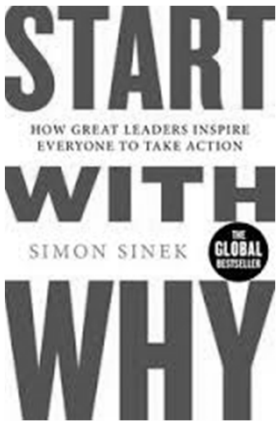
Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

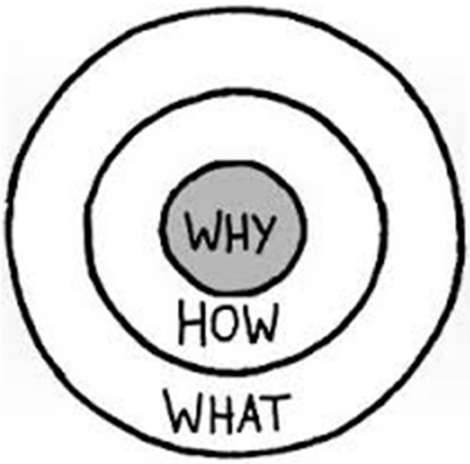
Why Do We Need Good Records?

Session 1

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

It Starts with Why





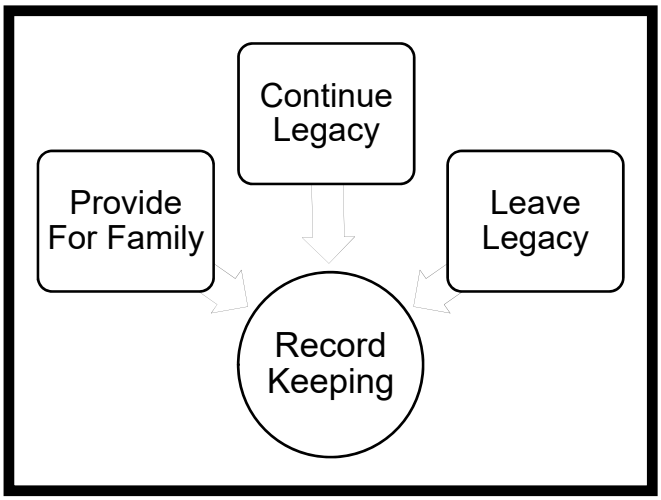
Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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?

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324



Why Do You Farm/Ranch ?

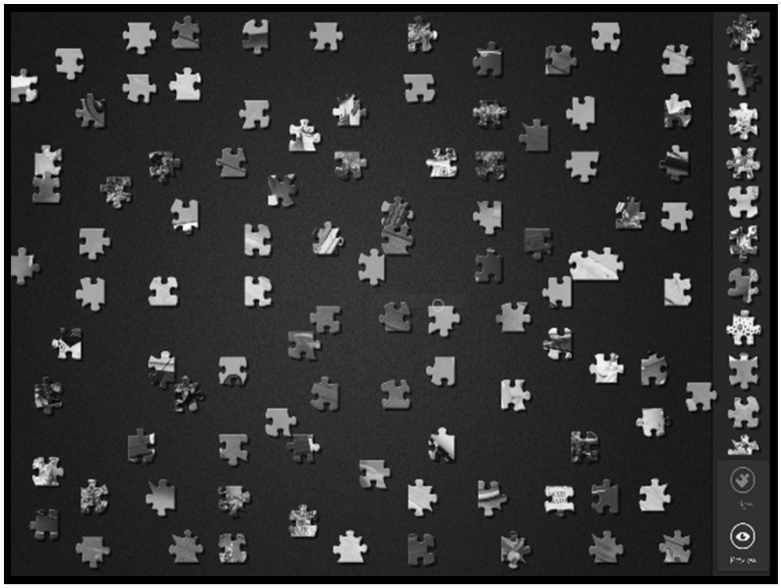
It all comes back to financial management

Putting “Fires” out takes away from the important things

- Harvest
- Planting
- Calving
- Employees

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Cash vs. Accrual Accounting



Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Cash Basis Records

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

Gross Cash Farm Income
- Gross Cash Farm Expenses
- Depreciation
= Net Cash Farm Income

Example 1: Joe

What is his cash basis income?

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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?

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Gross Income:		
Wheat Sales		$0
Cattle Sales		$262,500
Cattle Cost of Sales		($150,000)
Total Gross Income (A)	$112,500	
Gross Expenses:		
Feed		$25,000
Chemicals		$17,500
Fertilizer		$15,000
Vet		$1,500
Trucking		$1,500
Cash Rent		$25,000
Depreciation		$50,000
Other Farm Expenses		$50,000
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**

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Think About the Differences

Cash

- Income Received
- Expenses Paid

Accrual

- Income Earned
- Expenses Incurred

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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 **<u>throughout each stage</u>** but you can't recognize it until you **<u>sell it</u>**.

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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.

Inventories	Beginning	Ending	Change
Corn	$34,000	$42,500	$8,500
Beans	$12,575	$14,000	$1,425
Prepaid Fertilizer	$24,000	$0	($24,000)
Growing Wheat	$0	$3,000	$3,000
Total Inventory	$70,575	$59,500	($11,075)

Net Cash Income	$10,000
Inventory Change	+ ($11,075)
Net Accrual Income	($1,075)

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Example 2:
John had a cash basis loss of $73,000.

Total Gross Income (A)		$112,500
Total Gross Expenses (B)	-	$185,500
Cash Basis Income (A-B)		($73,000)

Example 2:
He contracted his wheat for the following year and also prepaid some seed that he didn't have before. Here is the information from his balance sheets.

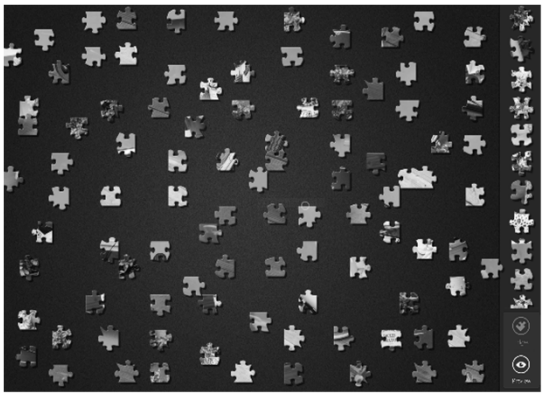
Inventories	Beginning	Ending	Change
Wheat	$0	$180,000	$180,000
Prepaid Seed	$0	$ 14,000	$14,000
Accrued Interest	$9,475	$12,050	($2,575)
Total Change			$191,425

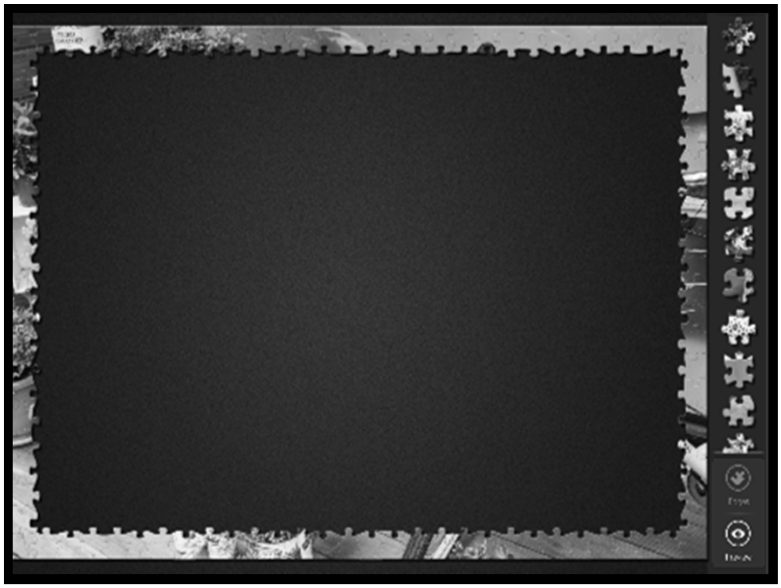
Net Cash Income		($73,000)
Total Accrual Adjustments	+	$ 191,425
Net Accrual Income		$ 118,425

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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!

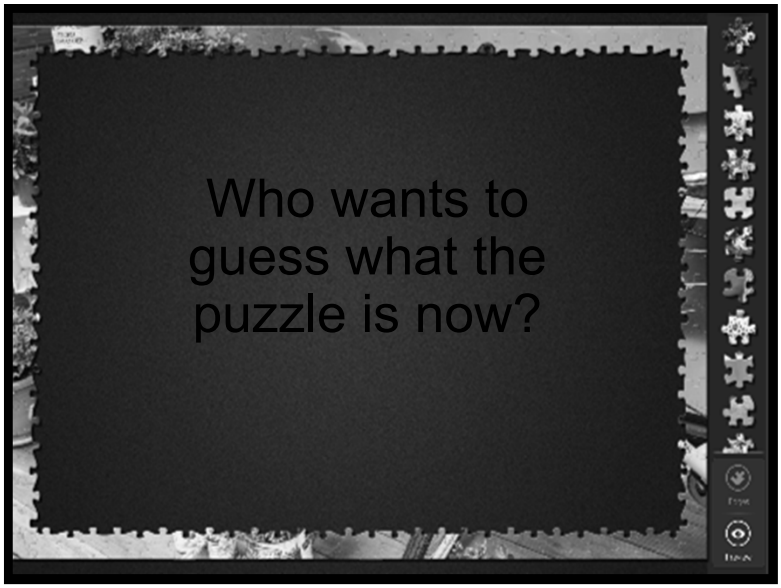




Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Cash Basis Records

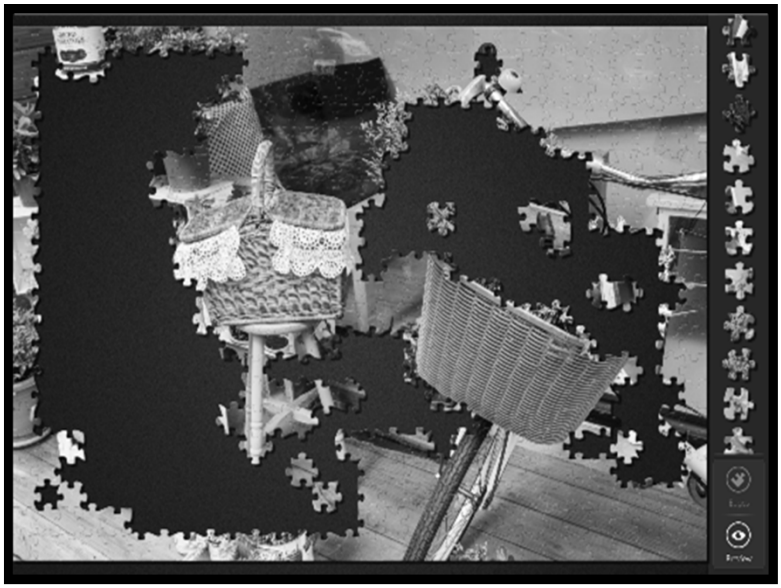
- Like the edge of the puzzle, cash basis records give us:
  - Clear defined edges, less pieces of information to process at once, and it's easier
- Cash basis accounting is the **foundation** for good records



Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Accrual Basis Records

- Why do we need accrual records?
  - No one *REQUIRES* it
- **Accrual records** will give you the confidence to make good decisions



Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

What Do You Need to Keep Good Records

Session 2

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Bank Statements

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

If Payment is By:	Then the statement must show:
• **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**

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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.

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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.

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

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tina@nfbi.net
(402) 464-6324

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

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 Your Landlord?

- Taxable This Year

- Taxable Next Year

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Check Register

Number	Date	Description of Transaction	C	Debit (-)	Credit (+)	Balance

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.

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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 30th, but don't take it to the bank until January 2nd, 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 31st 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.

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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.

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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.

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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.

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Principal Advance in Income

Before:

334	GEN	1	11/5/17	D 100	FSB Operating		5,000.00
334	GEN	6	11/12/17	D 100	Tina Barrett	Wages	4,500.12
334	GEN	7	11/27/17	D 100	Paul Jones	Sale of tools	200.00
334	GEN	19	11/27/17	D 100	Frontier	Refund	3,116.98
334	GEN	19	11/27/17	D 100	Jan Farmer	Refund for Window Repair	3,180.12
					SUBTOTAL Misc. Farm Income		**15,997.22**

Principal Advance in Income

- Principal advancements are **<u>not taxable</u>**
- Principal payments are **<u>not deductible</u>**
- Exception
  - Commodity Credit Loan through FSA

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Principal Advance in Income

Corrected:

Code	Ent	C/D #	Date	T	Bnk	Vendor	Description	Units	Weight	Amount
222	GEN	1	11/5/17	D	100	FSB Operating				5,000.00
222	GEN	10	11/5/17	D	100	FSB Operating				2,000.00
222	GEN	13	11/15/17	D	100	FSB Operating				50,000.00
222	GEN	11	11/23/17	D	100	FSB Operating				20,000.00
						SUBTOTAL Operating Loan				**77,000.00**

No Interest Split on Term Note

Before:

257	GEN	8	11/18/17	E	100	JDF Combine	Combine P& I Payment			(26,768.28)
						SUBTOTAL Equipment Loan				**(26,768.28)**

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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**

No Interest Split on Term Note

Corrected:

Code	Ent	C/D #	Date	T	Bnk	Vendor	Description	Units	Weight	Amount
257	GEN	8	11/18/17	E	100	JDF Combine	Combine Princ. Payment			(22,205.50)
257	GEN	13	11/30/17	E	100	JD Financial	Tractor Loan			90,000.00
						SUBTOTAL Equipment Loan				**67,794.50**

454	GEN	8	11/18/17	E	100	JDF Combine	Combine Interest			4,562.78
						SUBTOTAL Interest				**4,562.78**

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Purchase of Feeder Livestock in Cost of Sales in November

Before:

375	GEN	9	11/22/17	E	100	57 Livestock	Purchase of 30 Steers	30	24568	(57,862.21)
						SUBTOTAL Cost of Sales - Cattle		**30**	**24568**	**(57,862.21)**
						AVERAGE PRICE PER UNIT & WEIGHT		(1,928.74)	(2.36)	

Purchase of Feeder Livestock in Cost of Sales in November

- 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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Purchase of Feeder Livestock in Cost of Sales in November

Corrected:

190	GEN	9	11/22/17	E	100	57 Livestock	Purchase of 30 Steers	30	24568	57,862.21
						SUBTOTAL Market Cattle Purchased		**30**	**24568**	**57,862.21**
						AVERAGE PRICE PER UNIT & WEIGHT		1,928.74	2.36	

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

Before:

Code	Ent	C/D #	Date	T	Bnk	Vendor	Description	Units	Weight	Amount
400	GEN	10	11/4/17	E	100	Aurora Coop	Fert, Chem, Fuel, Car Rep			20,175.54
						SUBTOTAL Fertilizer & Lime				**20,175.54**

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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:

Code	Ent	C/D #	Date	T	Bnk	Vendor	Description	Units	Weight	Amount
400	GEN	10	11/4/17	E	100	Aurora Coop	Fertilizer			9,877.88
						SUBTOTAL Fertilizer & Lime				**9,877.88**
404	GEN	10	11/4/17	E	100	Aurora Coop	Chemicals			9,542.41
						SUBTOTAL Chemicals				**9,542.41**
Code	Ent	C/D #	Date	T	Bnk	Vendor	Description	Units	Weight	Amount
425	GEN	31	11/1/17	E	100	Casey's				51.45
425	GEN	10	11/4/17	E	100	Aurora Coop	Fuel			505.25
425	GEN	29	11/14/17	E	100	Cenex				54.45
425	GEN	30	11/15/17	E	100	Cenex				125.14
425	GEN	39	11/29/17	E	100	FCC	2017 Fuel			492.74
425	GEN	28	11/30/17	E	100	Cenex				63.54
425	GEN	40	11/30/17	E	100	Aurora Coop	2017 Fuel			1,596.78
						SUBTOTAL Farm Fuel & Oil				**2,889.35**
921	GEN	10	11/4/17	E	100	Aurora Coop	Car Repair			250.00
						SUBTOTAL Pers Auto Exp				**250.00**

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Sale of Cow/Calf Pairs in Breeding Livestock Sales

Before:

Code	Ent	C/D #	Date	T	Bnk	Vendor	Description	Units	Weight	Amount
152	GEN	4	11/23/17	D	100	57 Livestock	Sale of 6 Cow/Calf pairs	-6	-7598	(13,012.24)
152	GEN	25	11/28/17	E	100	57 livestock	Purchase 33 heifer calves	33	12586	20,165.24
						SUBTOTAL Breeding Cattle Purchased		**27**	**4988**	**7,153.00**
						AVERAGE PRICE PER UNIT & WEIGHT		264.93	1.43	

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Potential taxes on $50,000 of livestock sales depending on what type of livestock and how long you held the animals.

	ST Capital Gains	LT Capital Gains	Depreciation Recapture	SE Income
Examples	Raised Breeding < 24 mo. Old	Raised Breeding > 24 mo. Old	Purchased Breeding	Raised or Purchased Feeding
Gain	$50,000	$50,000	$50,000	$50,000
Total Tax Rate	15%	0%	15%	28%
Tax Due	$7,500	$0	$7,500	$14,000

Sale of Cow/Calf Pairs in Breeding Livestock Sales

Corrected:

Code	Ent	C/D #	Date	T	Bnk	Vendor	Description	Units	Weight	Amount
362	GEN	4	11/23/17	D	100	57 Livestock	Sale of 6 Calves	6	2800	3,600.00
						SUBTOTAL Sale of Raised Cattle		**6**	**2800**	**3,600.00**
						AVERAGE PRICE PER UNIT & WEIGHT		600.00	1.29	
368	GEN	4	11/23/17	D	100	57 Livestock	Sale of 6 Cows	6	7598	9,412.24
						SUBTOTAL Cull Breeding Lvst Sales		**6**	**7598**	**9,412.24**
						AVERAGE PRICE PER UNIT & WEIGHT		1,568.71	1.24	

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Before:

416	GEN	1	11/2/17	E	100	Bomagaars	Supplies	157.23
416	GEN	32	11/8/17	E	100	Walmart	Light Fixture	158.49
416	GEN	36	11/9/17	E	100	Bomgaars	Shop Supplies	286.50
416	GEN	36	11/9/17	E	100	Bomgaars	Propane Heater	21.15
416	GEN	36	11/9/17	E	100	Bomgaars	Supplies	106.99
416	GEN	36	11/9/17	E	100	Bomgaars	Batteries	236.67
416	GEN	36	11/9/17	E	100	Bomgaars	Gravel	873.54
416	GEN	36	11/9/17	E	100	Bomgaars	Impact Tool	1,468.63
416	GEN	19	11/24/17	E	100	Bomgaars	farm supplies	216.48
416	GEN	20	11/24/17	E	100	Walmart	Shop Towels	26.24
416	GEN	13	11/30/17	E	100	JD Financial	Tractor DP	15,000.00
						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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Corrected:

156	GEN	12	11/3/17	D	100	John Farmer	Sale of 74 Grain Cart			(5,000.00)
156	GEN	13	11/30/17	E	100	JD Financial	Tractor Purchase			105,000.00
						SUBTOTAL Machinery & Equipment				**100,000.00**

Code	Ent	C/D #	Date	T	Bnk	Vendor	Description	Units	Weight	Amount
257	GEN	8	11/18/17	E	100	JDF Combine	Combine Princ. Payment			(22,205.50)
257	GEN	13	11/30/17	E	100	JD Financial	Tractor Loan			90,000.00
						SUBTOTAL Equipment Loan				**67,794.50**

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

Before:

Code	Ent	C/D #	Date	T	Bnk	Vendor	Description	Units	Weight	Amount
801	GEN	5	11/5/17	D	100	Aurora Coop	Cash $1550, Equity $1550			1,550.00
						SUBTOTAL Interest & Dividend				**1,550.00**

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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 and 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

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

Corrected:

167	GEN	5	11/5/17	D 100	Aurora Coop		1,550.00
					SUBTOTAL Coop Equity		**1,550.00**

327	GEN	5	11/5/17	D 100	Aurora Coop	Cash $1550, Equity $1550	3,100.00
327	GEN	17	11/5/17	D 100	FCC	Dividend - NQ Equity $431	683.19
					SUBTOTAL Patronage Refunds		**3,783.19**

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Wages Received in Other Farm Income

Before:

334	GEN	1	11/5/17	D 100	FSB Operating		5,000.00
334	GEN	6	11/12/17	D 100	Tina Barrett	Wages	4,500.12
334	GEN	7	11/27/17	D 100	Paul Jones	Sale of tools	200.00
334	GEN	19	11/27/17	D 100	Frontier	Refund	3,116.98
334	GEN	19	11/27/17	D 100	Jan Farmer	Refund for Window Repair	3,180.12
					SUBTOTAL Misc. Farm Income		**15,997.22**

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Wages Received in Other Farm Income

Corrected:

Code	Ent	C/D #	Date	T	Bnk	Vendor	Description	Units	Weight	Amount
802	GEN	6	11/12/17	D	100	Tina Barrett	Wages			4,500.12
						SUBTOTAL Wages & Salaries				**4,500.12**

Utilities All in Farm, None in Personal

Before:

Code	Ent	C/D #	Date	T	Bnk	Vendor	Description	Units	Weight	Amount
443	GEN	2	11/5/17	E	100	NPPD	Electricity			364.25
443	GEN	3	11/12/17	E	100	Verizon	Phone			172.25
443	GEN	4	11/28/17	E	100	Great Plains Com	Landline/Internet			157.54
						SUBTOTAL Utilities / Farm				**694.04**

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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:

443	GEN	2	11/5/17	E	100	NPPD	Electricity	364.25
443	GEN	3	11/12/17	E	100	Verizon	Phone	172.25
443	GEN	4	11/28/17	E	100	Great Plains Com	Internet	90.00
443	GEN	1	12/31/17	J		Allocated Utilit	40% Utilites to Personal	250.60
						SUBTOTAL Utilities / Farm		**877.10**
922	GEN	4	11/28/17	E	100	Great Plains Com	Landline	67.54
922	GEN	1	12/31/17	J		Allocated Utilit	40% Utilites to Personal	(250.60)
						SUBTOTAL Personal Utilities		**(183.06)**

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Crop Insurance Payment Net of Premium With Memo “Indemnity $100,000, Check $40,000"

Before:

340	GEN	8	11/28/17	D 100	Rain and Hail	Indemnity 100K, check 40K	40,000.00
					SUBTOTAL Crop Ins Income		**40,000.00**

Crop Insurance Payment Net of Premium With Memo “Indemnity $100,000, Check $40,000"

- Impacts cost per acre
- Need to **increase** income to reflect the true payment
- Need to **increase** expenses to reflect the true costs

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Crop Insurance Payment Net of Premium With Memo “Indemnity $100,000, Check $40,000"

Corrected:

340	GEN	8	11/28/17	D 100	Rain and Hail	Indemnity 100K, check 40K	100,000.00
					SUBTOTAL Crop Ins Income		**100,000.00**

446	GEN	8	11/28/17	D 100	Rain and Hail	60,000.00
					SUBTOTAL Crop Insurance	**60,000.00**

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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.

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

	Actual Splits	Even Splits	Difference
Yield Per Acre	75.17	75.17	
Seed	$ 71.02	$71.15	$ 0.13
Fertilizer	$ 6.15	$ 40.58	$ 34.43
Crop Chemicals	$ 31.67	$ 56.51	$ 24.84
Crop Insurance	$ 13.02	$ 19.75	$ 6.73
Irrigation Energy	$ 24.77	$ 26.64	$ 1.87
Irrigation Repairs	$ 5.22	$ 5.22	$ -
Land Rent	$ 218.93	$ 174.79	$ (44.14)
Hauling & Trucking	$ 1.55	$ 1.60	$ 0.05
Marketing	$ 10.82	$ 10.82	$ -
Fuel & Oil	$ 14.03	$ 14.03	$ -
Repairs	$ 16.40	$ 16.40	$ -
Repair, Machinery	$ 8.61	$ 8.61	$ -
Repair, Buildings	$ 11.27	$ 11.27	$ -
Utilities	$ 3.03	$ 3.03	$ -
Operating Interest	$ 0.86	$ 0.86	$ -
	$ 437.35	$ 461.26	$ 23.91
Overhead	$ 126.74	$ 126.74	$ -
Total costs	$ 564.09	$ 588.00	$ 23.91
Cost Per Bushel	$ 7.50	$ 7.82	$ 0.32

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Costs without land rent adjustment

	Actual Splits	Even Splits	Difference
Yield Per Acre	75.17	75.17	
Seed	$ 71.02	$ 71.15	$ 0.13
Fertilizer	$ 6.15	$ 40.58	$ 34.43
Crop Chemicals	$ 31.67	$ 56.51	$ 24.84
Crop Insurance	$ 13.02	$ 19.75	$ 6.73
Irrigation Energy	$ 24.77	$ 26.64	$ 1.87
Irrigation Repairs	$ 5.22	$ 5.22	$ -
Land Rent	$ 218.93	$ 218.93	$ -
Hauling & Trucking	$ 1.55	$ 1.60	$ 0.05
Marketing	$ 10.82	$ 10.82	$ -
Fuel & Oil	$ 14.03	$ 14.03	$ -
Repairs	$ 16.40	$ 16.40	$ -
Repair, Machinery	$ 8.61	$ 8.61	$ -
Repair, Buildings	$ 11.27	$ 11.27	$ -
Utilities	$ 3.03	$ 3.03	$ -
Operating Interest	$ 0.86	$ 0.86	$
	$ 437.35	$ 505.40	$ 68.05
Overhead	$ 126.74	$ 126.74	$ -
Total costs	$ 564.09	$ 632.14	$ 68.05
Cost Per Bushel	$ 7.50	$ 8.41	$ 0.91

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Special Allocations

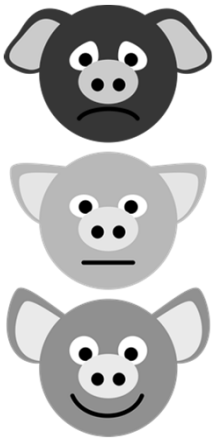
- Lime and Manure spreading
  - If you are spreading enough that it would last multiple years, you would need to allocate the expense over the years
    - We would put it on the balance sheet as a prepaid expense, and allocate a portion of it each year
    - Would be totally deductible in the year purchased

Balance Sheet Ratios

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

< 1.3
1.3 – 2.0
> 2.0

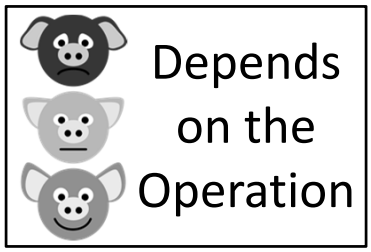
Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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



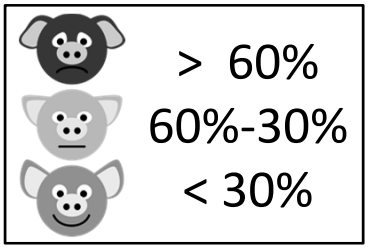
Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

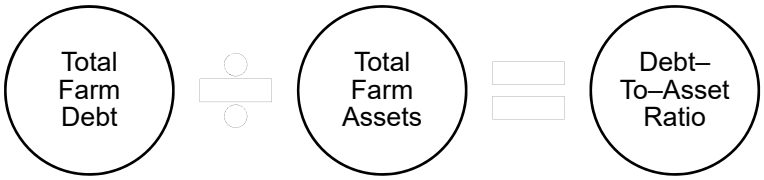
Working Capital

- 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





Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

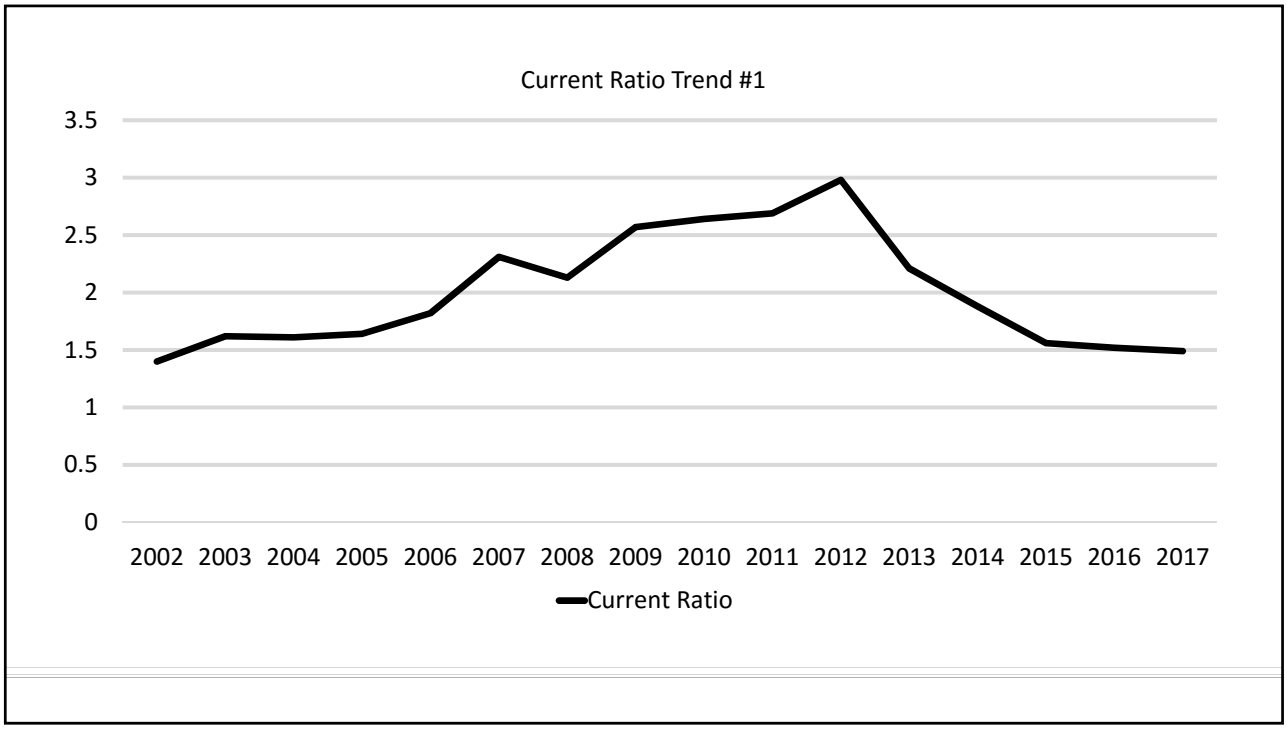
Debt to Asset Ratio

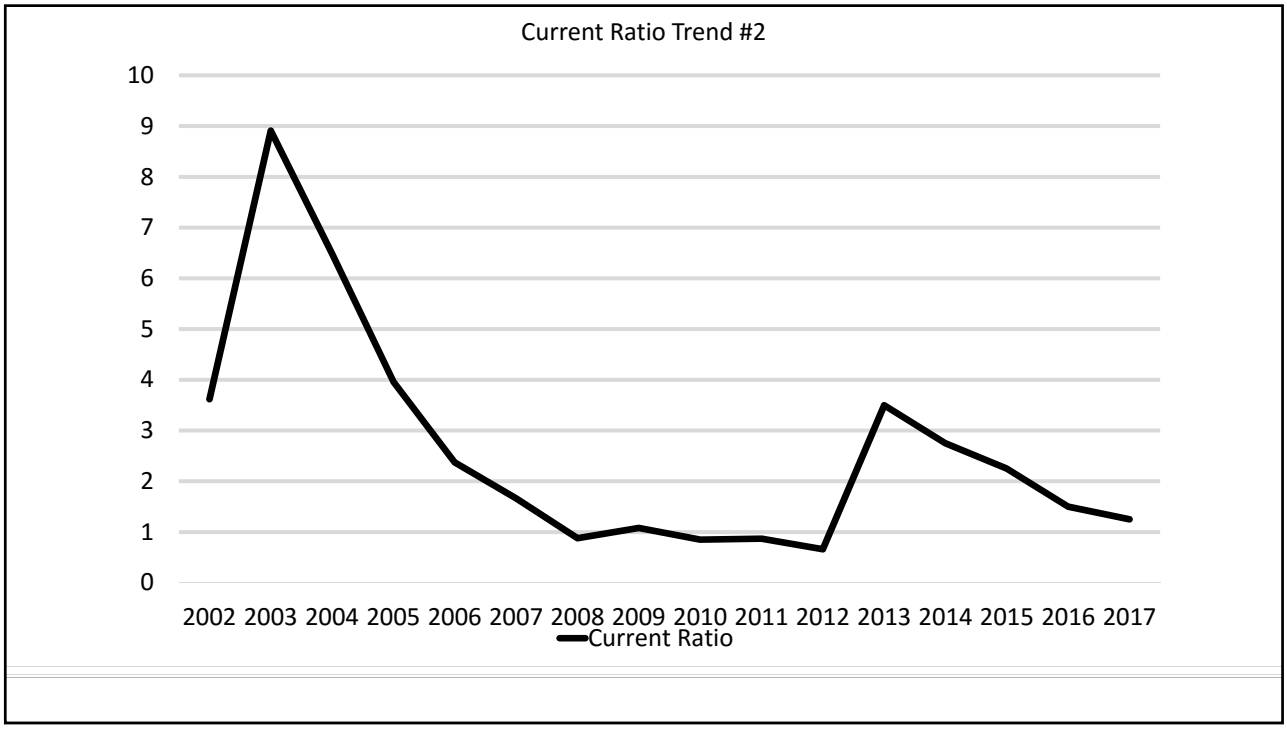
- The higher the number the more risk there is to the financial stability of the operation and lower **borrowing capacity**
- Keeping your debt to asset ratio low will allow you to be in the position to make purchases, refinance debt or make other management decisions if the need arises
- It is important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

Benchmarking Ratios

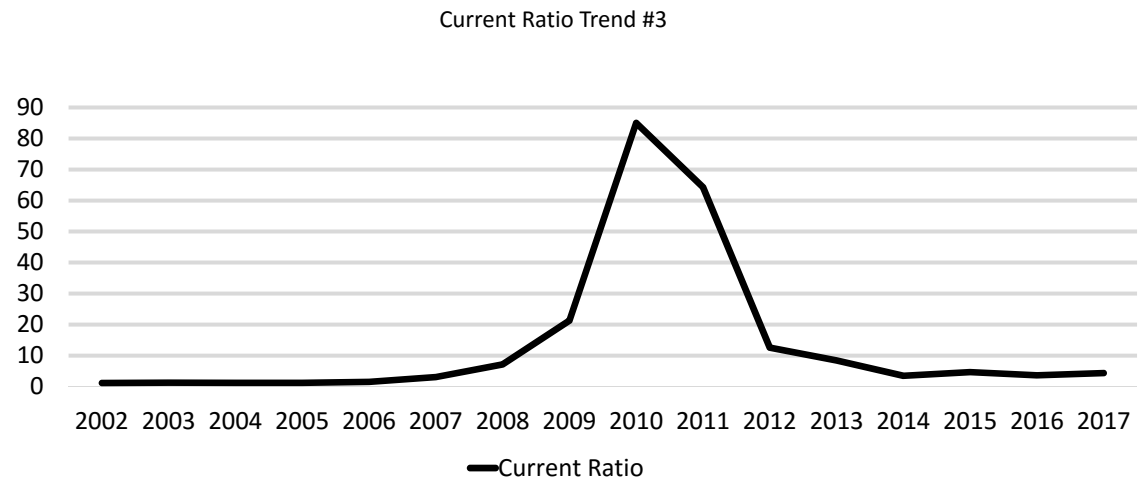
- Knowing what your ratios are and what they mean is just the beginning
- The first place to start benchmarking is against **your own** farm
  - We need to build a trend of ratios so you can compare them to past years
- Each trend line tells us a story of what is happening in an operation

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324





Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324



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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Beginning Net Worth
+ Net Farm Income
+ Personal Income
- Family Living/Owner Withdrawals
- Income & Social Security Tax
+/- Market Value Adjustment
= Ending Net Worth

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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 track to three areas
  - Net Non-Farm Costs
  - Debt Reduction
  - Cash spent on Capital Purchases
- One of the few deviances 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

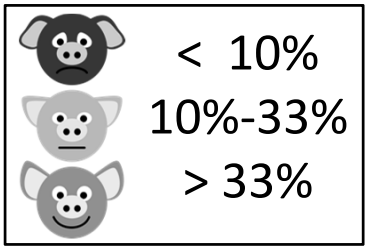
	Beginning Inventory
+	**Purchases**
-	**Sales**
-	**Ending Inventory**
=	**Depreciation Expense**

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

Income Statement Ratios

Working Capital to Gross Revenue

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



Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
Nebraska Farm Business, Inc.
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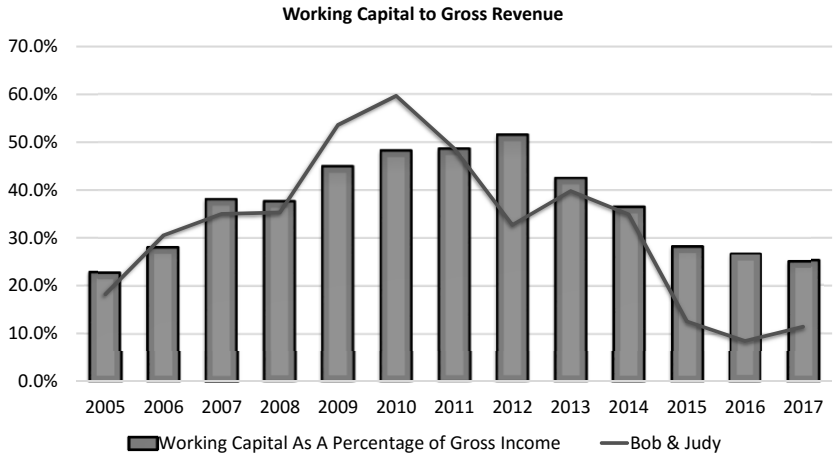
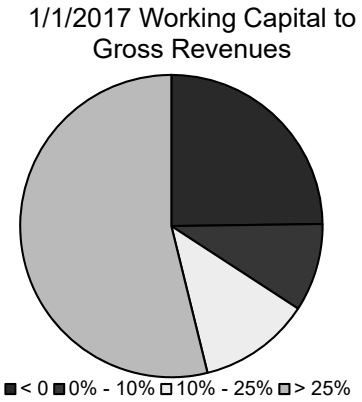
Bob and Judy Farmer Compared to the Nebraska Average



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



Tina Barrett
Nebraska Farm Business, Inc.
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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

Tina Barrett
Nebraska Farm Business, Inc.
tina@nfbi.net
(402) 464-6324

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

Tina Barrett
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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

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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 tells us how your operation is doing at specific point 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