Financial asset analysis

What to do and consider when analyzing financial statements and key financial information.

Step 1: Complete an initial assessment of your financial statements

Cash accounting method

☐ **Net worth**

- Are assets and liabilities listed with sufficient detail?
- Do assets = liabilities + equity?
- Are assets and liabilities in line with your sector?

☐ **Income tax return**

- Does the net income = revenue – expenses?
- Are there any income or expenses that seem unreasonable?

Accrual accounting method

☐ **Balance sheet**

- Do assets = liabilities + equity?
- Is there long-term debt?

☐ **Income statement**

- Does net income = revenue – expenses?
- Are there any income or expenses that seem unreasonable?

☐ **Cash flow statement**

- Do the end balances on the cash flow statement and balance sheet match?

Step 2: Complete a brief financial statement trend analysis

Cash accounting method

☐ **Net worth**

- Are there significant changes to the net worth from past years (for example, significant purchases or assets sold)?
- Double-check asset market values to make sure they're reasonable.

☐ **Tax returns**

List all income from different sources (gross farm income, off-farm income, business income)

- If there's off-farm income, calculate net off-farm income (Off-farm income = total income – net farming income – business income – taxable gains – ag-related rental income – any non-recurring income).
- If there's business income, is the income positive or negative? If negative, include a brief explanation of the business income and expenses.
- Overall, did revenues remain flat, increase or decrease year over year? Why?
- Are revenues in line with your industry and operation size?
- Did expenses remain flat, increase or decrease year over year? Why?
- Have there been inventory adjustments? If yes, explain why.
- Review your estimated living costs and adjust as needed. Don't forget to consider personal debt and average monthly expenditures on food, clothing and entertainment.
- Are expenses in line with your industry's standards?

Accrual accounting method

☐ **Balance sheet**

- Update the balance sheet to reflect any significant changes, such as large purchases or assets sold.

☐ **Income statement**

- Did revenues remain flat, increase or decrease year over year? Why?
- Did expenses remain flat, increase or decrease year over year? Why?
- Are expenses in line with your industry? If not, explain why.

Step 3: Assess your asset conversion cycle

Asset conversion cycle is the ongoing process through which your farm assets are used to generate revenues and cash flow through the business. It comprises a continuous set of operating cycles within or relating to a series of longer capital investment cycles.

OPERATING CYCLE + CAPITAL INVESTMENT CYCLE = ASSET CONVERSION CYCLE

1. Consider the following questions to evaluate your asset conversion cycle and its components:

- What percentage of total assets are current, and what percentage are non-current (term)?
- Is the nature and mix of assets appropriate for your industry?
- What is the purpose and contribution of each asset in the business?

2. Consider the following questions to evaluate your capital investment cycle and its components:

- Have any non-current (term) assets recently been purchased (within the last year), and how were they financed?
- Have non-current (term) assets been financed appropriately? (That is, the useful life of the asset matches the amortization of the loan)
- What is the average age of non-current (term) assets? When will they need replacement?
- What capital assets will be required in the future?

3. Consider the following questions to evaluate your operating cycle and its components:

- Is the operating cycle reflective of the industry you operate in?
- What is your level of short-term debt?
- How does the inventory on hand compare to the amount owing on the line of credit and other current liabilities?
- How does the inventory on hand compare to the gross revenue?
- What is the inventory management strategy? For example, when do you typically sell inventory? Do you typically withhold from selling to take advantage of better prices later in the year?
- Is there enough cash on hand to pay this year’s bills? Is your business meeting its financial obligations on time?