrected:

<p>| | | | | | | | | | | | | | | | | | |</p>
<table>
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<tr>
<td>446</td>
<td>GEN 8</td>
<td>11/28/17</td>
<td>D 100</td>
<td>Rain and Hail</td>
<td>SUBTOTAL Crop Insurance</td>
<td>60,000.00</td>
<td>60,000.00</td>
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<td></td>
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</tbody>
</table>

Meaningful Records

- Look for things that don’t make sense
- Make sure the 1099’s you receive match your books
- Getting your books to match your non-farm tax forms isn’t necessary to have a good tax return or meaningful records
Entities and Their Records

- The use of LLCs for liability protection and corporations for tax savings is becoming increasingly popular.

- Extra entities cause extra bookwork

- “This part of your business is separate”
  - If you are not keeping the entity’s records separate from the rest of your business, your entity can be disqualified

Entities and Their Record Requirements

- Have a separate checking account for the entity

- Have a separate set of books for the entity

- Do not pay entity expenses with your personal account or take entity income as your personal (or vice versa)

- Be sure you make any transactions between the entity and yourself on time according to documents that are on file
  - This includes wages, rent, etc.
Analysis of Multiple Entities

- Entities can add complication in figuring out how the operation is actually doing
- We need to see how the entity stands on its own and then collapse all of the entities to see how the *operation* is doing

Moving to Management Records

Session 6
Management Records

▪ The best option is to keep solid cash basis records and convert those to accrual annually (or more often if your operation warrants it)

▪ Even if we don’t do accrual records, there are things we need to do in the books to make the transition to accrual records easier and to turn our meaningful records into something we can really evaluate

Income

▪ To evaluate the business, we need income split by enterprise

▪ We also need to have quantities attached to the sales
  – Bushels for crops
  – Tons for hay
  – Head and pounds for feeding livestock
  – Head for breeding livestock.

▪ Other income items may also need to be allocated
Income, cont.

- Government Payments
  - Payments from FSA are assigned a specific crop, but the crop applies to your base acres instead of the actual crops you planted this year
  - Typically just split these evenly per crop acre

- Crop Insurance
  - Crop Insurance income or payments you receive as losses should be allocated to the crop at a minimum, but to the field would be best
  - Even if we can’t get 100% accurate, any allocation you can make will help you have more accurate information

Income, cont.

- Hedge Gain/Loss
  - Hedging gains and losses are again, not always easy to separate
  - We traditionally separate these evenly across all crop acres

- Custom Work
  - We don’t usually allocate custom work to crops or livestock unless the work rises to the level where we need to look at it as its own enterprise
Income, cont.

▪ Non-Cash Transactions
  – A common occurrence between family members and/or neighbors is the trading of goods or services
  – We talked about the tax implications but there is a bigger issue from a management standpoint
  – Taking the time to exchange checks could help a lot
    ▪ If you don’t want to exchange checks, consider making a journal entry to record the exchange

Allocating Expenses Between Crops and Livestock

▪ We need to allocate overhead expenses, such as fuel, depreciation, insurance, family living, etc., when we convert the books to accrual

▪ We first need to split them between crops and livestock
  – One option that I like to start with is allocating these expenses based on gross income.
  – You will need to fine-tune the split until it feels right
Expense Splits

- We want to start looking at some real management changes that can make a difference and that is splitting expenses by enterprise

- To show the difference that splitting the expenses by crop makes, I used an analysis for an operation that works very hard to get costs split per enterprise.

### All Costs Split

<table>
<thead>
<tr>
<th></th>
<th>Actual Splits</th>
<th>Even Splits</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Yield Per Acre</strong></td>
<td>75.17</td>
<td>75.17</td>
<td></td>
</tr>
<tr>
<td><strong>Seed</strong></td>
<td>$ 71.02</td>
<td>$71.15</td>
<td>$ 0.13</td>
</tr>
<tr>
<td><strong>Fertilizer</strong></td>
<td>$ 6.15</td>
<td>$40.86</td>
<td>$34.71</td>
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<tr>
<td><strong>Crop Chemicals</strong></td>
<td>$ 31.67</td>
<td>$56.51</td>
<td>$24.84</td>
</tr>
<tr>
<td><strong>Crop Insurance</strong></td>
<td>$ 13.02</td>
<td>$19.75</td>
<td>$ 6.73</td>
</tr>
<tr>
<td><strong>Irrigation Energy</strong></td>
<td>$ 24.77</td>
<td>$26.64</td>
<td>$ 1.87</td>
</tr>
<tr>
<td><strong>Irrigation Repairs</strong></td>
<td>$ 5.22</td>
<td>$ 5.22</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Land Rent</strong></td>
<td>$ 218.93</td>
<td>$174.79</td>
<td>$(44.14)</td>
</tr>
<tr>
<td><strong>Hauling &amp; Trucking</strong></td>
<td>$ 1.55</td>
<td>$ 1.60</td>
<td>$ 0.05</td>
</tr>
<tr>
<td><strong>Marketing</strong></td>
<td>$ 10.82</td>
<td>$10.82</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Fuel &amp; Oil</strong></td>
<td>$ 14.03</td>
<td>$14.03</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Repairs</strong></td>
<td>$ 16.40</td>
<td>$16.40</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Repair, Machinery</strong></td>
<td>$ 6.61</td>
<td>$ 6.61</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Repair, Buildings</strong></td>
<td>$11.27</td>
<td>$11.27</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Utilities</strong></td>
<td>$ 3.03</td>
<td>$ 3.03</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Operating Interest</strong></td>
<td>$ 0.86</td>
<td>$ 0.86</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Overhead</strong></td>
<td>$437.35</td>
<td>$461.26</td>
<td>$23.91</td>
</tr>
<tr>
<td><strong>Total costs</strong></td>
<td>$ 564.09</td>
<td>$588.00</td>
<td>$ 23.91</td>
</tr>
<tr>
<td><strong>Cost Per Bushel</strong></td>
<td>$ 7.50</td>
<td>$ 7.82</td>
<td>$ 0.32</td>
</tr>
</tbody>
</table>
Costs without land rent adjustment

<table>
<thead>
<tr>
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<th>Difference</th>
</tr>
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<tr>
<td>Fertilizer</td>
<td>$ 8.15</td>
<td>$ 40.58</td>
<td>$ 32.43</td>
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<td>Cost Per Bushel</td>
<td>$ 7.50</td>
<td>$ 8.41</td>
<td>$ 0.91</td>
</tr>
</tbody>
</table>

Allocating Expenses per Crop Type

- Start with the major expenses and work your way until there is no meaningful split
- The four expenses that tend to make the biggest difference are:
  - Seed
  - Crop Insurance
  - Chemicals
  - Fertilizer
Allocating Expenses per Crop Type

▪ Once you are comfortably splitting the major expenses, we can move toward other ones that are meaningful
  – Irrigation Energy
  – Cash Rent
  – Marketing
  – Etc.

Allocating Expenses per Field

▪ The more we allocate, the more we realize we need to allocate

▪ With variable rate technology, we should have the ability to identify how much seed to each field, and then how much was put on the dryland corners and under the pivot
Allocating Expenses

- There is a fine line between allocation work that is meaningful and allocation work that is just work
  - Start off with a split of crop types
  - Then think about which costs are applied significantly differently to irrigated vs dryland or from one field to another
  - Those will be the costs it may be worth splitting further than by crop type

Special Allocations

- Cover Crops
  - If you harvest the crop it will stand alone as its own enterprise
  - If you plant a cover crop that will be killed before planting or grazed, we will call it an expense to the following year crop
    - Expenses for the seed, application, etc. will be a prepaid expense for the year you pay for it, and an expense against the crop the following year
Special Allocations

▪ Lime and Manure spreading
  – If you are spreading enough that it would last multiple years, you would need to allocate the expense over the years
    ▪ We would put it on the balance sheet as a prepaid expense, and allocate a portion of it each year
    ▪ Would be totally deductible in the year purchased

Balance Sheet Ratios
Balance Sheet Ratios

- There are standards for most ratios that are considered “good”, “cautionary” or “poor”
- We often discuss them in terms of stop light, meaning that green is good, yellow is caution, and red is a problem

The Current Ratio

- The current ratio tells us how many times your current debt can be paid with the liquidation of your current assets

\[
\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}
\]

- Green: > 2.0
- Yellow: 1.3 – 2.0
- Red: < 1.3
The Current Ratio

- It is one of the most reactive ratios
  - This means it is one of the first to indicate a problem in the operation
  - This also means that it will sometimes throw a false alert

- It tells us nothing about the margin
  - Even if the ratio tell you that you are doing good, its not a good measure of financial health

Working Capital

- Working Capital shows us how much will be left over after all the current debts are paid

\[
\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}
\]

\[
\text{Working Capital} \text{ Depends on the Operation}
\]
Working Capital

- This ratio doesn’t have acceptable standards because it varies on the size of the operation
- We watch the trend of this ratio to know if you are “burning” working capital or building it
- We will use this to calculate Working Capital to Gross Revenue

Debt to Asset Ratio

- The debt to asset ratio is a measure of how much of the business you own versus how much the bank owns

<table>
<thead>
<tr>
<th>Debt–To–Asset Ratio</th>
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</thead>
<tbody>
<tr>
<td>&gt; 60%</td>
</tr>
<tr>
<td>60%‐30%</td>
</tr>
<tr>
<td>&lt; 30%</td>
</tr>
</tbody>
</table>
Debt to Asset Ratio

- The higher the number the more risk there is to the financial stability of the operation and lower borrowing capacity.
- Keeping your debt to asset ratio low will allow you to be in the position to make purchases, refinance debt or make other management decisions if the need arises.
- It is important that your assets are valued correctly for this ratio to be useful.

Benchmarking Ratios

- Knowing what your ratios are and what they mean is just the beginning.
- The first place to start benchmarking is against your own farm.
  - We need to build a trend of ratios so you can compare them to past years.
- Each trend line tells us a story of what is happening in an operation.
Balance Sheet Ratios

- A ratio gives some direction but by itself it is still just one piece of the puzzle
- Seeing how the trend is moving and knowing the story behind the numbers tells us how the operation is doing
The Income Statement

Session 8

Reminders

▪ Principle payment and deposits are not income or expense but instead affect the loan balance on the balance sheet

▪ Non-farm income should be separated from farm income just as non-farm expense should be separated from farm expenses
  – These items still do go to an income statement
Income Statement

- The income statement shows us what profit or loss has been recognized over a specific period, usually a calendar year.

- Although non-farm income and expenses do not calculate into the net farm income calculation, they do play into the calculation of net worth.

Net Worth Calculation

\[
\text{Beginning Net Worth} + \text{Net Farm Income} + \text{Personal Income} - \text{Family Living/Owner Withdrawals} - \text{Income & Social Security Tax} +/− \text{Market Value Adjustment} = \text{Ending Net Worth}
\]
Income Statement

- **Non-farm** income and expenses help us fill in the “holes” of the story

- Example
  - A dropping **current ratio** with good net farm income could be explained by extremely high non-farm costs

- We can’t manage what you don’t measure

Income Statement

- Ultimately, the profit or loss from the income statement is reflected on the **balance sheet**

- A profit will result in more assets or a reduction in debt
Income Statement

- One common question at tax planning time is “How did I make that much? I don’t have any cash left?”
- The money can usually be tracked to three areas
  - Net Non-Farm Costs
  - Debt Reduction
  - Cash spent on Capital Purchases
- One of the few deviations from that rule is depreciation

Depreciation for the Income Statement

- Since depreciation is a non-cash cost, it is often not “felt,” but it is a real expense

```
Beginning Inventory
+ Purchases
- Sales
- Ending Inventory
= Depreciation Expense
```
Income Statement Ratios

Working Capital to Gross Revenue

- This ratio measures how much of the gross income is available in working capital

<table>
<thead>
<tr>
<th>Working Capital to Gross Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>≤ 10%</td>
</tr>
<tr>
<td>10% - 33%</td>
</tr>
<tr>
<td>&gt; 33%</td>
</tr>
</tbody>
</table>
Working Capital to Gross Revenue

- This ratio uses accrual gross revenues, so it wouldn’t necessarily be the gross income from your tax return or income statement
- The standards vary for this ratio
- In addition to telling us what percentage of operating needs you need, it also tells us about the cushion available for unexpected expense or non-farm expenses

Benchmarking Ratios

- Along with benchmarking against yourself, it is also important to benchmark against your peers
- There is a happy medium between focusing on what others are doing and focusing on what you are doing
  - The problem with focusing too much on benchmarking against others is the old adage of “if your friends all jumped off a cliff, would you too?”
  - If you focus too much on benchmarking against yourself, you may miss the warning signed the rest of the industry noticed
Bob and Judy Farmer Compared to the Nebraska Average

Bob and Judy Farmer

- This pie chart shows the percentage of farms that fit into each color category
- Bob’s Working Capital to Gross Revenue is 8.4%
  - This is the “red light” range
  - Over 25% of the farms in our average are in worse shape than him.
Benchmarking

- It is important to remember that not all operations are coming from the **same point**
  - Comparing different debt-to-asset ratios
  - Comparing age groups
  - Comparing efficiency to Iowa/Illinois
- Know the data set you are comparing to

Benchmarking

- One of the most beneficial areas to benchmark to others seems to be costs per acre/head, etc.
- When we can calculate costs this way, you can see what the average is doing differently than you are
Bring It Back to Why

Session 9

Bring It Back to Why

- New Year’s resolutions cause attendance at fitness clubs and the enrollment in diet plan memberships to explode and estimates say that 80% of them fail by February.

- The resolution that I hear year after year is that I’m going to keep my record keeping up to date this year so I don’t have to do 11 months in November.
Bring it back to Why

▪ *EntreLeadership* by Dave Ramsey

▪ One of the things that he emphasizes is that most small business fail because of **poor accounting**

▪ He recommends giving yourself **48 hours** from the time you receive the bank statement to having it entered and reconciled
  – If you wait longer than that, you are procrastinating instead of prioritizing

---

Time Management

1: Important and Urgent

2: Important but not Urgent

3: Not Important but Urgent

4: Not Important and Not Urgent
Bringing It Back to Why

- Just like you can’t exercise for the month of January and all of a sudden see sustained weight loss and reduced blood pressure for the rest of your life, you can’t just work on record keeping once and expect it to make a significant impact.

- The ratios we’ve calculated tell us how your operation is doing at specific points in time but they will change
  - They are the vital signs of your business.

- You need to keep taking your operation’s temperature to anticipate and avoid problems.