



Economic Toolbox

Polished Annual Reports

"That" time of year is almost here again: financial statements, income taxes, banker meetings. If you are operating your farm like a business (i.e. "Profit is good"), then annual reports are as important as anything you do on the farm. *Annual Reports* are prepared at the end of business' fiscal year and are the responsibility of management, not the accountant or banker. They summarize the activities of the past year and any significant plans for the future. The annual report reflects your farm business. It pays to polish it.

Once the annual report is completed, it will serve many purposes and satisfy several audiences. It will help maintain or improve your lender-borrower relationship, provide insight into the management and goals of the business, and chronicle the year's activities for the historical record. Stockholders, partners, directors and spouses all benefit from the information provided. It provides a method to open the lines of communication on where the farm business is headed, and how. Developing a budget for the next fiscal year is an excellent way to involve partners and children in the business side of farming.

Report Highlights

There are many variations of how annual reports are formatted. A highlights page or two up front summarizes the financial statements and year in general. It should include significant changes in the business, unusual problems encountered, and a record of yields, price and the number of acres or head of livestock. The historical record alone pays dividends when the business needs to attract investors, borrow money, expand or implement estate plans. By collecting the information and summarizing it in one place, you save hours of digging in years to come.

For family run businesses like most farms, include significant family events that could or did affect the farm business such as marriages, births, graduations and deaths.

Operating the family farm like a business does not mean that the business does not need the family. Pictures of growing conditions, crops, livestock, buildings and equipment can help others relate to the story that the financial statements are telling. Include them in your annual report as well.

Financial Statements

A complete annual report should include a full set of financial statements, plus other items which are important for recording the story of your farm business during the year. A full set of financial statements includes a *Balance Sheet*, an accrual basis *Income Statement*, a *Statement of Cash Flows*, and a *Statement of Owner Equity*. At a minimum, the annual report should include the balance sheet and income statement.

Financial statements should also include footnotes to clarify the information being presented. For example, footnotes in the liabilities section of the balance sheet could describe the purpose for a note, the original amount of the loan, the interest rate and repayment schedule. If you valued stored apples, corn or cabbage at specific prices, you might want to note why. Your annual report may end up in the hands of a loan committee officer, a lawyer or an accountant who needs this information to justify his or her decision in your favor.

Financial Analysis

A financial analysis puts an absolute sheen on your annual report. It should include a complete set of ratios used to compare your farm business to previous years and to industry averages. Among other things, these analyses should provide the business with break-even and cost-per-unit calculations. Financial ratios should also follow the guidelines established by the Farm Financial Standards Task Force. Ratios and comparative analysis points out the strengths and weakness in your farm business. These provide the arena for management to defend the actions taken during the

previous year as well as determine what course of action is needed in the coming year.

Financial analyses should cover at least five areas of importance, each a subject for future columns: profitability, efficiency, (cash flow) coverage, liquidity and solvency. Each farm business will want to include industry specific measurements that may be common rules of thumb. Measurements such as investment per cow, feed cost per pound of weight gain, and debt payments per bearing acre are a few examples.

A budget for the next year is an excellent tool to include in an annual report. It indicates that you have considered your financial position and have developed a plan to make improvements or overcome obstacles in the coming year. Setting and striving for goals by using a budget and financial ratios shows creditors, investors and partners that you are taking the business of farming seriously.

An annual report should highlight success while presenting management's willingness to address problem areas. In industries outside of agriculture, annual reports are taken as a serious responsibility by management. Shareholders and others that require these reports force management to look back and look forward to see how to improve the business. This winter, become your own "shareholder" and see how working on an annual report can help you improve your farm business.