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Farm Management Information: The Financial Statements

OBJECTIVES

- To identify the elements of which the financial statements of a farming enterprise consist.
- To explain the concepts balance sheet and the concepts assets, liabilities and net worth.
- To indicate how the assets and liabilities are grouped together and arranged systematically in the balance sheet.
- To show the connection between the purpose for which a balance sheet is compiled and the value at which assets are included in the balance sheet.
- To suggest two forms according to which a balance sheet can be compiled and to distinguish between total asset value and total capital employed.
- To indicate the main information contained in the income and capital reconciliation statement.
- To give a schematic representation of an income and capital reconciliation statement.
- To define different concepts used in the income and capital reconciliation statement.
- To suggest a form according to which the income and capital reconciliation statement can be presented.
- To explain the concept, use and compilation of a flow-of-funds statement.
- To explain how to treat the financing cost component of assets acquired by means of instalment-sales and lease agreements.
- To explain the compilation of financial statements by means of a numerical example.

The basic components of a comprehensive set of financial statements for a farming enterprise are an initial (opening) balance sheet, an income and capital reconciliation statement, a final (closing) balance sheet and a flow-of-funds statement.

In this chapter these statements are discussed in logical order and their compilation is finally illustrated by means of a numerical example.

THE BALANCE SHEET

The balance sheet is a statement of the financial position of the farming enterprise on a specific day of the year. This day is usually the last day of the enterprise's financial year, although it is not unusual — in the case of enterprises with sophisticated financial systems — to find monthly, quarterly or six-monthly balance sheets.

Because the balance sheet reflects the financial position of the farmer on a specific day, the final balance sheet for a particular period is automatically the opening balance sheet for the next period.

The balance sheet gives a systematic exposition of the assets (possessions) and liabilities (commitments or debt) of the enterprise concerned, with their various values on the date of the balance sheet.

The *assets* which are included in the balance sheet, represent everything that the farming enterprise *owns* on the balance sheet date and which is *already available in the form of cash or which can be converted into cash.*

The inventory (asset register) which was discussed in chapter 5, always serves as basis for the compilation of the asset component of the balance sheet.

The *liabilities* appearing in the balance sheet represent all debt or commitments of the enterprise on the balance sheet date.

The difference between the value of the assets and the extent of the debts on the date of the balance sheet is known as the *net worth* (owner's interest or own capital) of the enterprise. The net worth is therefore the amount of capital that a farmer would have if he should sell all his assets on the date of the balance sheet at the values at which they were included in the balance sheet,and pay all his debts from the proceeds.

Should the extent of the debt exceed the asset value, the enterprise is insolvent or, in ordinary language, bankrupt.

The grouping and systematic classification of assets and liabilities in the balance sheet

To enhance the usefulness of the balance sheet and facilitate its use, it is necessary to group assets and liabilities with the same characteristics together and to arrange them systematically in the balance sheet.

Characteristics of a farm balance sheet

- It is compiled on a specific day.
- It shows, in a systematic way, the assets (possessions) and liabilities (debts) of the enterprise with their respective values on that particular day.
- Assets include everything which the enterprise owns on that particular day and which are already available in cash or can be converted into cash.
- The liabilities consist of all the debts of the enterprise on that day.
- The difference between the assets and the liabilities is known as the net worth of the enterprise.

The assets

If the characteristics of farm assets are analysed, they can be grouped together in four homogeneous groups in the balance sheet:

- Current assets (also known as short-term assets)
- Investments and other
- Movable assets (also known as medium-term assets)
- Fixed assets (also known as long-term assets)

Distinction is made between these four groups of assets as follows (see also chapter 8 for a further discussion of the criteria according to which farming assets are distinguished):

- *Current assets* are —
  - — already available in cash or near cash such as cash on hand, positive bank balance, money on ordinary savings account and debtors;
  - — expenditure in respect of the coming year that is already paid on the date of the balance sheet; this is known as *prepaid expenditure;*
  - — assets which were produced or purchased with the aim of selling them, and which will *normally* be converted into cash within one year and the conversion into cash of which will not adversely affect the existing production capacity of the enterprise. These include stocks of finished products such as harvested grain, wool clips, skins and hides, and eggs that are ready to be marketed but have not yet been marketed, and similar stocks that have already been consigned to the market, but have not yet been sold. They also include supplies of semi-finished products such as crops on the lands, fruit in orchards, wool on sheep and forestry plantations. This subgroup of assets also includes livestock for specula-

tion purposes, slaughter stock and commercial flocks or herds. Note that the most important criterion that distinguishes this subgroup from other groups of assets, is not so much the conversion into cash within a year, but the fact that it is destined for sale and that its selling will have no adverse effect on the production potential of the enterprise;

— assets which will, in the normal course of event, be used within a year in the production process, (production supplies such as seed, fertiliser, fuel, herbicides and stock remedies).

- *Investments and other* are represented by —
  - — paid-up share capital in cooperatives;
  - — interest in cooperative members' levy funds, rotating members' levy funds, deferred bonus payment funds and rotating deferred bonus payment funds;
  - — money on fixed deposit;
  - — interest (financing costs) on, for example, instalment-sales and lease agreements; calculated in advance.

(The accountancy procedure for handling this particular aspect is discussed in full later in this chapter in the paragraph dealing with the handling of the financing cost component in instalment-sale and lease agreements.)

- *Movable assets* consist of assets used in the production process to produce other saleable assets or assets used in the normal administration of the enterprise. These assets are not acquired for the purpose of selling them in the normal course of events. Although the assets in this group have a useful life of more than one year, their life is nevertheless in most instances limited to between five and 15 years. These assets are usually subject to depreciation, the extent of which is related to the estimated useful life of the asset concerned. (See chapter 5 for a discussion of depreciation methods and rates). Assets included in this group are vehicles, implements, tractors, office equipment, breeding and dairy animals, woolled flocks, orchards, vineyards, sugar-cane plantations, etc. Depending on the useful life of the asset concerned, it may be more meaningful to classify some of the above-mentioned movable assets as fixed assets, and vice versa.
- Like movable assets, *fixed assets* are used to produce other saleable assets in the normal production process. However, compared with movable assets they have a much longer life (sheds, pens and fences) that could even be unlimited (land). This group of assets consists of fixed improvements and land. Fixed improvements are also subject to depreciation, although it usually

occurs over a long period. Provided there is no over cropping, there is no depreciation in the inherent ability of the soil to produce.

Systematic arrangement of the assets in the balance sheet can be done in one of two ways:

- Start with the most liquid group of assets, namely current assets, and the other groups then follow in order of decreasing liquidity, namely investments and other, movable assets and fixed assets. The separate subgroups within each group are also arranged in order of liquidity. In the case of current assets, start with cash on hand, followed by the credit bank balance, prepaid expenses, debtors, etc., or whatever the expected order of liquidity in a specific case may be.
- In the alternative approach the assets are arranged in exactly the reverse order of the previous one. Start with the most illiquid group of assets (those that will probably be the last to be converted into cash), namely fixed assets, and within this group, again start with the most illiquid subgroup, namely land. The fixed assets are then followed by movable assets, investments and other, and, finally, current assets. Within each group the subgroups are arranged according to increasing liquidity until the assets are concluded with cash.

> In the balance sheet the assets are grouped into current assets, investments and other, movable assets and fixed assets,and arranged systematically on the basis of decreasing or increasing liquidity.

The liabilities

Farm liabilities are grouped into three groups in the balance sheet:

- Current liabilities (also called short-term liabilities)
- Medium-term liabilities
- Long-term liabilities.

- *Current liabilities* are those liabilities or debt that are payable within the coming year. They include liabilities such as uncashed cheques, outstanding expenses in respect of the previous year, negative bank balance, trade creditors, provision for income tax payable on income earned during the previous year, provision for auditor's or accountant's remuneration payable in respect of the preceding year and provision for payment of the coming year's instalments on medium and long-term loans.

- *Medium-term liabilities* are debts that are repayable over a period that may vary from one to ten years, and include debts incurred in terms of lease and instalment-sale agreements, and Land Bank medium-term loans.
- *Long-term liabilities* include debts that are repayable over a period of more than ten years and are usually represented by Land Bank and other mortgage loans.

In the case of medium and long-term liabilities it is necessary to give particulars about the terms of repayment of each separate loan in the balance sheet.

The division of less than one year, between one and ten years and more than ten years to distinguish between short-term, medium-term and long-term liabilities is arbitrary and may, in practice, differ from one case to the next.

As indicated earlier in this chapter, the difference between the total value of the assets and the total extent of the liabilities is known as the *net worth*. In the case of the solvent enterprise this will mean that the value of the assets will exceed the extent of the liabilities, and the net worth then appears together with the liabilities as the balancing figure (assets = liabilities + net worth).

The systematic *arrangement of the liabilities* is done on the basis of the time of repayment, starting with those that are repayable first and ending with those that are repayable last or, alternatively, starting with those that are repayable last and ending with those that are repayable first. If the first alternative is chosen, the order of arrangement is current liabilities, medium-term liabilities, long-term liabilities and net worth as balancing figure. Within each group the subgroups are also arranged in the same time order, namely starting with those that have to be repaid first and ending with those that have to be repaid last.

If the *second alternative* is decided upon, the procedure is reversed and one starts with the net worth and ends with the current liabilities.

The alternative decided upon for the systematic arrangement of the liabilities will depend on the method chosen for arranging the assets. If the assets are arranged in order of diminishing liquidity, the liabilities are arranged in the order of current liabilities, medium-term liabilities and long-term liabilities, with the net worth as balancing figure. The reverse order applies for liabilities if the assets are arranged in order of increasing liquidity.

> In the balance sheet the liabilities are grouped into current liabilities, medium-term liabilities and long-term liabilities, and arranged systematically on the basis of the time of repayment.

The values at which assets are included in the balance sheet

In chapter 5 the valuation of assets for inclusion in the inventory was discussed. The question now arises at what values stocks and, especially, movable and fixed assets should be included in the balance sheet.

The answer to this question will depend on the purpose for which the balance sheet is compiled. In the ongoing farming enterprise balance sheets are usually drawn up for two reasons, namely to serve as basis for negotiations with providers of loan capital and as an aid to scientific decision-making (management) in the enterprise.

The *providers of loan capital* are usually interested in the security a farmer can offer. Such security is to be found in the surplus between the realisation value of the assets and the extent of existing debt. Providers of loan capital therefore want to know whether the farmer will be able to repay his loans from the yield of his assets. If the balance sheet is to reveal this information, it is necessary to include the assets at the following values:

- Stocks of finished products (including livestock classified as current assets) at net sales value;
- Stocks of semi-finished products at the lowest of production cost or net sales value, or, where products are insured against all risks, at insured value;
- Stocks of production supplies at the lowest of cost price or market value;
- Movable assets at a realistic market value; and
- Fixed assets, also at a realistic market value.

As an *aid to scientific decision-making* the balance sheet is used, among other things, to compare the farmer's performance over time and also to compare a farmer's performance in a specific year with that of other farmers (also see the discussion on the analysis and interpretation of financial results in chapter 7). To make these comparisons meaningful, it is necessary for this purpose that the assets concerned are included at the following values when compiling a balance sheet (see also the section on the valuation of assets in chapter 5):

- Stocks at the same values as in the previous instance;
- Movable assets at cost price less accumulated depreciation or at initial value minus accumulated depreciation. The exceptions are orchards, vineyards, sugar-cane plantations, etc., which are valued at establishment cost less accumulated depreciation;
- Fixed improvements at the same values as movable assets;
- Land at a realistic market value that is adjusted every three to five years.

Because the assets can be included in a balance sheet at different values, it is necessary to leave the user in no doubt about the values at which they were included. It is therefore essential that most assets be accompanied with a clear

indication of the value at which they were included, for example (see also the examples in the next paragraph):

Movable assets

Implements at cost price	R180 000
less: Accumulated depreciation	R 80 000
	R100 000

> In the case of most assets the balance sheet must give an indication of the value at which the specific asset was included.

The form of the balance sheet

Balance sheets can be drawn up in a variety of forms. An example of a balance sheet in more traditional form is given on p. 127.

An example of a balance sheet in more modern form is as follows. For the purposes of the example, only the main groups of assets and liabilities are shown. Detailed descriptions as shown in the balance sheet in more traditional form are, however, required in practice.

N. Farmer
Balance sheet as at 28 February 1985

Current assets	XXX	(A)
Less: **Current liabilities**	XX	(B)
Net current assets (-liabilities) (A-B)	X	(C)
Plus: **Investments and other**	X	(D)
Plus: **Movable assets**	X	(E)
Plus: **Fixed assets**	X	(F)
Net current assets + all others (C+D+E+F)	XXXX	(G)
Financed by:		
Medium-term liabilities	X	(H)
Long-term liabilities	X	(I)
Net worth [(G-(H+I)]	XX	(J)
(G=K)	XXXX	(K)

Total capital employed = value of own assets + value of leased land; where own assets = (A+D+E+F).

Some of the concepts in the examples call for explanations:

- *Total assets and total capital employed:* The capital of a farming enterprise can be defined as the monetary value of the goods and services that are *used* to obtain a money yield. From an analysis of this definition it is clear that the capital employed by a farming enterprise could include more than the assets of the enterprise. Hence the addition of the value (usually the market value) of leased land (plus fixed improvements where applicable) to the asset value to obtain the total capital employed. The leased land is also used to obtain a money yield for the enterprise concerned.
- *Uncashed cheques*: It is sound accountancy practice to include the bank balance according to the bank statement on the date on which the financial year ends, in the balance sheet. If this procedure is followed, it is necessary to show the value of uncashed cheques (cheques issued but not yet included in the bank statement) as a current liability in the balance sheet.
- *The repayment conditions of medium and long-term liabilities and the inclusion of "interest calculated in advance" as an asset.* Repayment of the capital sum and interest (financing costs) of long and medium-term loans occurs in one of two ways:
  - The periodic total instalments consist of a capital repayment component, the amount of which remains the same for each instalment, while the sum of the interest component is calculated on the outstanding capital balance owed. In this instance the total instalment diminishes each time because the interest component decreases while the capital repayment component remains constant. In the case of long and medium-term loans with such conditions of repayment, only the capital component still due is shown as a liability in the balance sheet. Compare Land Bank (medium-term liability) and J. Venter (long-term liability) in the preceding example of a balance sheet in traditional form.
  - The periodic total instalment remains constant for the full term of the loan. The value of the interest component in each total instalment declines, however, while the value of the capital repayment component of each instalment increases correspondingly. (See explanation later in this chapter in the paragraph dealing with the handling of the financing cost component in instalment-sales and lease agreements). In the case of loans with these conditions of repayment, it is desirable, and in the case of lease and instalment-sales agreements even essential, to list the total amount due on the loan (capital owed plus interest due for the remaining period of the loan) in the balance sheet. The interest outstanding component is then included as a counter entry — interest calculated in advance — as an asset in the balance sheet. Other examples of these type of loans are Land Bank and building society mortgage loans.

N. Farmer
Balance sheet as at 31 December 1985

Liabilities				Assets			
Current liabilities				*Current assets*			
Uncashed cheques		X		Cash on hand		X	
Bank overdraft		X		Cash in bank		X	
Expenditure in arrears		X		Debtors		X	
				Stocks			
Cooperative account		X		Finished products at net sales value	X		
Other trade creditors		X		Semi-finished products at production cost	X		
Provision for auditor's remuneration		X		Production supplies at cost price	X	XX	XXX
Provision for income tax		X					
Provision for instalments on meduim and long-term loans		X	XX				
Medium-term liabilities				*Investments and other*			
Farmers' Bank, in respect of instalment-sale agreements; interest and capital repayable in equal annual payments of Rx	XX			Interest calculated in advance			
				Instalment-sale interest: Farmers' Bank	X		
				Lease interest: Farmers' Bank	X	XX	
Less: Provision for 1985/86 instalment	X	X		Rotating members' levy fund		X	XXX
				Movable assets			
Farmers' Bank, in respect of lease agreement; interest and capital repayable in equal annual payments of Rx	XX			Implements at cost price	XX		
				Less: Accumulated depreciation	X	X	
				Orchard at establishment cost	XX		
Less: Provision for 1985/86 instalment	X	X		*Less*: Accumulated depreciation	X	X	XX
				Fixed assets			
Landbank; Capital redemption in equal annual instalments of Rx plus interest at 18% p.a. on outstanding balance	XX			Fixed improvements at cost price	XX		
				Less: Accumulated depreciation	X	X	
				Land at cost price	X		
Less: Provision for 1985/86 capital redemption	X	X	XX	*Plus*: Accumulated appreciation to 28/2/84	X	XX	XXX
Long-term liabilities							
J.Venter, in respect of mortgage loan registered on land. Capital repayment in equal annual payments of Rx, plus interest at 15% p.a. on outstanding balance	XXX						
Less: Provision in respect of 1985/86 capital repayment	X	XX	XX				
Total liabilities (B)			XXX				
Net worth (A-B)			X				
Total liabilities + net worth			RXXXX	Total assets (A)			XXXX
				Value of leasehold land			X
				Total capital employed			RXXXX

THE INCOME AND CAPITAL RECONCILIATION STATEMENT

The financial records dealt with in the previous chapter, serve as basis for compiling the income and capital reconciliation statement.

Information contained in the income and capital reconciliation statement

The income and capital reconciliation statement contains the following main information:

- The value of the farm production during a specific period, usually the financial year. This value is known as *gross production value*.
- The production, marketing and administrative costs incurred to achieve the preceding gross production value.
- The surplus (shortfall) which the farming activities realised during the period concerned. This surplus is known as the *net farm income*, and is calculated by subtracting the production, marketing and administrative costs from the gross production value.
- The amount that was payable during the period concerned to the providers of foreign capital for the use of that capital.
- The profit which the farming enterprise delivered to the owner during the period concerned. This profit is known as the *farm profit* and is calculated by subtracting the remuneration to the suppliers of foreign capital from the net farm income.
- The extent to which the owner's(s') net worth increased during the period concerned (positive or negative) and to what this growth can be attributed.
- A reconciliation between the net worth according to the opening balance sheet and the net worth according to the closing balance sheet.

A more detailed description of certain concepts in the income and capital reconciliation statement

The meaningful use of the income and capital reconciliation statement calls for absolute clarity about the meaning of the different concepts used therein:

Gross production value

The concept *gross production value* (GPV) refers to the monetary value of the *farm production* during an accounting period, which usually covers a financial year. Farm production can normally be divided into three broad categories:

- Livestock production (branches such as sheep,cattle and poultry)
- Crop production (crop branches such as maize, wheat, vegetables and fruit)
- Miscellaneous production.

(a) The gross production value of a *livestock branch* (e.g. sheep) is the total monetary value of the saleable production of *livestock units* (sheep) and *livestock products* (wool) during the period under review. It normally includes the following items (see page 130):

Schematic representation of the income and capital reconciliation statement
The information contained in the income and capital reconciliation statement, can be schematically summarised as follows:

Gross production value
—
Production, marketing and administrative costs
=
Net farm income
—
Remuneration to suppliers of foreign capital
=
Farm profit (loss)
+
Increases in the value of assets over liabilities as a result of non-farming activities
—
Decreases in the value of assets over liabilities as a result of non-farming activities
=
Growth in net worth (positive or negative)
+
Net worth according to opening balance sheet
=
Net worth according to closing balance sheet

- Livestock units = Livestock sales + value of livestock slaughtered for the household (including donations) + value of livestock slaughtered for labourers + plus insurance payouts on livestock losses + stock adjustments [closing stock value - (opening stock value + value of livestock purchases)].
- Livestock products = Livestock product sales + value of livestock products consumed by household (including donations) + value of livestock products consumed by labourers + value of livestock products used in other branches + stock adjustment (closing stock value - opening stock value)[1].

(b) The gross production value of a *crop branch* (e.g. maize) is the total monetary value of the saleable production of that branch during the period under review, and usually includes the following: sales + insurance payments on crop losses + value of crops consumed by the household (including donations) + value of crops consumed by labourers + value of crops used in other branches such as seed and fodder + stock adjustment (closing stock value - opening stock value)[1].

(c) *Miscellaneous production* is production achieved by means of a farming activity, but which cannot be directly allocated to a specific branch of farming. Examples are —
- incidental income from pasture rental and hay sales;
- incidental income from forage;
- farm produce sold but which is difficult to allocate and/or constitutes small amounts; and
- money prizes won at shows.

The gross production value of a farming enterprise is the monetary value of the saleable farm production during an accounting period.

Production, marketing and administrative costs

The costs involved here are the production, marketing and administrative costs *incurred* to produce a specific gross production value. The following are typical examples:

- Production supplies such as seed, purchased and self-produced fertilisers, fuel, stock remedies,purchased and self-produced stockfeed, insecticides and pesticides;
- Labour costs that could include cash wages, remuneration in kind, purchased or self-produced rations, unemployment and accident insurance, medical costs, paid transport and training fees;

- Cost of White employees, including salaries and farm produce consumed;
- Depreciation on movable assets and fixed improvements;
- Additions to the replacement reserve;
- Maintenance and repair costs;
- Electricity;
- Contract work;
- Crop, fire and other short-term insurance premiums;
- Rental costs of depreciable capital items [see also explanation on p.137-8]
- Telephone, stationery and postage costs;
- Accountant's fees;
- Membership fees and subscription fees for magazines;
- Entertainment expenses;
- Legal costs.

Net farm income

The net farm income (NFI) is calculated by subtracting the production, marketing and administrative costs incurred to produce the gross production value, from that gross production value. The net farm income is therefore that portion of the gross production value that remains as compensation for own and foreign capital and for the owner/farmer as worker, manager and entrepreneur.

> The net farm income of a farming enterprise is the gross production value of that enterprise less the production, marketing and administrative costs *incurred* to produce that production value.

Remuneration to the providers of foreign capital

Remuneration to the providers of foreign capital consists of interest on loan capital (including the interest components on instalment-sales and lease payments — see also the discussion on p. 142), rental of inherently non-depreciable capital items (usually only land) and share-cropping payments.

Farm profit (loss)

The farm profit (loss) (FP) is calculated by subtracting remuneration to providers of foreign capital from the net farm income. Farm profit is therefore that portion of the gross production value that remains as compensation for the owner/farmer's own capital investment in the enterprise and to him as worker, manager and entrepreneur. If this amount is negative, it is known as a farm loss.

The farm profit (loss) is the net farm income of a farming enterprise less the remuneration paid (payable) to the providers of foreign capital for the period under review.

Growth in net worth and the reconciliation between the net worth of two successive balance sheets

In the discussion of the balance sheet earlier in this chapter, the net worth of a farming enterprise was defined as the difference between the total asset value and the extent of the debt (liabilities or commitments) according to the enterprise's balance sheet (net worth = total asset value - extent of debt on the date of a balance sheet).

A *growth (decrease) in net worth* refers to the positive (negative) change in net worth according to two successive balance sheets, for example:

N. Farmer
Balance sheet as at 31 December 1984

Liabilities		Assets	
Current liabilities	15 000	Current assets	50 000
Medium-term liabilities	50 000	Movable assets	150 000
Long-term liabilities	200 000	Fixed assets	500 000
Total debt	265 000		
Net worth	435 000		
	R700 000		R700 000

N. Farmer
Balance sheet as at 31 December 1985

Liabilities		Assets	
Current liabilities	10 000	Current assets	40 000
Medium-term liabilities	40 000	Movable assets	130 000
Long-term liabilities	180 000	Fixed assets	520 000
Total debt	230 000		
Net worth	460 000		
	R690 000		R690 000

Positive growth in net worth of N. Farmer for the period 1 January 1985 to 31 December 1985 = R460 000 - R435 000 = R25 000.

In our capitalistic system most profit-seeking enterprises pursue maximum sustained growth in net worth over the long term, and this generally also applies to commercial farming enterprises. Which transactions, activities and/or events however influence the growth in net worth?

From the above definition and example it emerges that *any transaction, activity or event which will lead to an increase or decrease in the asset value of an enterprise without a corresponding compensating increase or decrease in the extent of the liabilities, will lead to a corresponding increase* (positive growth) *or decrease* (negative growth) *in the net worth of the enterprise*. Conversely, *any increase or decrease in the extent of the liabilities without a corresponding increase or decrease in the asset value will lead to a decrease* (negative growth) *or increase* (positive growth) *in net worth*.

To explain the above statements, take the following simplified examples:
As *point of departure*, take N. Farmer's balance sheet at 1 January 1985:

N. Farmer
Balance sheet as at 1 January 1985

Liabilities		Assets	
Debt at cooperative	50 000	Cash in bank	150 000
Net worth	100 000		
	R150 000		R150 000

Example 1
Suppose the following were N. Farmer's only transactions during the period 1 January 1985 to 31 December 1985.

He buys 100 head of cattle for cash at R350 each (R35 000) and sells them, for cash, at R450 a head (R45 000) — a cash profit of R10 000. What would his balance sheet look like on 31 December 1985?

N. Farmer
Balance sheet as at 31 December 1985

Liabilities		Assets	
Debt at cooperative	50 000	Cash in bank	160 000
Net worth	110 000	(150 000 - 35 00 + 45 000)	
	R160 000		R160 000

Conclusion: The transaction during the year caused the asset value to increase by R10 000 without a corresponding compensating increase in the extent of the liabilities. The net worth therefore increased (positive growth) by the corresponding amount (R160 000 -R150 000 = R10 000).

Example 2

Suppose the following were N. Farmer's only transactions during the period 1 January 1985 to 31 December 1985:

He buys 100 cattle for cash at R350 each (R35 000) and sells them for R300 cash each (R30 000) — a cash loss of R5 000. What will his balance sheet look like on 31 December 1985?

N. Farmer
Balance sheet as at 31 December 1985

Liabilities		**Assets**	
Debt at cooperative	50 000	Cash in bank	145 000
Net worth	95 000	(150000 - 35000 + 30000)	
	R145 000		R145 000

Conclusion: The transaction during the year caused the asset value to decline by R5 000 without a corresponding compensating decrease in the liabilities. The net worth therefore decreased (negative growth) by the corresponding amount (R100 000 - R95 000 = R5 000).

Example 3

Suppose N. Farmer's only transaction during the period 1 January 1985 to 31 December 1985 was that he paid the R50 000 debt at the cooperative. What would his balance sheet look like on 31 December 1985?

N. Farmer
Balance sheet as at 31 December 1985

Liabilities		**Assets**	
Debt at cooperative	—	Cash in bank	100 000
(50 000 - 50 000)		(150 000 - 50 000)	
Net worth	100 000		
	R100 000		R100 000

Conclusion: A change in the asset value accompanied by a corresponding (compensating) change in the extent of the liabilities (and vice versa) has no influence on the net worth (there is therefore no change in net worth).

Example 4

Suppose N. Farmer's only transaction during the period 1 January 1985 to 31 December 1985 was that he bought a tractor for R20 000 cash. How would his balance sheet look on 31 December 1985?

N. Farmer
Balance sheet as at 31 December 1985

Liabilities		Assets	
Debt at cooperative	50 000	Cash in bank	130 000
Net worth	100 000	(150 00 - 20 000)	
		Movable assets	20 000
	R150 000		R150 000

Conclusion: A change in the assets value of a specific asset accompanied by a corresponding compensating change in the value of another asset has no influence on the net worth (there is therefore no change in the net worth).

The same principle applies to the liabilities.

Example 5

Suppose N. Farmer had no transactions during the period 1 January 1985 to 31 December 1985, but that the cooperative charged 10% interest (R5 000) on the outstanding debt. What would his balance sheet look like on 31 December 1985?

N. Farmer
Balance sheet as at 31 December 1985

Liabilities		Assets	
Debt at cooperative (50 000 + 50 000)	55 000	Cash in bank	150 000
Net worth	95 000		
	R150 000		R150 000

Conclusion: An increase in the size of a liability without a corresponding compensatory change in the asset value causes the net worth to decline (negative growth). Similarly, a decrease in the size of a liability without a compensatory drop in the asset value will cause the net worth to increase (positive growth).

In the normal course of events the following transactions, activities or events lead to a positive growth in the net worth of the farming enterprise:

- Farm profit;

- Capital appreciation on non-destructible (inherently non-depreciable) assets, that is land;
- Non-farming income such as salary earned outside the farming enterprise, interest and dividends on outside investments — including interest on cooperative levy funds, shares and investments — and also subsidies;
- Capital gain through selling movable and fixed assets (selling price less book value);
- Additions to replacement reserve (see the section on the calculation of depreciation and asset depreciation under inflationary conditions in Chapter 5);

In contrast with the foregoing, the following transactions, activities or events normally cause negative growth in the net worth of an enterprise:

- Farm losses;
- Capital depreciation of non-destructible (inherently non-depreciable) assets, that is land;
- Capital loss with the selling of movable and fixed assets (book value less selling price);
- Private withdrawals;
- Value of farm produce consumed by the household and donated;
- Provision for income tax.

The net result of the above transactions, activities or events represents the amount by which a farming enterprise's net worth experienced positive or negative growth during the accounting period under review. If this amount is added to the net worth according to the opening balance sheet, this should correspond with the net worth according to the closing balance sheet.

> The net result of the transactions, activities or events during an accounting period that have a positive or negative influence on the net worth of a farming enterprise, represents the growth (positive or negative) in net worth. If this growth is added to the net worth according to the opening balance sheet, it should correspond (balance) with the net worth according to the closing balance sheet.

Additional explanations

Some of the concepts and entries (items) in the income and capital reconciliation statement need further emphasis and/or explanations:

- Some farmers tend to include only the cash receipts and payments during an accounting period in the income and capital reconciliation statement for that period. Credit transactions, changes in stocks values, prepaid and in arrears expenditure, provision for income tax, internal consumption of farm produce, etc, are then ignored to a greater or lesser degree in such an approach. The result usually has very little merit as regards management information and for decision-making purposes. The so-called "matching" approach taken in this chapter has as its point of departure the matching (inclusion in the same income and capital reconciliation statement) between the production for a specific period and the costs incurred to achieve that production, as well as the inclusion of other income and expenditure in the income and capital reconciliation statement in the period during which it accrues to the enterprise or is ascribable to the enterprise. The latter approach, although slightly more complicated, has more merit than the former.

- Only the production supplies (seed, fertiliser, fuel, etc.) *used* during the accounting period under review are taken into account. Adjustments therefore have to be made in respect of changes in stocks and the sale of surplus production supplies. Production supplies used = [(opening value of stocks + purchases) - (closing value of stocks + sales)].

- To enable the farmer to make a meaningful comparison between his own farming results over time and between his farming results for a given period, and that of other farmers, a distinction is made in the income and capital reconciliation statement between net farm income and farming profit. The two amounts differ in that interest on loan capital, rental in respect of inherently non-depreciable assets and share-cropping payments are deducted from the net farm income to determine the farm profit. This enables the farmer who, for example, leases all his land or finances a large part of his assets with loan capital, to compare his farming results at net farm income level with those of a farmer who farms only on his own land, or who finances all his assets from his own funds. It also enables the farmer to compare his own farming results at net farm income level over time, regardless of whether or not he leased land at certain times, or whether he had different debt ratios at certain times.

- Why the distinction between rental paid in respect of inherently non-depreciable assets (land) and inherently depreciable assets (the neighbour's combine harvester)? Why is the former deducted from the net farm income

to determine the farm profit and the latter from the gross production value to determine net farm income? The point of departure is still the comparison of farming results at net farm income level. In the case of depreciable assets, the farmer who, for example, has a self-propelled combine harvester will deduct its depreciation and repair costs from his gross production value to determine his net farm income. However, the farmer who rents his neighbour's combine will not have such costs and, for purposes of comparison between himself and the other farmer, it is therefore sensible to deduct the rental paid for the combine from his gross production value to determine his net farm income. Ownership of inherently non-depreciable assets (land) does not hold any such costs for the owner which is why — again for purposes of comparison at net farm income level — it is necessary that land rental is only taken into account after calculation of net farm income. From a strictly theoretically point of view, the above approach would mean that the farmer who leases land together with fixed improvements, should already take the rental in respect of the fixed improvements (inherently depreciable) into account when calculating his net farm income, and only the rental for the land afterwards. In most cases, however, such a distinction is impossible or impractical, and the total rent payment is regarded as land rental.

- Insurance premiums on short-term insurance are deducted from the gross production value as production costs to determine the net farm income. Claim payments in respect of crop damage or stock losses are taken into account when determining the gross production value. Claim payments in respect of damage to, for example, implements, vehicles and buildings are credited against the repair of such damage and the amount by which the repair costs exceed the claim payment is deducted from the gross production value to determine the net farm income. Should the claim payment exceed the repair costs of the damage, the amount by which the repair costs are exceeded is taken into account as a non-farming income when determining the growth in net worth.

- The value of farm produce consumed by labour or the value of products from one branch used in another, is initially regarded as part of the gross production value of the branch by which it was produced. The corresponding value is later deducted from the gross production value as production costs to calculate the net farm income. This approach makes possible a meaningful comparison between the profitability of different production branches, between different farmers, and for the same farmer over a period of time.

- The value of farm produce consumed by the household and donated, is initially regarded as part of the gross production value of the branch concerned, and later, since it represents consumption of profit, deducted from the farm profit to determine growth in net worth.

- A capital gain or loss represents the difference between the selling price of fixed and movable assets and the book value of such assets on the date of sale. Should the selling price exceed the book value, a capital gain is realised, and if the reverse is the case, a capital loss. Only this capital gain or loss is entered in the income and capital reconciliation statement since it represents the amount which causes the value of assets above liabilities to increase or decrease.

The form of the income and capital reconciliation statement

There are no hard and fast directives about the form in which the income and capital reconciliation statement must be presented. Any of a variety of forms may be used, provided they are logical and systematic. The following represents an example of a form in which the income and capital reconciliation statement can be compiled:

N. Farmer
Income and capital reconciliation statement for the period 1 January 1985 to 31 December 1985

Item	Production branch					
	Wheat	Maize	Cattle	Milk	Miscel-laneous	Total
Sales						
Cash	XX	XX	XX	X	X	XXX
Credit	X	X	X	X	X	X
Deduction						
Cooperative account	X	X	X	X	—	X
Cooperative levy	X	X	X	X	—	X
Barter	X	X	X	X	X	X
Insurance claim payments	X	X	X	—	—	X
Total sales	XXX	XXX	XXX	XX	X	XXX(a)
Consumption						
Labour	X	X	X	X	—	X
Household	X	X	X	X	—	X
Donations	X	X	X	X	—	X
Internal	—	X	—	—	—	X
Total consumption	X	X	X	X		XX(b)
Stock adjustments						
Closing stock	X	X	X	X	—	X
Less opening stock	(X)	(X)	(X)	(X)	—	(X)
Less livestock purchases	—	—	(X)	—	—	(X)
Total stock adjustment (+ or -)	XX	XX	XX	XX	—	XX(c)
Gross production value (a) + (b) + (c)	XXX	XXX	XXX	XX	X	XXXX(d)

Less: Production, marketing and administrative costs

(i) Production supplies

Item	Opening stock	+ Purchases	+ Farm products	- Sales	- Closing stock	= Usage
Fertiliser	X	X	—	(X)	(X)	X
Fuel	X	X	—	—	(X)	X
Seed	X	X	—	(X)	(X)	X
Spraying materials	X	X	—	(X)	(X)	X
Stockfeed	X	X	X	(X)	(X)	X
—	X	X	X	(X)	(X)	X
Total	X	X	X	(X)	(X)	XX(e)

(ii) Labour costs			
Cash wages	X		
Wages due	X		
Purchased rations	X		
Farm products consumed	X		
Clothing	X		
Medical costs	X		
Contract transport costs	X		
—	X	XX(f)	
(iii) Capital recovery			
Depreciation	X		
Replacement reserve	X	XX(g)	
(iv) Repair and maintenance costs		X(h)	
(v) Other			
Electricity	X		
Telephone and postage	X		
Accountant's fee	X		
Product insurance premiums	X		
Other short-term insurance premiums	X		
—	X	XX(i)	
Total production, marketing and administrative costs (e) + (f) + (g) + (h) + (i)			XX(j)
Net farm income (d) - (j)			XXX(k)
Less: Land rental		X(l)	
Less: Interest			
Bank overdraft	X		
Cooperative	X		
Instalment-sales	X		
Lease	X		
Bonds	X		
—	X	XX(m)	
Less: Share-cropping payments		X(n)	
Total rental, interest and share-cropping payments (l) + (m) + (n)			XX(o)
Farm profit (loss) (k) - (o)			XX(p)
Plus: Capital appreciation on land		X	
Non-farming income		X	
Capital gains		X	
Addition to replacement reserve		X	X(q)
			XXX (r) = (p) + (q)
Less: Capital losses		X	
Private and household expenses		X	
Income-tax provision		X	
Value of farm products consumed by household		X	
Value of farm products donated		X	
Cash donations		X	
Private withdrawals		X	
—		X	XX(s)
Growth in net worth + or - [(r) - (s)]			X(t)
Plus: Net worth on 1/1/85			XX(u)
NET WORTH ON 31/12/85 (t) + (u)			RXXX(v)

THE FLOW-OF-FUNDS STATEMENT

Although the opening balance sheet, income and capital reconciliation statement and closing balance sheet, if properly compiled, contain all financial information which the farmer normally needs for further analysis and decision-making, it is desirable that the financial statements should also give an overview of the flow of funds within the enterprise during the period under review. A flow-of-funds statement is compiled for this purpose. It contains information concerning the sources from which funds were generated during the period and the purposes for which the funds were used. The data contained in the opening balance sheet, the income and capital reconciliation statement and the closing balance sheet serve as basis for compiling the flow-of-funds statement.

As was the case with the other financial statements, flow-of-funds statements are also compiled in a variety of forms. The one on the opposite page is an example.

PROCEDURE FOR HANDLING THE FINANCING COST (INTEREST) COMPONENT IN INSTALMENT-SALES AND LEASE AGREEMENTS

The periodic instalments in the case of purchases by means of instalment-sales and lease agreements consist of a capital repayment and an interest component. Although there is a school of thought which regards the total "price" (capital + interest or financing costs) in such cases as the purchase price of the asset (mostly implements), this approach is wrong.

The financing costs or interest component must be separated from the capital component and only the capital component must be regarded as the purchase price of the asset concerned. The financing costs or interest component represents interest on loan capital and must be deducted from the net farm income as interest *in the period during which it is allocatable to the enterprise to determine the farm profit (loss) for that period.* The *balance of the interest component* is then regarded as "interest calculated in advance". The correct accounting procedure for handling the financing cost component in the case of instalment-sales and lease agreements can be explained by means of a simplified numerical example:

Say N. Farmer buys a tractor with a cash price of R20 000 on 31 December 1984 and decides to finance it through the Farmer's Bank by means of an instalment-sales agreement. GST of 12% and a deposit of R2 400 are payable. The balance of the purchase price at an effective annual interest rate of 24% (12% per half-year) is payable in ten half-yearly instalments, the first of which is due on 30 June 1985.

N. Farmer

Flow-of-funds statement for the period 1 January 1985 to 31 December 1985

Sources of funds			Use of funds		
1 *Farming activities*			1 *Farming activities*		
Farm profit (- loss)	.....				
+ Depreciation	.....				
+ Replacement reserve	.....				
- Farm products for domestic use and donations	.....				
	.....	.....			.....
		(Surplus)			(Deficit)
2 *Non-farming activities*			2 *Non-farming activities*	.....	
Non-farming income	.....		Capital losses	.....	
Capital gains	.....		Provision for income tax	.....	
	.....	.....	Private withdrawals	.....	
			Cash donations	.....	
			Other	.....	
				.....	.....
3 *Increase in debt* (liabilities) (bank overdraft excluded)			3 *Decrease in debts* (assets) (bank overdraft excluded)		
Trade creditors	.....		Trade creditors	.....	
Medium-term loans	.....		Medium-term loans	.....	
Long-term loans	.....		Long-term loans	.....	
Other liabilities (eg. provisions)	.....		Other liabilities (eg. provisions)	.....	
	.....	.....		.....	.....
4 *Decrease in possessions (assets)* (excluding cash in bank and on hand)			4 *Increase in possessions (assets)* (excluding cash in bank and on hand)		
Debtors	.....		Debtors	.....	
Prepaid expenditure	.....		Prepaid expenditure	.....	
Stock values	.....		Stock values	.....	
Investments	.....		Investments	.....	
Sales			Sales	.....	
Movable assets[1]	.....		Movable assets[2]	.....	
Fixed improvements[1]	.....		Fixed improvements[2]	.....	
Land[1]	.....		Land[2]	.....	
	.....	.....		.....	.....
Subtotal		.....	Subtotal		.....
Balance (decrease in cash/ increase in overdraft		XX	*Balance* (increase in cash/ decrease in overdraft		XX
		RXXX			RXXX

1 At book value on day of sale.
2 At purchase price.

Therefore:	Cash price	20 000
	GST at 12%	2 400
	Total cost price	22 400
	Deposit	2 400
Amount to be financed		20 000
Financing costs (interest)		15 400
Total amount to be financed		R35 400

The amount of R35 400 is repayable in ten instalments of R3 540 each. Please note: The effective interest rate, total financing costs, extent and time of instalments are given on the instalment-sales or lease agreement. Given a specific effective interest rate, number and regularity of instalments, the total financing costs and size of instalments can also be calculated with the aid of table 3.3 in the annexure. Effective interest rate (i) = 24% p.a. or 12% per half-year; number of instalments (n) = 10; capital plus interest payment per instalment per R1 borrowed = R0,177; capital borrowed plus total financing costs = (10 x 20 000 x 0,177) = R35 400; Financing costs = (35 400 - 20 000) = R15 400;

Size of instalments $\frac{35\ 400}{10} = R3540$

The division of each instalment between capital and interest repayment will then be as follows:

Date	Loan	Interest at 24% p.a.	Instalment	Capital Repayment
30/6/1985	20 000	2 400	3 540	1 140
31/12/1985	18 860	2 263 (4 663)	3 540	1 277
30/6/1986	17 583	2 110	3 540	1 430
31/12/1986	16 153	1 938 (4 048)	3 540	1 602
30/6/1987	14 551	1 746	3 540	1 794
31/12/1987	12 757	1 531 (3 277)	3 540	2 009
30/6/1988	10 748	1 290	3 540	2 250
31/12/1988	8 498	1 020 (2 310)	3 540	2 520
30/6/1989	5 978	717	3 540	2 823
31/12/1989	3 155	385 (1 102)	3 540	3 155
		R15 400	R35 400	R20 000

If it is assumed that N. Farmer's financial year is from 1 January to 31 December, the allocatable interest for each financial year will be as follows:

1/1/1985 — 31/12/1985 = (2 400 + 2 263)	=	4 663
1/1/1986 — 31/12/1986 = (2 110 + 1 938)	=	4 048
1/1/1987 — 31/12/1987 = (1 746 + 1 531)	=	3 277
1/1/1988 — 31/12/1988 = (1 290 + 1 020)	=	2 310
1/1/1989 — 31/12/1989 = (717 + 385)	=	1 102
Total	=	R15 400

Should it now further be assumed that N. Farmer depreciates the tractor according to the declining-balance method at a rate of 20% p.a., the *applicable* balance sheet entries for the years concerned will be as follows:

N. Farmer

Balance sheet as at 31 December 1984

Liabilities		Assets	
Farmer's Bank	R35 400	Interest calculated in advance	R15 400
		Movable assets	R22 400

N. Farmer

Balance sheet as at 31 December 1985

Liabilities		Assets	
Farmer's Bank (35 400 - 7 080)	R28 320	Interest calculated in advance (15 400 - 4 663)	R10 737
		Movable assets (22 400 - 4 480)	R17 920

N. Farmer

Balance sheet as at 31 December 1986

Liabilities		Assets	
Farmer's Bank (28 320 - 7 080)	R21 240	Interest calculated in advance (10 737 - 4 048)	R6 689
		Movable assets (17 920 - 3 584)	R14 336

N. Farmer

Balance sheet as at 31 December 1987

Liabilities		Assets	
Farmer's Bank (21 240 - 7 080)	R14 160	Interest calculated in advance (6 689 - 3 277)	R3 412
		Movable assets (14 336 - 2 867)	R11 469

N. Farmer

Balance sheet as at 31 December 1988

Liabilities		Assets	
Farmer's Bank (14 160 - 7 080)	R7 080	Interest calculated in advance (3 412 - 2 310)	R1 102
		Movable assets (11 469 - 2 294)	R9 175

N. Farmer
Balance sheet as at 31 December 1989

Liabilities		Assets	
Farmer's Bank (7 080 - 7 080)	—	Interest calculated in advance (1 102 - 1 102)	—
		Movable assets (9 175 - 1 835)	R7 340

The handling of the financing cost component in the case of purchases by means of a lease agreement is essentially the same as the above example of purchases by means of an instalment-sales agreement.

NUMERICAL EXAMPLE OF A FARMING ENTERPRISE'S FINANCIAL STATEMENTS

The above discussion of the financial statements of a farming enterprise can finally be explained by means of a numerical example.

Say the following financial information is available in respect of N. Farmer's enterprise for the period 1 March 1985 to 28 February 1986:

Transactions for the period 1 March 1985 to 28 February 1986

Cash sales:		
Slaughter stock		100 000
Crops		151 000
Cash purchases:		
Slaughter stock		40 000
Fertiliser		60 000
Old implement sold for cash on 1.9.1985		1 900
Cash capital repayment on bond		20 000
Interest on bond paid cash		20 000
Land rental paid cash		5 000
Income tax paid cash		5 000
Received from debtors in cash		1 000
Farm products used:		
For household:	Crops	300
	Livestock	200
For labour:	Crops	500
	Livestock	500
For stockfeed:	Crops	750
As donations:	Livestock	100
Cash received direct from insurers in respect of hail damage to crops		9 000
Cash withdrawn for private use		12 000
Cash wages paid		3 000
Repairs paid for in cash		2 000
Electricity paid cash		1 500
Slaughter stock sold but payment not yet received		1 000
Rations bought for cash		1 200

N. Farmer
Balance sheet as at 1 March 1985

Liabilities			Assets			
Current liabilities			*Current assets*			
Cooperative account	20 000		Cash in bank		6 000	
Prov. for income tax	5 000		Debtors		1 000	
Prov. for bond instalment 1985/86	20 000	45 000	Stocks			
			Slaughter stock @ net sales value	30 000		
Long-term liabilities			Crops on lands @ prod. cost	20 000		
J. Venter in respect of mortgage bond registered on land.			Fertiliser at cost price	3 000	53 000	60 0000
Capital repayment in equal annual instalments of R20 000 plus interest @ 10% p.a.			*Investments*			
			Rotating member's levy fund (cooperative)			30 000
on outstanding balance	200 00					
Less: Provision in respect of			*Movable assets*			
1985/86 capital repayment	20 000	180 000	Implements at cost price	159 000		
			Less: Accumulated depreciation	60 000	99 000	
			Office equipment at cost price	1 800		
Total liabilities		225 000	*Less: Accumulated depreciation*	800	1 000	100 000
Net worth		525 000				
			Fixed assets			
			Fixed improvements at cost price	80 000		
			Less: Accumulated depreciation	20 000	60 000	
			Land at cost price	300 000		
			Plus: Accumulated appreciation	200 000	500 000	560 000
Total liablities + net worth		R750 000	Total assets			R750 000
			Market value of leasehold land			50 000
			Total capital employed			R800 000

Crop insurance premiums paid cash 8 000
Stocks on 28/2/1986
Slaughter stock at net sales value 35 000
Crops on land at production costs 10 000
Fertiliser . . . . . —
Cash in bank on 28/2/1986 . . . . . 91 200

Notes

- The amount of R151 000 shown as cash crop sales, is the net cash sum received from the cooperative after the cooperative deducted its account of R20 000 and a contribution to the rotating member's levy fund of 10% of the yield.
- During the year N. Farmer experienced a shortage of fertiliser and was compelled to exchange one of his slaughter cattle worth R300, for fertiliser from his neighbour.
- Own land is entered in the books at market value and the market value on 28 February 1986 is estimated at R550 000.
- Depreciation is calculated according to the declining-balance method at a rate of 20% p.a. on movable assets and 5% p.a. on fixed improvements. Capital recovery is equal to depreciation.
- The cost price of the old implement sold for R1 900 on 1 September was R4 000 and its book value on 1 March 1985 was R2 000.
- Provision must be made for the payment of income tax to the amount of R30 000 for the 1985/86 financial year.
- N. Farmer again leases the land and its market value on 28 February 1986 is estimated at R55 000.

Questions

1) Compile N. Farmer's income and capital reconciliation statement for the period 1 March 1985 to 28 February 1986.
2) Compile N. Farmer's balance sheet as at 28 February 1986.
3) Compile a flow-of-funds statement for the period 1 March 1985 to 28 February 1986.

Answer

N. Farmer
Income and capital reconciliation statement for the period 1 March 1985 to 28 February 1986

Item	Production branch		Total
	Slaughter stock	Crops	
Sales			
Cash	100 000	151 000	251 000
Credit	1 000	—	1 000
Deduction - cooperative account	—	20 000	20 000
Deduction - cooperative levy	—	19 000[1]	19 000
Barter	300	—	300
Insurance claim payment	—	9 000	9 000
Total sales	101 300	199 000	300 300

Consumption			
Labour	500	500	1 000
Household	200	300	500
Donations	100	—	100
Internal	—	750	750
Total consumption	800	1 550	2 350
Stock adjustments			
Closing stocks	35 000	10 000	45 000
Less: Opening stock	(30 000)	(20 000)	(50 000)
Less: Livestock purchases	(40 000)	—	(40 000)
Total stock adjustments	(35 000)	(10 000)	(45 000)
Gross production value	R67 100	R190 550	257 650

Less: Production, marketing and administrative costs

(a) *Production supplies*

Item	Opening Stock	+ Purchases	+ Bartered	+ Farm products	- Closing stock	= Consumption
Fertiliser	3 000	60 000	300	—	—	63 300
Stockfeed	—	—	—	750	—	750
Total	R3 000	R60 000	R300	R750	—	64 050

(b)	*Labour costs*			
	Cash wages	3 000		
	Purchased rations	1 200		
	Farm products consumed	1 000	5 200	
(c)	*Depreciation*			
	Implements			
	(97 000 x 20%) + (2 000 x 20% x $^1/_2$)	19 600[2]		
	Office equipment (1 000 x 20%)	200		
	Fixed improvements (60 000 x 5%)	3 000	22 800	
(d)	*Repairs and maintenance costs*		2 000	
(e)	*Other*			
	Product insurance premiums	8 000		
	Electricity	1 500	9 500	
Total production, marketing and administrative costs				103 550
Net farm income				154 100
Less: Land rental			5 000	
Less: Interest on bond			20 000	
Total rental and interest				25 000
Farm profit				129 100

Plus:	Capital appreciation on land	50 000	
	Capital gain	100[3]	50 100
			179 200
Less:	Provision for income tax	30 000	
	Value of farm products used in household	500	
	Value of farm products donated	100	
	Private withdrawals	12 000	42 600
Growth in net worth			136 600
Plus: Net worth on 1/3/1985			525 000
NET WORTH ON 28/2/1986			R661 600

Notes

(1) The cooperative levy was calculated as follows:

Cash received from cooperative		151 000
Cooperative deduction for accounts		20 000
	90%	171 000
	100%	190 000
	10% levy	19 000

(2) Depreciation on implements was calculated as follows:
Book value of implements on 1 March 1985 = R99 000. The implement sold on 1 September 1985 had a book value of R2 000 on 1 March 1986. The book value of the implements in use for the full year therefore came to (99 000 - 2 000) = R97 000 on 1 March 1985. Depreciation was therefore (2 000 x 20% x 1/2) + (97 000 x 20%) = R19 600.

(3) Capital gain on implement sold = selling price - book value
= (1 900 - 1 800)
= R100

N. Farmer

Flow-of-funds statement for the period 1 March 1985 to 28 February 1986

Sources of funds			Use of funds	
Farm profit	129 100		Tax provision	30 000
+ Depreciation	22 800		Private withdrawals	12 000
- Donations	(100)		Decrease in creditors	20 000
- Farm products in household	(500)	151 300	Decrease in bond	20 000
Capital gain		100	Increase in investments	19 000
Increase in tax provision		25 000	Balance (increase in cash)(91 200 - 6 000)	85 200
Decrease in stock		8 000		
Sale of implement at book value		1 800		
		R186 200		R186 200

N. Farmer
Balance sheet as at 28 February 1986

Liabilities			Assets			
Current liabilities			*Current assets*			
			Cash in bank		91 200	
Prov. for income tax	30 000		Debtors		1 000	
Prov. for bond instalment 1986/87	20 000	50 000	Stocks			
			Slaughter stock @ net sales value	35 000		
Long-term liabilities			Crops on lands @ prod. costs	10 000	45 000	137 200
J. Venter in respect of mortgage bond registered on land. Capital repayment in equal annual instalments of R20 000, plus interest @ 10% p.a. on outstanding balance	180 00		*Investments*			
			Rotating member's levy fund (cooperative)			49 000
			Movable assets			
			Implements at cost price	155 000[1]		
Less: Provision in respect of 1986/87 capital repayment	20 000	160 000	*Less: Accumulated depreciation*	77 400[1]	77 600[1]	
			Office equipment at cost price	1 800		
			Less: Accumulated depreciation	1 000	800	78 400
Total liabilities		210 000				
Net worth		661 600	*Fixed assets*			
			Fixed improvements at cost price	80 000		
			Less: Accumulated depreciation	23 000	57 000	
			Land at cost price	300 000		
			Plus: Accumulated appreciation	250 000	550 000	607 000
Total liablities + net worth		R871 600	Total assets			R871 600
			Market value of leasehold land			55 000
			Total capital employed			R926 600

1 Only particulars of those implements still owned are entered in the balance sheet. The cost price and accumulated depreciation of the implement sold are therefore withdrawn.

SUMMARY

The financial statements of a farming enterprise consist of —

- an opening balance sheet,
- an income and capital reconciliation statement,
- a closing balance sheet, and
- a flow-of funds statement.

If these statements are compiled with due care, they represent an indispensable source of management information. This chapter gave guidelines for proper compilation of the financial statements. The next chapter will deal with, among other things, the further analysis and interpretation of the information contained in these statements.

END NOTES

1 The stock values include the value of semi-finished products such as crops on the lands, fruit on fruit trees and wool on sheep.