

Sources of Financial Information to Measure Business Performance

by Jack McAllister

A dairy farm business usually has several financial objectives. Examples would usually include to “make money”, to be able to pay bills and make debt payments when they come due, to earn a return on the investment in the business and to increase the value of the owners share of the business over time. Where are the sources of information which would help you determine if these objectives are being met? A look at the farm account check book bank balance might be the first place we would look. This would be helpful but by itself it would not provide all the financial information necessary to make the judgment. In fact, to effectively evaluate the financial performance of the business requires financial information from three sources: a balance sheet, an income statement and a cash flow statement. Each of these financial summaries gives important, information of somewhat different type, for making that overall assessment of how the dairy farm business is doing.

Balance Sheet

The balance sheet is a summary of what the business owns (its assets) and what it owes (its liabilities) and the difference between the two (net worth, also called owner’s equity). Assets are categorized into two kinds, current and non-current. Current assets are those that are cash or can readily be converted to cash within the next year. They can include cash and checking account balances, growing crops or market livestock, and monies owed to the business. Non-current assets include intermediate assets and long term assets. Intermediate assets will include breeding livestock, farm machinery and equipment and titled vehicles. Intermediate assets are those assets that could be sold, used up or might last from one to five years. Long term assets include land and farm buildings. Intermediate and long term assets can be valued on a cost basis or a market value basis. Cost basis valuation uses purchase price less accumulated depreciation. Market value reflects the expected selling price of the asset if it were sold. Liabilities are also categorized as current and non-current. Current liabilities cover a period over the next year. They include interest on debts which is accumulating and is due to be paid in the next year, principal payments on term debts which will be due in the next year and taxes to be due in the next year. Intermediate liabilities cover the same period as intermediate assets and include debt on farm machinery, breeding livestock and equipment which is to be paid off in the next two to five years. Long term liabilities are debts to be paid over a period of more than five years such as that on land and buildings. Any taxes which might be due if the assets were to be sold must be included as deferred liabilities. The total assets and total liabilities are calculated. The net worth of the business is the difference between the total assets and the total liabilities and represents the balance of the assets and the liabilities.

Income Statement

The income statement summarizes the income and expenses of the dairy farm business and usually covers periods from one month to one year. Sources of income to the dairy are usually categorized into milk sales, cull livestock sales (i.e. cull cows and bull calves), and breeding livestock sales. If there are crop sales of crops usually used in the dairy, such as hay, they would be included as well. Expenses fall into several categories: Seed, Fertilizer, Chemicals, Custom hire, Purchased feed, Breeding fees, Veterinary, Livestock supplies, Livestock and milk marketing, Interest, Fuel and oil, Repairs, Hired labor, Real estate taxes, Farm insurance,

Utilities, Dues and professional fees and Miscellaneous. Net cash income is the difference between total farm income and total cash expenses from all categories. Net farm income is net cash income less depreciation.

Cash Flow Statement

The cash flow statement is a log of cash inflows (cash coming in to the business as income) and cash outflows (cash going out of the business as cash expenses). The cash of the business coming in and leaving is generally categorized in the cash income and expense categories used in the income statement. It tracks the cash position of the business on a monthly basis. A positive cash flow position is one where cash inflows are greater than cash outflows. The cash flow statement can be a history of the cash flow for the business. Predicted cash income and outgo can also be a planning tool for the dairy farm business as well and can be constructed from historical cash data from the business.

From these sources of information, there are many measures which can help the dairy farm business owner determine how the business is doing.