

Farm Name: _____
Year: _____ * Completed yearly

Farm Financial Statements & Recordkeeping



Skagit County

WASHINGTON STATE UNIVERSITY
EXTENSION



Food Systems

WASHINGTON STATE UNIVERSITY



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Glossary of Terms

Account Types— Businesses categorize financial activities by grouping them into different accounts that are qualitatively distinct. The major account types are: **Income, Expenses, Assets, Liabilities, Equity**

Income/Revenue - Earnings from sales of product or services, or through other means

Cost of Goods Sold (COGS) – direct costs of making a sale, or cost of product that will be resold

Gross Profit – Difference between total revenue and COGS

Expenses – Costs associated with running your business

Operating Expenses – Expenses directly related to the operational activities of the business

Assets – what the business has that has economic value (land, equipment, buildings, cash, etc.)

Liabilities – what the business owes (loans, credit card balances, etc. – i.e. debt)

Equity – what the business owns, and the difference between assets and liabilities, or the “worth of the business” in monetary terms

Net Income – Difference between total revenue and total expenses

Retained Earnings - cumulative net income from previous years (minus owners’ draw)

Owners’ Draw – money that owners take out of business to pay themselves

Financial Statements – Financial documents used in accounting that summarize financial activity in your business. The three primary financial statements are: the **income statement**, the **balance sheet** and the **cash flow statement**.

Income Statement – summarizes income, expenses and net income, over a period of time (e.g. month, quarter, year, etc.)

Balance Sheet – summarizes assets, liabilities and owners’ equity (“net worth”) and must always be in balance, according to the following formula: $ASSETS = LIABILITIES + OWNERS' EQUITY$

Cash Flow Statement – summarize changes in cash position -- cash coming in and going out of business, over a period of time

Budget – Summary of *projected* income and expenses for future period (usually year or multiple years)

Financial Statements

Financial statements are tools that help business owners organize, interpret and analyze the financial activities of their business, as well as understand the profitability, cash position, and worth of their business overtime and at any single point in time.

Unlike a budget, which a business owner can choose to create or not, the financial statements are a reflection of business activity, and are therefore inherent to it. The moment a business earns any revenue or incurs any expense, or records ownership of any product or obligation of any debt, the financial statements come into existence to reflect the financial activity taking place. There are three primary financial statements:

- Income Statement
- Balance Sheet
- Cash Flow Statement

Understanding how to organize and interpret financial statements will help you with overall financial management of your business. Additionally, financial statements are the main documents required for applying for a loan or raising capital, as well as for filing taxes.

Each statement summarizes financial activity in a different way, and together, they communicate three key financial indicators that describe the financial “health” of your business:

- a. What your business is earning and spending *over a period of time* (Income Statement)
- b. What your business has, what it owes, and what it owns, at any *single point in time* (Balance Sheet)
- c. What the cash position of your business is – i.e. how much cash you have – and what the cash flow of your business is – i.e. how cash “flows” in and out of your business (Cash Flow Statement)

Think of these key indicators as the “language” of business. The more fluently you speak it, the better you will be able to manage the financial affairs of your business, and communicate with banks, lenders, investors, accountants, etc.

Income Statement

The Income Statement reflects earning coming into the business, or “income,” and spending going out of the business, or “expenses.” Because earning and spending are ongoing within a business, the income statement presents a summary of activities ***over a period of time*** (e.g. week, month, quarter, year, etc.).

Primary Features

- Summarizes activities **over a period of time**
- Details activities directly associated with the business operations, e.g.:
 - Product Sales
 - Seed purchases
 - Wages and payroll expense

- Rent expense
- Etc.
- Also details activities not directly associated with operations, e.g.
 - Rental income, for example, if business owner leases land to another farmer
 - Interest expense on a loan
 - Depreciation expense on equipment or infrastructure
 - Tax expense
- Presents total revenue, total expenses, and difference between revenue and expenses, or “net income”

Note: The income statement is sometimes referred to as the “profit and loss statement.”

Ultimately, the purpose of the income statement is to help you understand the profitability of business activities, by comparing income and expenses and coming up with your net income (profit) or net loss.

All income statements display revenue, expenses, and net income, but it is somewhat up to you how you organize them. At the very least, it is important that your income statement includes the relevant revenue and expense categories listed on the Schedule F form (see section on Schedule F), which is the tax form that all farmers should file each year. For further analysis, you may find it helpful to organize your income statement by the following categories.

Sales: Sales activities are generally presented on the income statement in one of two ways: 1) by market channel (e.g. wholesale, farmers’ market, CSA, etc.), or 2) by product type (e.g. produce sales, meat sales, value added sales, etc.). For the income statement, it is best to stick to one, in order to keep the information consistent. That said, business owners can create separate financial reports that look at sales by sales channel *and* product type (e.g. produce sales at farmers’ markets vs. produce sales through a CSA). Accounting software programs (QuickBooks, etc.) make it easy to generate these more detailed reports.

Cost of Goods Sold (COGS): For farm businesses, COGS can be confusing to track. Generally, COGS refer to costs incurred with each additional sale, where for every sale made, there is the associated COGS. But for a farm business, the distinction between costs associated with sales and costs not associated with sales is a blurry one. If you sell 10 cases of kale, is the kale a COGS? What about the packaging? What about the labor to harvest and pack the kale? What about the delivery? For many farm businesses, it is more straightforward to track “variable” and “fixed” costs (defined below), instead of COGS. The exception to this would be if you buy in product for resale. For example, if you run a CSA and you buy some product from other farmers, the cost of that product would be tracked as a COGS. For our purposes, we will focus on variable and fixed costs.

Variable vs. Fixed Costs:

In short, variable costs increase as sales increase, whereas fixed costs stay more or less constant regardless of sales. For example, packaging is a variable expense – for every additional case sold, you need an additional box. Internet, on the other hand, is a fixed cost. Regardless of your sales for the season, your monthly internet expense remains the same. Separating expenses into these two categories can help you understand what it costs to make a sale, which will give you important information about the price you need to charge for your product, whether or not you want to continue growing a certain crop, etc.

Within one season, it is fairly straightforward to identify the variable and fixed costs that make up your operating expenses. However, year over year, it gets more complicated, specifically with regard to assessing fixed costs. As a farm business grows, its fixed costs change. In that sense, many fixed costs are still variable, but over a longer period of time. Rent is a good example of this. If you rent one acre, your rent cost is fixed regardless of your sales for the season. But as you build your business, you will likely expand production based on increased demand for your product. In order to expand production, you will acquire more land, so your rent expense will increase. While the rent cost is fixed for a given season, irrespective of sales, the increase in land is an result of the increase in sales.

Operating Expenses: Operating expenses encompass all expenses related to business operations. For tax purposes, simply listing operating expenses according to the Schedule F categories (see Schedule F) is sufficient. However, you may find that further categorizing your operating expenses gives you valuable insight into spending patterns, which can be very helpful when making management decisions for your business. Below are examples of the types of categories that can be useful:

- **Direct operating expenses** are those that are associated directly with production and sales: seeds & plants, fertility & pest management, supplies and packaging, animal feed, farmers' market fees, delivery costs, etc.
- **Labor costs** include employees' wages and benefits, payroll taxes and contract labor costs. *Importantly, payment to owners is not considered a labor cost. Owners' payment shows up on the balance sheet.*
- **Land or occupancy costs** include rent or mortgage expense, property taxes, utilities, etc.
- **Repairs and maintenance costs** include repairs to equipment, buildings, irrigation systems, vehicles, etc.*
- **Administrative/general costs** include expenses not directly associated with production and sales, such as office supplies, insurance, phone and internet expense, accounting or CSA software expense, marketing and advertising, mileage and other vehicle expenses. Sometimes these general costs are referred to as "overhead" costs.

Balance Sheet

The income statement summarizes the incoming and outgoing flow of money (or its proxy, for example, if you trade your products for other goods or services) in the business, otherwise known as earning and spending. It also shows you how profitable your business is, based on its direct operating activities. But the income statement can't really tell you how much your business is worth, or whether it is increasing or decreasing in value over time.

However, higher value purchases are not included on your income statement. Large purchases of equipment, infrastructure, land, etc. do not show up on the income statement because, while you incur the expense of purchasing them, you also now have something that adds value to your business. The income statement can't really quantify that increased value in your business, so we need a different tool to measure the overall value of your business. That tool is the balance sheet.

The balance sheet summarizes what a business owns and owes, and in turn, what it is worth. What it owns is its "assets." An asset is something that the business owns, that will last multiple years and has a significant monetary value. What it owes is its "liabilities," or debt. A liability, or debt, is something that a business owes, which is generally a loan of some kind. The difference between assets and debt is the "owners' equity" of a business, also called "net worth." The balance sheet summarizes assets, liabilities and owners' equity at **one point in time** (usually at the end of a fiscal period, e.g. month, quarter, year, etc.). Whereas the income

statement is like a video clip summarizing business activity over a period of time, think of the balance sheet as a snapshot of your business at a single moment.

There is a formula for the balance sheet that must always be true:

$$\text{ASSETS} = \text{LIABILITIES} + \text{OWNERS' EQUITY}$$

Primary Features

- Gives a snapshot of the business at **one point in time**
- Summarizes assets (what the business owns), liabilities (what the business owes) and the owners' equity (net worth) of the business (the difference between assets and liabilities)

Assets

Assets are tangible things that your business owns, and that could theoretically be sold to generate cash.

Generally speaking, assets can be used for more than one year, and are worth at least several hundred dollars.

- Cash in the bank – yes, cash is an asset!
- Outstanding invoices – unpaid invoices that customers still owe you (“accounts receivable”)
- Tractor and implements
- Vehicles
- Buildings
- Land
- Etc.

Liabilities

- Operating or equipment loan
- Mortgage
- Credit card balances
- Line of credit
- Unpaid bills
- Etc.

Owner's Equity (Net Worth)

- Retained earnings – net income of current year + cumulative net income from previous years
- Grants
- Owners' equity
- (-owners' draw)

Chart of Accounts

Account Types

ASSETS – what the business has, including land, buildings, equipment, breeding animals, etc. Also includes, business bank accounts, cash on hand, prepaid expenses and accounts receivable (unpaid invoices).

LIABILITIES – what the business owes (its debt), including short- and long-term loans, credit card balances, mortgage, etc.

EQUITY – what the business owns, including the owners' capital, retained earnings, net income (or loss) at the end of the year, minus owners' draw

INCOME – revenue generated from sales, as well as rent revenue or any other business activity that generates revenue (such as educational offerings, events, agritourism, etc.)

EXPENSES – any costs associated directly business operations, including costs directly associated with production, such as seeds, packaging, payroll, inputs, etc., as well as administrative and general costs. It also includes costs not directly related to operations, such as interest expense.

Example Chart of Accounts

Account Name	Account Type
Sales: Wholesale	Income
Sales: CSA	Income
Sales: Farmers' Markets	Income
Sales: Restaurants	Income
Direct Operating: Car and Truck Expenses	Expense
Direct Operating: Fertilizer and Spray	Expense
Direct Operating: Gasoline, fuel	Expense
Direct Operating: Packaging	Expense
Direct Operating: Repairs and Maintenance	Expense
Direct Operating: Seeds and Plants	Expense
Direct Operating: Storage	Expense
Direct Operating: Supplies/Small Tools	Expense
Direct Operating: Vehicles, Machinery, Equipment	Expense
Payroll: Labor Expense	Expense
Payroll: Workers' Comp	Expense

Payroll: Employee Benefits	Expense
Payroll: Payroll Service	Expense
General/Administrative: Computer/Printer	Expense
General/Administrative: Insurance (General/Product Liability)	Expense
General/Administrative: Certifications/Licenses/Permits	Expense
General/Administrative: Marketing/Advertising	Expense
General/Administrative: Office Supplies	Expense
General/Administrative: Software/Website	Expense
General/Administrative: Telephone/Internet	Expense
Occupancy: Rent/Lease	Expense
Occupancy: Utilities	Expense
Other: Interest expenses	Expense
Other: Taxes	Expense
Business Checking Account	Bank
Cash on Hand	Bank
Accounts Receivable	Current Asset
Inventory	Current Asset
Owned Land	Long Term Asset
Business Credit Card	Credit Card
Accounts Payable	Current Liability
Mortgage	Long Term Liability

Appendix 1: Income Statement Template

Start date:	End date:
Revenue	\$ Value
Sales	
Wholesale	
CSA	
Farmers' Markets/Farm Stands	
Restaurants	
Other	
Total Revenue	
Cost of Goods Sold (product purchased for resale)	
Gross Profit	
Operating Expenses	
Direct Operating Expenses	
Seeds and Plants	
Fertilizer and Spray	
Feed	
Pest Management	
Supplies and Packaging	
Hired Labor	
Hired Employees - wage + payroll	
Workers' Comp + Disability	
Contract Work	
General & Administrative Expenses	
Liability Insurance	
Office Supplies	
Telephone/Internet	
Software (Accounting, POS, etc.)	
Marketing/Advertising	
Permits, Licenses, Certifications	
Other	
Repairs & Maintenance Expense	
Car and Truck Expenses (mileage)	
Storage	
Fuel	
Repairs & Maintenance Expense	
Tools	
Other	
Occupancy	
Rent/Lease	
Utilities	
Total Operating Expenses	
Operating Income	
Other Expenses	
Interest Expense	
Depreciation	
Total Other Expenses	
Income before Taxes	
Taxes	
Net Income (or loss)	

Appendix 2: Balance Sheet Template

As of date:	
ASSETS	\$ Value
Current (short-term) Assets	
Farm Bank Account	
Cash on Hand	
Accounts Receivable	
Inventory	
Fixed (long-term) Assets	
Farm Land	
Farm Equipment	
Farm Vehicles	
Farm Buildings	
Other	
<i>Total Depreciation (-)</i>	
Total Assets	
LIABILITIES	
Short-term Liabilities	
Credit Card Loan Balance	
Accounts Payable	
Operating Loan Balance (1-12 mos.)	
Long-term Liabilities	
Tractor/Equipment Loan Balance	
Mortgage	
Long-term Operating Loan Balance (12+ mos.)	
Vehicle Loan	
Other Loans/Debt	
Total Liabilities	
EQUITY	
Owners' Capital/Owners' Contribution	
Net Income (or loss)	
Retain Earnings	
<i>Owners' Draw (-)</i>	
Total Equity	
Total Liabilities + Total Assets	
ASSETS = LIABILITIES + EQUITY	

Appendix 4: Schedule F

SCHEDULE F (Form 1040) <small>Department of the Treasury Internal Revenue Service (99)</small>		Profit or Loss From Farming ► Attach to Form 1040, Form 1040NR, Form 1041, Form 1065, or Form 1065-B. ► Information about Schedule F and its separate instructions is at www.irs.gov/schedulef.		<small>OMB No. 1545-0074</small> 2015 <small>Attachment Sequence No. 14</small>	
Name of proprietor				Social security number (SSN)	
A Principal crop or activity		B Enter code from Part IV <div style="border: 1px solid black; padding: 2px; display: inline-block;">1111300</div>		C Accounting method: <input checked="" type="checkbox"/> Cash <input type="checkbox"/> Accrual	
				D Employer ID number (EIN), (see instr)	
E Did you "materially participate" in the operation of this business during 2015? If "No," see instructions for limit on passive losses <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No					
F Did you make any payments in 2015 that would require you to file Form(s) 1099 (see instructions)? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No					
G If "Yes," did you or will you file required Forms 1099? <input type="checkbox"/> Yes <input type="checkbox"/> No					
Part I Farm Income—Cash Method. Complete Parts I and II (Accrual method. Complete Parts II and III, and Part I, line 9.)					
1a Sales of livestock and other resale items (see instructions)		1a			
b Cost or other basis of livestock or other items reported on line 1a		1b			
c Subtract line 1b from line 1a		1c			
2 Sales of livestock, produce, grains, and other products you raised		2		99,340	
3a Cooperative distributions (Form(s) 1099-PATR)		3a		3b Taxable amount	
4a Agricultural program payments (see instructions)		4a		4b Taxable amount	
5a Commodity Credit Corporation (CCC) loans reported under election		5a		5c Taxable amount	
b CCC loans forfeited		5b		5c Taxable amount	
6 Crop insurance proceeds and federal crop disaster payments (see instructions)					
a Amount received in 2015		6a		6b Taxable amount	
c If election to defer to 2016 is attached, check here <input type="checkbox"/>		6d Amount deferred from 2014			
7 Custom hire (machine work) income		7		2,000	
8 Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)		8		0	
9 Gross income. Add amounts in the right column (lines 1c, 2, 3b, 4b, 5a, 5c, 6b, 6d, 7, and 8). If you use the accrual method, enter the amount from Part III, line 50 (see instructions)		9		101,340	
Part II Farm Expenses—Cash and Accrual Method. Do not include personal or living expenses (see instructions).					
10 Car and truck expenses (see instructions). Also attach Form 4562		10		4,211	
11 Chemicals		11		0	
12 Conservation expenses (see instructions)		12		0	
13 Custom hire (machine work)		13		750	
14 Depreciation and section 179 expense (see instructions)		14		13,266	
15 Employee benefit programs other than on line 23		15		0	
16 Feed		16		0	
17 Fertilizers and lime		17		808	
18 Freight and trucking		18		98	
19 Gasoline, fuel, and oil		19		624	
20 Insurance (other than health)		20		175	
21 Interest:					
a Mortgage (paid to banks, etc.)		21a		0	
b Other		21b		0	
22 Labor hired (less employment credits)		22		0	
23 Pension and profit-sharing plans		23		0	
24 Rent or lease (see instructions):					
a Vehicles, machinery, equipment		24a		135	
b Other (land, animals, etc.)		24b		0	
25 Repairs and maintenance		25		2,655	
26 Seeds and plants		26		11,444	
27 Storage and warehousing		27		0	
28 Supplies		28		25,699	
29 Taxes		29		2,115	
30 Utilities		30		3,888	
31 Veterinary, breeding, and medicine		31		0	
32 Other expenses (specify):					
a FARMERS MKT. FEES		32a		5,004	
b LICENSES & PERMITS		32b		855	
c ORGANIC CERTIFICATION		32c		725	
d		32d			
e		32e			
f		32f			
33 Total expenses. Add lines 10 through 32f. If line 32f is negative, see instructions		33		73,452	
34 Net farm profit or (loss). Subtract line 33 from line 9		34		27,888	
If a profit, stop here and see instructions for where to report. If a loss, complete lines 35 and 36.					
35 Did you receive an applicable subsidy in 2015? (see instructions) <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No					
36 Check the box that describes your investment in this activity and see instructions for where to report your loss.					
a <input checked="" type="checkbox"/> All investment is at risk. b <input type="checkbox"/> Some investment is not at risk.					

<https://civileats.com/2018/04/27/ive-been-a-family-farmer-for-30-years-heres-my-irs-schedule-f/>