Western Beef Resource Committee Third Edition

Cattle Producer's Handbook

Finance Section 918

Common Errors in Financial Record Keeping

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Ranchers keep financial records for bankers, the Internal Revenue Service (IRS), and—most important of all—to make sound management decisions. In order to make good financial decisions the financial records need to be accurate and understood. This paper provides an overview of common errors that occur when recording financial information and developing and using financial statements.

Recording financial transactions requires that the information be properly categorized as revenue, expense, asset, liability, or equity, and recognizing the effect of financial transactions on the financial statements. The term "Financial Statements" refers to the Statement of Cash Flow, Income (Profit/Loss) Statement, Balance Sheet, and Statement of Owner Equity.

These statements are interrelated and form the financial base of the business. An error in one of the statements could cause an error in the other financial statements.

A major issue in financial record keeping is whether to include personal and business records together or separately. The Farm Financial Standards Council (FFSC) says it is preferable to have separate financial statements for business and personal items. Separating business assets from the personal assets better facilitates farm business analysis. FFSC acknowledges, however, that in smaller operations, this may not be possible (see 915, "Farm Financial Standards").

Statement of Cash Flow

The Statement of Cash Flow shows the **sources and uses of cash** as a result of operating, investing, and financing activities of the ranch (see 935, "Cash-Flow Budgeting"). Let's explain each of these terms.

Operating Activities: Cash provided or used from operating the ranch, such as calf sales or business expenses.

Investing Activities: Cash provided or used from buying or selling capital assets such as land, breeding livestock, machinery, or securities (stocks, bonds, etc.).

Financing Activities: Cash provided or used by borrowing activities, off farm income or uses, or gifts and inheritances.

The Statement of Cash Flow does **not** measure profit or loss. It does not include non-cash expenses such as depreciation or non-cash revenues such as calves or feed held over for sale the following year. It may include non-business cash such as outside wages used in the business. The Statement of Cash Flow includes distributions to owners (money taken out of the business for the owner's personal use) or investment by owners (money invested into the business by the owner but not generated by the business), which affect cash flow and business assets, but not profit.

Common Mistakes

- Not including all sources of cash inflow or outflow that affects the business in Statement of Cash Flow.
- Using the financial transactions on the Statement of Cash Flow to show profit/loss.

Income Statement

The objective of the Income Statement is to measure **profitability of the business** by comparing the revenue and expense generated by the business. An Income Statement can be prepared on a cash or accrual basis (see 951, "Income Statement Preparation and Use").

Revenue is cash or products produced by the business. Examples of revenue are sales of cattle or feed, or inventory that is generated in one year and held over to the next for sale (retained ownership of calves or feed sales).