

Managing your accounts

Will Phillips takes a practical look at how to manage your accounts.

Use your Accounts and challenge your accountant

The majority of dairy farmers have March year-ends. Accounts should be prepared as soon as possible after the year end even if only in draft results can be reviewed and decisions made for the future.

A business plan should be in place to see what is likely to happen in the coming year and if necessary the years to follow. Plan and take a close look at business performance – not just profit but net worth, assets and liabilities.

- Do you owe more than you did last year?
- Have you reduced your borrowing?
- Have your assets increased to offset extra liabilities?

Farming has a major advantage over many other businesses. Within reason, you can forecast reasonably accurately what you are going to sell, what your cost levels will be and whether or not you will make enough profit. (You don't have to rely on whether customers are coming into your shop or you have to go out getting sales appointments etc)

Basic accounts designed for the taxman should have a mass of information about how your business is performing. But these are the key bits of information that you should focus on

- 1. Turnover**
- 2. Profit**
- 3. Net worth**
- 4. Change in total assets and liabilities**

Your accountant will have all the details of payments and receipts to prepare your accounts, so ask for more details so you know exactly what is happening to your business.

For example, most accounts need additional break down of income and expenditure. Get the key figures split into categories that mean something. To have feed, fertiliser and seed all lumped together and then see a separate heading for telephone is ridiculous.

Challenge your accountant to provide you with accounts that you can use.

Then it is up to you and your consultant to use the information to best advantage. Why not start with turnover. Turnover determines the level of income the business is generating. Is turnover a fundamental reason for good or bad results? For example, many farmers concentrate on cost cutting

(especially over the last few years), but there will be costs that you just cannot cut further; you will have a minimum level that simply cannot be reduced.

Cutting variable costs could have a detrimental effect and reduce income creating a downward spiral. These elements need to be examined. If turnover is too low-cost cutting is unlikely to solve problems.

What about variable costs? Taking the business as a whole, what proportion of costs that are allocated to individual enterprises eat into your turnover. Depending on the type of farm and the mix of enterprises, between 30 and 40% may be reasonable.

Look carefully at overheads. This is the area where there tends to be major differences. The most profitable businesses will have the lowest percentage of their turnover eaten up by overheads. Top performing businesses will have overheads between 30 to 40% of turnover. Therefore, profit will be in a range between 20 and 40% of turnover. But be warned, Turnover needs to be high enough to generate reasonable profits. If it is too low, even 40% retained as profit may not be adequate to meet your commitments resulting in increased borrowings and falls in Net Worth.

Alternatively, turnover could be higher than average, but the burden of costs eats too deeply into your turnover and reduces profit. If this is the case then reducing costs is almost certainly the answer. This type of simple analysis will highlight where the problems may lie and the areas that need to be changed.

Profit must be adequate to cover minimum requirements including personal drawings, tax and retirement provision.

Any capital repayments on loans and hire purchase commitments also need to be paid – most farmers I meet are very keen to reduce their overdraft. All these items must come out of profit. So, when you are planning why not start with profit and then plan how to achieve it.

Why not start by getting some good management information? Identify strong and weak areas and then prepare a business plan (not a budget) to meet your profit requirements.

Finally and most importantly, look at total net worth and the trends. Prepare a current or 'farmers' balance sheet – this is likely to be very different from your accounts. Include all your assets and liabilities. Find out what your insurance policies are worth and how valuable your pension is. Tot up all the machinery you have - include the cars and the old bits of kit that don't get used much – you may be surprised how much you have tied up in your business. Also, make a list of your debtors and creditors.

This process will help identify strengths and weaknesses and help you make decisions for the future that will improve profits. Above all, aim for a balanced structure to your business finances.

Will Phillips

For detailed advice designed to suit your own situation, contact P&L on 01948 880261 and talk to us about assessing your business.