

January 2, 2001**FEFO 01-01****YEAR END RECORD CLOSING AND FARM BUSINESS ANALYSIS
CONSIDERATIONS**

The end of the year is not only a time for Holidays but also the close of the business year for most farmers. The majority of farm operators use a calendar year (January 1 – December 31) as their business year for income tax purposes and also to prepare financial statements about their operation. Even if a business is on a different fiscal year for tax reporting purposes, they may still want to prepare financial statements based on a calendar year.

Since most farmers also use a cash basis method for filing their income taxes, it is important to realize some of the additional information that is needed in preparing two of the basic financial statements for the farm business. These two statements are an accrual income statement and a balance sheet. The accrual income statement measures the profitability of the business for the year. It provides a more accurate measure of profitability than the income tax schedule F. The balance sheet measures the operator's level of ownership or equity in the business. These statements should be prepared using the same time period or point in time from year to year. The income statement typically covers the January 1 through December 31 time period while the balance sheet should usually be prepared as of December 31.

ACCRUAL ADJUSTMENTS

An accrual income statement matches revenues with costs for a given time period, regardless of when revenue was actually received or when expenses were actually paid. For example, plow down fertilizer applied and paid for in the fall of 2000 is considered a 2001 expense for business analysis purposes even though it will be taken as an expense on the 2000 income tax return for a cash basis tax payer. This is because it will be utilized for the 2001 crop.

To arrive at an accrual income statement, adjustments are made to cash income and expenses for changes in values between the beginning and end of the year for grain and livestock inventories, accounts receivable, accounts payable and prepaid expenses. The exact dollar amounts for these items are also used in preparing a balance sheet.

GRAIN AND LIVESTOCK INVENTORIES

Grain and livestock inventories are generally the most significant item to consider when making these adjustments. Therefore it is very important to estimate the quantity and value of these items as accurately as possible. Grain should be valued based on the local cash market as of the end of the year with a couple of exceptions. Grain that is still eligible for government loans or loan deficiency payments (LDP's) should be valued at the loan rate if the loan rate is above the cash price. Grain in which the LDP has been taken should be valued based on the local cash market even if this is below the loan rate. LDP's that have been established but not received by December 31 should be listed as an account receivable. Grain in which a Commodity Credit Corporation loan has been taken should still be shown as an inventory item

valued at the higher of the loan rate or cash price while the loan amount should be shown as a current liability.

Determining the proper value for livestock can be more difficult. Again, it is important to get an accurate estimate of the number and weight of the animals. The current cash price can be used for estimating values for market livestock. A conservative "base value" should be used for breeding livestock. A conservative base value would reflect the value for slaughter purposes rather than for breeding stock purposes. However, judgment should be used in how these values reflect on individual circumstances. This base value can utilize local cash prices but should not fluctuate significantly from year to year. This prevents net farm income and net worth changes simply due to valuation changes in breeding livestock, an asset that normally wouldn't be liquidated for an on-going business.

ACCOUNTS RECEIVABLE, ACCOUNTS PAYABLE AND PREPAID EXPENSES

Other accounts receivable, beside LDP's that have been established but not received, might include custom work which has been performed but payment not received, outstanding settlements with landlords for seed and pesticides for the 2000 crop or crop insurance proceeds that are due for the 2000 crop.

Prepaid expenses as of December 31 would include inputs and supplies that have been purchased and paid for in 2000 but are for the 2001 crop. The most common items are seed, chemicals, fertilizer, fuel and feed. Plowdown fertilizer and nitrogen that have been applied in the fall of 2000 for next year's crop are considered prepaid expenses.

Accounts payable are expenses that have been incurred for the 2000 business year but have not been paid for as of December 31. This could include a variety of items. Examples of accounts payable include outstanding drying and storage charges, accrued interest on operating and term loans, payroll taxes, cash rent, repairs and real estate taxes. Real estate taxes are considered an account payable because they are always due one year in arrears. An advance received in December for the 2001 AMTA or market transition payment is considered a current liability and not included in 2000 income for analysis purposes. It is not considered "earned" until the 2001 crop year.

BALANCE SHEET CONSIDERATIONS

Other items that shouldn't be overlooked when preparing a balance sheet include an estimated current liability for the income and social security tax that will be due in the spring for the 2000 tax year. Since farmers are not required to make estimated income tax payments, this maybe a significant amount, depending on the situation. Principal due on intermediate and long-term notes should be divided into what is due within and beyond 12 months. This is important in accurately assessing the liquidity of the operation and determining the short-term cash flow needs for the upcoming year.

Many producers are now leasing machinery and other assets. While lenders may not require that the total outstanding lease be included as a liability, it would helpful to provide a footnote on the balance sheet describing the terms of the lease. The lease payment for the upcoming year should be listed as a current liability. If significant equity is being built up in the leased item, one alternative to reflect this equity on the balance sheet is to list the value of the leased item as an asset and the remaining balance on the lease as a liability. This should be discussed with your lender to adequately disclose the financial obligation.

Since machinery is usually a significant asset for most producers, it would be prudent to attach a detailed machinery listing with individual valuations rather than just one total value. Machinery dealers can assist in estimating values for individual machinery items.

Issued by: Dale Lattz, Department of Agricultural and Consumer Economics