

UNDERSTANDING FINANCIAL STATEMENTS

Presenter: Melanie De Jong, CPA



BEHIND THE SCREEN



- Dordt grad
- 3 years in public accounting
- Originally from Washington



OUR TEAM



FS FUNDAMENTALS



OBJECTIVES

- Understand the 3 main financial statement reports and their importance
- Understand the difference between cash and accrual reporting



WHO CARES?

- Tool for management
- Lenders
- Estate/Retirement Planning



Basics

➤ 3 main reports

- Balance Sheet → Value
- Income Statement → Profitability
- Statement of Cash Flows → Cash in/out

➤ Recordkeeping

- FS are only as valuable as info used to prepare them



BALANCE SHEET



BALANCE SHEET OVERVIEW

- Financial position at a **specified date**
- Reflects **all** past transactions
- Purpose
 - Financial health
 - Own vs. owe
- **Assets = Liabilities – Owners Equity**
 - Difference in assets & liabilities indicates *solvency* at a certain date



ASSETS

- **Owned resource** with economic value that is expected to produce a **future benefit**
- Asset vs. Expense
 - Timing
 - The full cost of an asset is **not** written off immediately in period purchased
 - Depreciated or expensed over a defined period of time
 - Expenses have a **direct effect** on taxable income, assets have an **indirect effect** on taxable income
- Asset Classes
- Valuation



ASSETS

➤ Current (Life < 1 Year)

- Cash
- A/R
- Inventories
- Investment in Growing Crop

➤ Noncurrent (Life > 1 Year)

- Machinery, Equipment, Livestock
- Real Estate
- Coop Stock/Retains



SAMPLE DAIRY
BALANCE SHEET
DECEMBER 31, 2018

ASSETS

CURRENT ASSETS, pledged:

Cash and cash equivalents	\$	45,368
Accounts receivable, Dairymans Cooperative Inc.		463,173
Inventories:		
Hay - 3,016 tons	\$	238,440
Silage - 35,783 tons		1,206,507
Investment in growing crops		38,723
Total inventories		1,483,670
Prepaid expenses		190,895
Total current assets		2,183,106

DAIRY HERD, pledged:

2,544 Cows	3,945,744
2,041 Heifers	1,696,071
Total	5,641,815
Accumulated depreciation	(1,429,728)
Dairy herd, net	4,212,087

DAIRY FARM AND EQUIPMENT, pledged:

Land - 325 acres	1,446,487
Buildings and improvements	7,261,795
Machinery and equipment	1,823,488
Autos and trucks	166,831
Total	10,698,601
Accumulated depreciation	(5,788,995)
Dairy farm and equipment, net	4,909,606

OTHER ASSETS:

Cooperative retains	26,907
Total other assets	26,907
Total assets	\$ 11,331,706

See accompanying notes and independent accountants' Review report.



LIABILITIES & EQUITY

➤ Liabilities

- Classes
- All claims against the business

➤ Equity (Net Worth)

- $\text{Equity} = \text{Total Assets} - \text{Total Liabilities}$
- Reflects money that would be returned to shareholders/members if all assets were liquidated and debts paid
- Net income is reflected in OE section



EQUITY

- **Components:** Beginning equity, Net income, owners contributions (cash/property), owner distributions (dividends, cash, property, etc)
- **Increases** when a profit is generated and retained (rather than distributed to owners) or money contributed
- **Decreases** when a loss is generated and cash/property is distributed to owners



LIABILITIES & EQUITY

➤ Current (Due within 1 year)

➤ AP

➤ Line of Credit

➤ Current portion of LT debt

➤ Noncurrent (Due beyond 1 year)

➤ Term loans (portion due after one year)



SAMPLE DAIRY
BALANCE SHEET
DECEMBER 31, 2018

LIABILITIES AND PARTNERS' CAPITAL

CURRENT LIABILITIES:

Accounts payable, feed dealers	\$	555,738
Other trade payables		465,086
Accrued interest payable		18,803
Wages and payroll taxes payable		52,146
Farmers Bank, line of credit, secured by inventories and dairy herd, variable payments monthly plus 4.7% interest, matures September 2019		2,414,350
Estimated current portion of long-term debt		<u>286,000</u>
Total current liabilities		3,792,123

LONG-TERM DEBT:

Notes and loans payable:		
Farmers Bank, secured by real estate and equipment:		
Payable \$15,025 monthly including 3.45% interest, matures January 2021	\$	360,600
Payable \$4,800 monthly including 3.38% interest, matures December 2023		278,208
Payable \$9,395 monthly including 3.35% interest, matures January 2027		865,840
Payable \$10,000 monthly including 3.72% interest, matures January 2030		1,267,200
John Deere Financial, secured by equipment,		
payable \$5,000 monthly, non-interest bearing, matures February 2020		70,000
GM Financial, secured by equipment,		
payable \$1,500 monthly including 3.98% interest, matures June 2022		63,000
Estimated current portion		<u>(286,000)</u>
Long-term debt, net		2,618,848

SAMPLE DAIRY, PARTNERS' CAPITAL:

Balance at December 31, 2018		<u>4,920,735</u>
Total liabilities and members' equity	\$	<u>11,331,706</u>

See accompanying notes and independent accountants' Review report.



Not retained earnings because not a corporation, a partnership.

SAMPLE DAIRY

**STATEMENT OF PARTNERS' CAPITAL
FOR THE YEAR ENDED DECEMBER 31, 2018**

Balance at December 31, 2017	\$ 4,969,242
Net loss	<u>(36,724)</u>
Subtotal	4,932,518
Distributions	<u>(11,783)</u>
Balance at December 31, 2018	<u>\$ 4,920,735</u>

Profitability of operations reflected on balance sheet here, therefore affecting the value of the company.



There's more.

INCOME STATEMENT



INCOME STATEMENT

- Shows income and expenses for a **period of time** (quarterly, monthly, annual)
- **Purpose**
 - Lender/investor/management analysis
 - Profitability
- **Components**
 - Revenue
 - Operating income
 - Cost of goods sold
 - Gross Profit
 - Operating expenses
 - Other income/expenses



SAMPLE DAIRY
STATEMENT OF INCOME
FOR THE YEAR ENDED DECEMBER 31, 2018

	AMOUNT	PER CWT OF MILK	PER CWT EC MILK	PER COW
INCOME FROM OPERATIONS:				
Milk	\$ 10,439,484	\$ 15.85	\$ 15.52	\$ 4,148
Calves	93,444	0.14	0.14	37
Patronage dividends	10,423	0.02	0.02	4
Agricultural program payments	45,240	0.07	0.07	18
Farming, net, Schedule 1	(12,169)	(0.02)	(0.02)	(5)
Other	38,819	0.06	0.06	15
Total income from operations	<u>10,615,241</u>	<u>16.12</u>	<u>15.79</u>	<u>4,217</u>
OPERATING EXPENSES:				
Feed:				
Hay	751,971	1.14	1.12	299
Grain and commodities	3,416,058	5.19	5.08	1,357
Silage	1,100,041	1.67	1.64	437
Heifer and dry cow raising	1,323,476	2.01	1.97	526
Cost of feeding heifers	(1,540,251)	(2.34)	(2.29)	(612)
Total feed	<u>5,051,295</u>	<u>7.67</u>	<u>7.51</u>	<u>2,007</u>
Herd replacement cost:				
Depreciation - cows	901,166	1.37	1.34	358
Loss on sale of cows	162,689	0.25	0.24	65
Total herd replacement cost	<u>1,063,855</u>	<u>1.62</u>	<u>1.58</u>	<u>423</u>
Other operating expenses:				
Interest	206,765	0.31	0.31	82
Labor	1,151,292	1.75	1.71	457
Partners salary	147,150	0.22	0.22	58
Depreciation - other	692,404	1.05	1.03	275
Milk hauling	9,251	0.01	0.01	4
Industry assessments	116,013	0.18	0.17	46
Supplies	550,290	0.84	0.82	219
Bedding	246,851	0.37	0.37	98
Repairs and maintenance	299,859	0.46	0.45	119
Utilities	229,994	0.35	0.34	91
Taxes and licenses	118,884	0.18	0.18	47
Insurance	170,625	0.26	0.25	68
Fuel and oil	151,360	0.23	0.23	60
Professional fees	20,773	0.03	0.03	8
Veterinary and breeding	264,361	0.40	0.39	105
Testing and trimming	104,961	0.16	0.16	42
Miscellaneous	38,830	0.06	0.06	15
Cost of raising heifers	(58,685)	(0.09)	(0.09)	(23)
Total other operating expenses	<u>4,460,978</u>	<u>6.77</u>	<u>6.64</u>	<u>1,771</u>
Total operating expenses	<u>10,576,128</u>	<u>16.06</u>	<u>15.73</u>	<u>4,201</u>
Income from operations	39,113	\$ 0.06	\$ 0.06	\$ 16
OTHER EXPENSES:				
Loss on sale of assets	(75,837)			
Net loss	<u>\$ (36,724)</u>			

See accompanying notes and independent accountants' Review report.

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INCOME STATEMENT & BALANCE SHEET

- Should be prepared for the **same periods** because of the link between the two
- Every period income is closed to **Equity**(a balance sheet account)

SAMPLE DAIRY	
STATEMENT OF PARTNERS' CAPITAL FOR THE YEAR ENDED DECEMBER 31, 2018	
Balance at December 31, 2017	\$ 4,969,242
Net loss	(36,724)
Subtotal	4,932,518
Distributions	(11,783)
Balance at December 31, 2018	\$ 4,920,735

SAMPLE DAIRY					
STATEMENT OF INCOME FOR THE YEAR ENDED DECEMBER 31, 2018					
	AMOUNT	PER CNT 10 MILK	PER CNT 100 MILK	PER COW	
INCOME FROM OPERATIONS:					
Milk	\$ 1,149,481	\$ 15.85	\$ 15.52	\$ 4,148	
Losses	10,846	0.14	0.14	37	
Percentage dividends	3,423	0.02	0.02	4	
Agricultural program payments	45,240	0.60	0.60	18	
Farming, net, Schedule 1	(12,100)	(0.16)	(0.16)	(5)	
Other	30,227	0.39	0.39	12	
Total income from operations	1,235,235	16.32	15.79	4,912	
OPERATING EXPENSES:					
Feed	751,951	1.14	1.12	299	
Hay	3,610,006	5.19	5.08	1,397	
Grain and commodities	1,183,008	1.67	1.64	497	
Salage	1,323,470	2.10	1.97	526	
Water and dry cow rations	(1,746,780)	(0.24)	(0.24)	(66)	
Cost of feeding heifers	2,011,200	2.80	2.70	729	
Total feed	5,022,855	7.00	6.86	1,887	
Hand replacement cost:					
Depreciation - cows	165,180	1.37	1.34	388	
Loss on sale of cows	26,200	0.25	0.24	66	
Total hand replacement cost	191,380	1.62	1.58	224	
Other operating expenses:					
Balances	276,702	0.31	0.31	82	
Labor	1,111,202	1.75	1.71	497	
Fuel and energy	1,617,761	2.22	2.12	586	
Depreciation - other	602,404	1.08	1.03	278	
Milk hauling	925	0.01	0.01	4	
Reluctant assessments	1,621,018	0.18	0.17	46	
Supplies	590,240	0.84	0.82	219	
Producers	298,801	0.41	0.37	98	
Repairs and maintenance	299,879	0.46	0.45	119	
Utilities	229,068	0.31	0.34	91	
Taxes and licenses	113,884	0.16	0.18	47	
Insurance	170,028	0.23	0.23	68	
Food and oil	131,360	0.23	0.23	60	
Professional fees	37,075	0.05	0.05	14	
Veterinary and breeding	264,361	0.40	0.39	108	
Training and mentoring	180,040	0.26	0.26	62	
Maintenance	86,830	0.09	0.08	23	
Cost of raising heifers	750,000	1.05	1.04	282	
Total other operating expenses	4,450,076	6.17	6.14	1,191	
Total operating expenses	9,472,931	13.17	12.80	3,078	
Net loss	(7,237,696)	(10.18)	(10.01)	(2,166)	
OTHER EXPENSES:					
Loss on sale of assets	(17,827)			(5)	
Net loss	\$ (7,255,523)			(2,171)	



STATEMENT OF CASH FLOWS



STATEMENT OF CASH FLOWS

➤ Purpose

➤ Critical questions

- Where did we obtain funds?
- Are we expanding faster than we can generate funds?
- What is our ability to repay our debt obligations (creditors)?

➤ Reconcile Net income to cash balance



STATEMENT OF CASH FLOWS

➤ Components

➤ Operating activities

- Net income/loss
- Increases/decreases in current assets and liabilities
- Depreciation

➤ Investing activities

- Asset expenditures
- Coop retains

➤ Financing activities

- Changes in long term liabilities(debt) & equity

➤ Beginning/Ending cash balance



SAMPLE DAIRY
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2018

CASH FLOW FROM OPERATING ACTIVITIES:

Net loss	\$	(36,724)
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The following is a reconciliation of net loss to net cash provided by operating activities:

Non-cash patronage dividends	\$	(2,545)
Depreciation		1,625,207
Loss on sale of cows		162,689
Proceeds from sale of cows		367,940
Purchase of heifers		(15,875)
Purchase of replacement cows and bulls		(10,500)
Capitalized cost of growing heifers		(1,598,936)
Loss on sale of assets		75,837
Increase in accounts receivable		(23,662)
Decrease in inventories		248,856
Decrease in investment in growing crops		14,261
Increase in prepaid expenses		(179,524)
Increase in accounts payable and accrued expenses		507,422
Total adjustments		1,171,170

Net cash provided by operating activities		1,134,446
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CASH FLOW FROM INVESTING ACTIVITIES:

Purchase of fixed assets		(975,936)
Return of cooperative capital		809
Net cash used in investing activities		(975,127)

CASH FLOW FROM FINANCING ACTIVITIES:

Borrowing of short-term debt		3,450,367
Repayment of short-term debt		(3,940,972)
Borrowing of long-term debt		945,734
Repayment of long-term debt		(602,665)
Distributions		(11,783)
Net cash used in financing activities		(159,319)

Net decrease in cash and cash equivalents		-
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Cash and cash equivalents balance at December 31, 2017		-
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Cash and cash equivalents balance at December 31, 2018	\$	-
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See accompanying notes and independent accountants' Review report.



CASH & ACCRUAL



ADVANTAGES OF CASH REPORTING

- **Simplicity**
- **Tax benefit** → FS manipulation
 - Prepay expenses
 - Defer income
- **Timeliness**



ADVANTAGES OF ACCRUAL REPORTING

- Why Do It?
 - More Lenders Are Requiring It
 - More Accurate-Removes the “Games” We Play to Tax Plan
 - Allows for Benchmarking
 - Decision Making
 - Assessing profitability, risk, cost of production, etc.



CASH METHOD

- Recognizes revenue when payment is **received** regardless of when the revenue is actually earned
- Expenses cash when **paid**, regardless of what period it's for
- Doesn't accurately reflect "**true**" costs of operation



ACCRUAL METHOD

- Recognizes revenue when **earned** rather than when cash is received
- Books expenses when **incurred** rather than when paid
- **Key concept: accrual accounting seeks to match revenues and expenses**



SIMPLE EXAMPLE- DECEMBER

➤ Facts:

- Deposited November milk check for \$500 in December, actual revenue for milk shipped in December is \$600, which was deposited in January 2020.
- Paid feed bill of \$50 for November, December feed bill of \$65 not paid until January 2020.
- Received a bill for \$30 supplies purchased in early December, not due (and won't be paid) until January 2020.

DECEMBER INCOME STATEMENT		
	Cash Basis	Accrual Basis
Revenue:		
Milk Income	\$ 500.00	\$ 600.00
Expenses:		
Feed	\$ (50.00)	\$ (65.00)
Supplies	-	(30.00)
Net Income:	<u>\$ 450.00</u>	<u>\$ 505.00</u>



BEYOND THE BASICS



ACCRUAL ACCOUNTS

- New accounts → Accrual accounts
 - Accounts Payable
 - Accounts Receivable
 - Inventories
 - Prepaid Expenses
 - Accrued Expenses
 - Investment in Growing Crop



INCOME STATEMENT

Profit & Loss

	Accrual	Tax
Revenue From Operations	5,423,384	5,406,082
Operating Costs & Expenses		
Crop & Other Expense	3,909,926	4,685,587
Depreciation	211,137	667,301
Total Expense	4,121,063	5,352,888
Net Income Before Taxes	1,302,321	53,194
Income Tax Provision	(434,620)	(8,299)
Net Income	867,701	44,895



ASSETS

Balance Sheet

	Accrual	Tax
ASSETS		
Current Assets		
Accounts Receivable	4,084,402	-
Inventory	307,898	-
Income Tax Receivable	4,522	-
Income Tax on Deposit	2,080	-
Prepaid Expenses-Crop Input	788,788	-
Commodity Account	62,412	72,163
Total Current Assets	5,250,102	72,163
Fixed Assets		
Property & Equipment	2,762,417	2,712,770
Accumulated Depreciation	(772,437)	(2,305,701)
Net Fixed Assets	1,989,980	407,069
Other Assets	2,900,699	2,900,699
Total Assets	10,140,781	3,379,931



LIABILITIES & EQUITY

Balance Sheet

	Accrual	Tax
LIABILITIES & EQUITY		
Current Liabilities		
Bank Account (Overdraw)	48,762	48,762
Current Notes Payable	2,899,414	2,898,397
Current Deferred Income Tax	1,761,224	-
Total Current Liabilities	4,709,400	2,947,159
Long-Term Liabilities		
Notes Payable	353,016	353,016
Non-Current Deferred Income Tax	538,190	-
Total Liabilities	891,206	353,016
Equity		
Stock	3,672,474	36,470
Net Income	867,701	43,286
Total Equity	4,540,175	79,756
Total Liabilities & Equity	10,140,781	3,379,931



A FINAL NOTE

- Usefulness of FS
- Garbage in = garbage out
- Your Operation



QUESTIONS?

