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Assessing how you stand financially

by *Kristen Schulte, farm business management specialist, kschulte@iastate.edu, 563-547-3001*

Do you know where your business stands financially? Completing year-end financial statements can help one evaluate a business, large or small, on the profitability and ability to cash flow through statement and ratio analysis.

Most farm families do a good job of keeping records of income and expenses for the purpose of filing income tax returns. Values from the tax return, however, may not accurately measure the economic performance of the farm. The numbers in your tax return are the key to various reports that can be used to gauge the health of your farm, business or personal finances. Let's look at some of these tools.

Balance sheet

A balance sheet is also called a net worth statement. It captures a snapshot of assets and liabilities on the given date it is constructed. Net worth (assets less liabilities) is the amount of capital retained in the business from profits or investment. Additionally, a net worth statement can provide insight to one's ability to pay current and long term debts. Like profits, one should want their net worth to grow from year to year.

Income statement

An income statement calculates profit by taking revenue less expenses. A majority of this information is available on a tax return; however, one must be sure to include actual depreciation and interest paid. A cash income statement can provide insight to how profitable a business is during a year's time based on the net income calculated (accounting profit). Another measure of profit is economic profit, accounting profit less opportunity cost of investment and labor. Additionally, one can also calculate accrual net income, the cash income statement adjusted for inventory adjustments that results in a more accurate measure of profitability for the given time period. Profitability is important

to measure from year to year to measure the feasibility of financial success.

A balance sheet and income statement should also be completed at the end of December to provide a consistent time frame for comparison year to year.

Other financial statements

Additional financial statements should be prepared to get a complete picture of the financial health of a business. A cash flow statement is a look at the flow of cash in and out of a business during a period of time. A business may be profitable, but not able to cash flow or meet financial obligations during periods of year based on inflow of cash. Another statement is the statement of owner's equity; this statement uses both the balance sheet and income statement and measures the growth in equity between time periods.

Ratio analysis

As you close out 2011 records, you should prepare year-end financial statements to evaluate the financial health of your operation. Various ratios can be calculated from these statements that can reveal areas you can work on in 2012 to be a more financially viable business. Key ratios that can be reviewed include current ratio, working capital, debt-to-asset, return on assets, net farm income ratio, and operating expense ratio. These ratios are important to measure against benchmark averages and over time to gauge change in one's business.

Understanding the financial health of your farm or business is key to its success. Additional information on formulating financial statements and completing analysis can be found on Ag Decision Maker at www.extension.iastate.edu/agdm/wdfinancial.html, or at the Center for Farm Financial Management at www.cffm.umn.edu/publications/FarmMgtTopics.aspx.

Research briefs from ISU Department of Economics

Estimating the Importance of the Ethanol Industry to the Iowa Economy in 2011

Swenson, David A., December 2011

At ISU we produce estimates of the total value of certain industries to the state's economy using modeling systems that contain up-to-date secondary data on the major components of industrial production in the state. We, for example, periodically describe the importance of agriculture and ag-related manufacturing to jobs and incomes in Iowa for the College of Agriculture and Life Sciences as it promotes its education and outreach services to its many and diverse stakeholders. Similar studies have been done for manufacturing clusters, like the Cedar Rapids area food and kindred products manufacturing sector, or whole industries, like the state's vaunted insurance sector.

This report summarizes the ethanol industry's value to the state of Iowa using the same methods ISU employs with other industries it periodically evaluates as well as the same methods it has deployed in previous studies of Iowa's ethanol sector.

Full text available at: <http://www.econ.iastate.edu/sites/default/files/publications/papers/p14755-2011-12-30.pdf>.

Does the Jack of All Trades Hold the Winning Hand?: Comparing the Role of Specialized Versus General Skills in the Returns to an Agricultural Degree

Artz, Georgeanne M.; Kimle, Kevin; Orazem, Peter, WP #11021, November 2011

This paper examines the roles of specialized versus general skills in explaining variation in the returns to an agriculture degree across majors inside and outside the agricultural industry. The focus on returns by sector of employment is motivated by the finding that most agricultural majors are employed in non-agricultural jobs. A sample of alumni graduating from a large Midwestern Public University between 1982 and 2006 shows that alumni with majors more specialized in agriculture

earned a premium from working in the agriculture industry, but this advantage has diminished over time. More generally trained agriculture majors earn more outside than inside agriculture, and their advantage has increased over time. During sectoral downturns in the agriculture economy, more specialized majors suffer large pay disadvantages compared to more generally trained agriculture majors and majors in other colleges. These findings suggest that greater levels of specialization may limit a graduate's ability to adjust to changing economic circumstances. Agriculture degree programs could benefit from curriculum innovations focused on developing more generalized skills.

Full text available at: <http://www.econ.iastate.edu/sites/default/files/publications/papers/p14591-2011-11-10.pdf>.

Environmental Impacts of Emerging Biomass Feedstock Markets: Energy, Agriculture, and the Farmer

Rebecca S. Dodder, Amani Elobeid, Timothy L. Johnson, P. Ozge Kaplan, Lyubov A. Kurkalova, Silvia Secchi, Simla Tokgoz, December 2011 [11-WP 526]

The tighter linkages between energy and crop markets due to recent climate and energy legislation in the US have large potential environmental impacts beyond carbon sequestration and climate mitigation. These range from effects on water quality and quantity, soil erosion, habitat and biodiversity preservation. These impacts are very location and management-decision specific, as they are the product of atomistic decisions and depend on soil and landscape specific variables. In order to fully understand the effects of biomass markets, the new and stronger linkages and feedback effects between national- and global-scale energy and commodity markets must be properly understood and identified using an integrated perspective. We discuss the various interactions between agricultural and energy markets and their environmental impacts for existing biomass crops and detail how these interactions may be strengthened with the emergence of corn stover as a second generation biofuel

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feedstock. The tighter coupling of land use and management and energy systems needs to be accounted for to ensure that we have accurate indicators of the sustainability of biomass as an energy resource.

Full text available at: <http://www.card.iastate.edu/publications/dbs/pdffiles/11wp526.pdf>.

In the news...

New online game helps farmers develop crop marketing skills

Chad Hart, ISU's grain extension economist, talks about a new online tool that helps farmers improve strategies for selling cash corn and soybeans, and learn how to use futures and ag options in marketing. Read the story by Ron Swoboda of Wallaces Farmer, in the December 2011 edition at: <http://magissues.farmprogress.com/WAL/WF12Dec11/WF01%20to17.html>

Swenson discusses Iowa's economy and demographics on C-SPAN's Washington Journal

Dave Swenson, associate scientist with the Department of Economics, spoke with C-SPAN's Washington Journal about the demographics of Iowa's population and the underpinnings of the economy which make it stand apart from other states. Watch the interview at: <http://www.c-span.org/Events/Washington-Journal-for-Friday-December-30/10737426741/>

Babcock analyzes expiration of ethanol tax credit on NPR

The multi-billion dollar subsidy for ethanol has expired, which had been in place for more than 30 years. Bruce Babcock, the Cargill endowed chair of energy economics at Iowa State University, spoke to National Public Radio's Linda Wertheimer about the effects of the subsidy expiring on both the ethanol industry and consumers. Listen to the interview at: <http://www.npr.org/2012/01/03/144605485/congress-ends-era-of-ethanol-subsidies>

High land prices, high commodity prices make this a great time, bad time to start farming

With farm land prices reaching record levels, and demand for agricultural products higher than ever, this is the best time and the worst time for young farmers to be getting into the business, says Mike Duffy, professor of economics and director of Iowa State University Extension's Beginning Farmer Center. Read the full ISU News Service story by Daniel Kuester at: <http://www.news.iastate.edu/news/2011/dec/duffy>

Beghin and Jensen explore effective ways to tax sweetened products

A 'sin tax' applied to sweetened goods on store shelves is not the most efficient, effective method of lowering caloric intake from sweet food and would be more disruptive to consumers than necessary, according to research by Professors John Beghin and Helen Jensen of the Department of Economics. To learn more about their work, read the full ISU News Service article by Dan Kuester at: <http://www.news.iastate.edu/news/2011/dec/beghinjensen>

Fading rural vitality DMR article features Edelman (CVC) and Eathington (ReCAP)

Dramatic losses in population in rural Iowa counties have raised serious questions about the future vitality of these areas. The issue was broached in an article by Kyle Munson of The Des Moines Register. The article featured commentary from Professor Mark Edelman, director of the Community Vitality Center, and Liesl Eathington, assistant scientist with ReCAP. Read the full article by Kyle Munson at: http://www.desmoinesregister.com/article/20111127/NEWS03/311270044/-1/gallery_array/Pockets-vitality-flourish-statistics-remain-grim

Jensen's work on food policy featured in Stories magazine

Helen Jensen, head of the food and nutrition policy division for the Center for Agricultural and Rural Development (CARD), and professor in ISU's Department of Economics, was profiled recently in

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the CALS publication Stories. Read the online article at: <http://www.ag.iastate.edu/stories/2011/11/crunching-the-numbers-for-better-food-policy/>

Veterans are focus of ISU's Beginning Farmer Center's new partnership

The Beginning Farmer Center, part of ISU's Extension and Outreach program, is beginning to work with the new, national California-based Farmer Veteran Coalition that works with Iraq and Afghanistan war veterans who want a career in agriculture. The coalition then matches them with farmers who are transitioning out of the field.

Read the full article by Daniel Kuester of ISU News Service at: <http://www.news.iastate.edu/news/2011/nov/BFCvet>

Renewable Fuel Standard examined by Miranowski and biofuels committee

John Miranowski, professor of economics at ISU, served on the Committee on Economic and Environmental Impacts of Increasing Biofuels Production, appointed by The National Research Council at the request of the US Congress. The committee

included 18 individuals from universities, consulting firms, and companies around the United States with expertise in biofuel production.

The committee was asked to provide an independent assessment of the economic and environmental consequences associated with achieving the RFS by 2022. Their report entitled "Renewable Fuel Standard: Potential Economic and Environmental Effects of US Biofuel Policy," concludes that the US is unlikely to meet the Renewable Fuel Standard by 2022, and that environmentally, the standard may not be effective in addressing global greenhouse-gas emissions. Read or purchase the full report at: <http://dels.nas.edu/Report/Renewable-Fuel-Standard-Potential-Economic/13105>

Huffman's findings on consumer willingness to pay for GMO

Wallace Huffman, professor of economics at ISU, was featured in an ISU News Service feature story on consumer willingness to pay for genetically modified foods. Read the full story by Dan Kuester at: <http://www.news.iastate.edu/news/2011/sep/huffmanGMO>

Updates, continued from page 1

Internet Updates

The following information files and tools have been added or updated on www.extension.iastate.edu/agdm.

Estate Planning Terms -- C4-50 (6 pages)

Forms of Property Ownership -- C4-51 (4 pages)

Business Entities -- C4-52 (8 pages)

The Estate Settlement Process -- C4-53 (4 pages)

Power of Attorney and Other Forms of Substitute Decision Making -- C4-54 (4 pages)

Farm Transfer Strategies -- C4-55 (6 pages)

Current Profitability

The following tools have been updated on www.extension.iastate.edu/agdm/info/outlook.html.

Corn Profitability -- A1-85

Soybean Profitability -- A1-86

Season Average Price Calculator -- A2-15

Ethanol Profitability -- D1-10

Biodiesel Profitability -- D1-15

Returns for Farrow-to-Finish -- B1-30

Returns for Weaned Pigs -- B1-33

Returns for Steer Calves -- B1-35

Returns for Yearling Steers -- B1-35

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Whitten Building, 14th and Independence Avenue, SW, Washington, DC 20250-9410 or call 202-720-5964.

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