

## Lesson B3–4

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# Using Financial Statements in Business Decisions

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**Unit B.** Starting and Operating the Agribusiness

**Problem Area 3.** Keeping and Using Records in an Agribusiness

**Lesson 4.** Using Financial Statements in Business Decisions

### **New Mexico Content Standard:**

**Pathway Strand:** Agribusiness Systems

**Standard: III:** Apply generally accepted accounting principles and skills to manage budget, credit, and optimal application of AFNR business assets.

**Benchmark: III-A:** Use key accounting fundamentals to accomplish dependable book-keeping and associated files.

**Performance Standard:** 1. Budget resources (e.g., capital, human, financial, time). 5. Prepare and interpret financial statements (e.g., balance sheet, profit/loss statement, cash flow statement).

**Student Learning Objectives.** Instruction in this lesson should result in students achieving the following objectives:

1. Identify business and accounting principles and means to measure performance.
2. Explain how financial records are processed.
3. Explain what a balance sheet is and how one is used.
4. Explain what a profit and loss statement is and how one is used.
5. Explain what a cash flow statement is and how one is used.
6. Identify different types of budgets and their purposes.
7. Describe how production control records are used.

**List of Resources.** The following resources may be useful in teaching this lesson:

**Recommended Resources.** One of the following resources should be selected to accompany the lesson:

Gibson, Jerry D., et al. *Agribusiness: Management, Marketing, Human Resource Development, Communication, and Technology*. Danville, Illinois: Interstate Publishers, Inc., 2001. (Textbook, Chapter 6 and 9)

Ricketts, Cliff and Omri Rawlins. *Introduction to Agribusiness*. Albany, New York: Delmar Publishers, 2001. (Textbook, Chapter 7)

**Other Resources.** The following resources will be useful to students and teachers:

Elliot, Jack. *Agribusiness Decisions and Dollars*. Albany, New York: Delmar Publishers, 1999.

## List of Equipment, Tools, Supplies, and Facilities

Writing surface  
Overhead projector  
Transparencies from attached masters  
Copies of student lab sheet

**Terms.** The following terms are presented in this lesson (shown in bold italics):

Accountant  
Accounting  
Accounts receivable  
Asset  
Balance sheet  
Budget  
Business transaction  
Capital  
Cash expenditure budget  
Cash flow budget  
Cash flow statement  
Current liabilities  
Debenture  
Equity  
Expenses  
General ledger  
Inventory  
Invoice  
Journal

Liability  
Long-term liabilities  
Operating budget  
Profit and loss statement  
Record  
Revenue  
Taxation  
Transaction

**Interest Approach.** Use an interest approach that will prepare the students for the lesson. Teachers often develop approaches for their unique class and student situations. A possible approach is included here.

*Invite the manager of a local agribusiness into the classroom to talk to your students. Likewise, plan to take your class to the agribusiness if time and space allow. Choose a business that may surprise students, such as a grocery store or restaurant. Have the manager discuss such issues as their general accounting and inventory. Ask students to compare this type of business with what they may consider a “traditional” agribusiness such as a farm or grain elevator.*

## Summary of Content and Teaching Strategies

**Objective I:** Identify business and accounting principles and means to measure performance.

**Anticipated Problem:** What are the basic principles associated with running a business and how can business performance be measured?

- I. In a successful agribusiness, funds must always be available. Availability of funds will ensure that all expenses can be met. **Expenses** are the costs related to producing a good or service. Managers can make informed decisions based on the records kept. A **record** is a permanent collection of notes or information. There are four specific types of records a business keeps: balance sheet, profit and loss statement, cash flow statement, and budget projections.
  - A. Financial records do more than aid the manager in making business related decisions. Financial records are also useful in helping a business keep track of financial activities that affect the taxation and regulation of their business. **Taxation** is the principle of levying taxes.
  - B. Financial records can also be used to help a business assess its performance. Business performance can be measured against its performance in past years or against other businesses in the same industry.
  - C. Financial records and transactions are monitored by an accountant. A **transaction** is a business deal or an agreement. An **accountant** is a person who inspects, keeps, and adjusts accounts and financial records. An accountant may also be responsible for pre-

paring financial statements, providing management with estimates based on past data, tax returns, budgets, and government reports.

1. **Accounting** refers to the practice of recording, presenting, and interpreting financial accounts and information. Accounting deals with assets and equities. In accounting, assets equal equities.
2. An **asset** is property owned by a business, either seen or unseen.
3. **Equity** is the value or worth of the property beyond what is owed on it. There are two types of equity. A **liability** is a debt owed to someone outside the business. **Capital** are the properties owned by the business and money borrowed by the business.

Refer to TM: B3–4A, *Basic Accounting Principles*, for a review of the accounting terminology presented in this objective. Reading from the recommended texts may also be useful. Chapter 9 in *Agribusiness* includes a section on financial records that provides excellent information.

**Objective 2:** Explain how financial records are processed.

**Anticipated Problem:** How are financial records processed?

- II. Financial records must be processed so they provide accurate recording and reporting of information, measurement of operational information, assignment of responsibility, and internal control. Records of business transactions can be kept manually or on the computer. A **business transaction** is a business event or activity that must be recorded.
  - A. The first step in the flow of the business transaction is to prepare a document such as a sales ticket, cash receipt, bank deposit, or invoice. An **invoice** is an itemized list of goods or services rendered.
  - B. After preparing the document, the transaction should be recorded in the journal. A **journal** is a book used to record all business transactions with reference to the account to which it belongs.
  - C. After the transaction is recorded in the journal, it is transferred to its specific account by posting it in the general ledger. The **general ledger** contains the balance sheet and income statements.
  - D. The final step of the transaction is the summarization or classification of the account totals for the financial statement.

Use TM: B3–4B, *Flow Followed in Processing Financial Records*, as a review of the process stated in objective two. Assign readings in the recommended resource text. The *Financial Records* section in *Agribusiness* covers the objective in good detail.

**Objective 3:** Explain what a balance sheet is and how one is used.

**Anticipated Problem:** What is a balance sheet and how is it used?

- III. A **balance sheet** is a financial statement that summarizes the assets, liabilities, and net worth of a business. A properly prepared balance sheet will identify what a business owns and owes and its net worth on any specific date.
- A. The main categories on the asset side of a balance sheet include the amount of cash on hand, accounts receivable, notes receivable, inventory, and prepaid expenses.
1. **Accounts receivable** are money claims due to the business by others.
  2. **Inventory** is the merchandise held for sale and the materials used in the process of production.
- B. There are three categories on the liability side of the financial statement. They are current liabilities, long-term liabilities, and total liabilities.
1. **Current liabilities** are those liabilities due within a one-year period. Examples include insurance and property tax.
  2. **Long-term liabilities** include bonds, secured and unsecured long-term notes, and debentures. A **debenture** is a voucher or certificate that acknowledges a debt owed by the signer.
  3. Total liabilities are the sum of the current and long-term liabilities of a business.

*Refer to TM: B3–4C which is a copy of a balance sheet. Additional reading from the recommended resources may be necessary. The Financial Records section of Chapter 6 in the Agribusiness text provides good basic information relating to the objective.*

**Objective 4:** Explain what a profit and loss statement is and how one is used.

**Anticipated Problem:** What is a profit and loss statement and how is one used?

- IV. A **profit and loss statement** is a statement detailing the profits and losses of a business over a given period of time, such as monthly, quarterly, or yearly. A profit and loss statement is also referred to as an income and expense summary or an operating statement. There are four main sections of a profit and loss statement: revenue, expenses, taxes, and “other”.
- A. **Revenue** is the increase in capital resulting from business activities. Sales, services, interest, and dividend income are sources of revenue for a business.
- B. Expenses are the costs related to producing a good or service. Expenses may include operating expenses and depreciation.
- C. Taxes are considered a loss for a business. Income tax and self-employment taxes are counted on the profit and loss statement. However, property and employee taxes are not considered business expenses so they cannot be included on the profit and loss statement.

- D. The “other” section of the profit and loss statement includes other expenses which may arise in the given period of time that are not normally accounted for on the profit and loss statement.

Refer to TM: B3–4D Four Sections of the Profit and Loss Statement to review objective four. Assigned readings in the recommended resource texts will also be useful. Have students read the Analyzing the Agribusiness section in Chapter 6 of the Gibson text.

**Objective 5:** Explain what a cash flow statement is and how one is used.

**Anticipated Problem:** What is a cash flow statement and how is one used?

- V. Cash flow statements are also used to help businesses analyze their financial standing. A **cash flow statement** indicates the amount of income and cash expenses for a business in a given period of time. An accurate cash flow statement enables a business to manage debt more effectively.
  - A. Cash flow statements help show the need for borrowing funds, when those funds will be needed, and when those funds can be repaid.
  - B. Operations, investments, and financing are reported within a cash flow statement.

TM: B3–4E, Cash Flow Statement, is an example of a cash flow statement which should be used as a review for objective five. Have students read the relevant sections of the suggested chapters in the recommended resource texts. The Financial Management Plan section in Chapter 6 of Agribusiness includes good basic information.

**Objective 6:** Identify different types of budgets and their purposes.

**Anticipated Problem:** What are the different types of budgets and what are their purposes?

- VI. A **budget** is a formal financial statement that makes plans for the future. Making a budget projection helps a business compare its actual performance with its desired performance. There are three types of budgets that should be prepared: operating budget, cash flow budget, and capital expenditures budget.
  - A. An **operating budget** is used to summarize the expected sales and production costs for the year. It should include both the estimated sales and expenses for the coming year as well as an estimate of the fixed and variable costs. This should be a positive statement including the management’s plans to increase profit.
  - B. A **cash flow budget** is a summary of when and how much income will flow into the business in the coming year. It shows when cash will be available to the business and when cash payments are due by the business. A cash flow budget does not include credit sales, depreciation, or non-cash expenses.
  - C. A **cash expenditure budget** is a list of capital expenditure items the management intends to purchase along with their expected price. This information will help the business set aside the money needed to make these purchases.

Use TM:B3–4F, *Types of Budgets*, to discuss the definitions of budget, operating budget, cash flow budget, and cash expenditure budget. Use assigned readings in the recommended resource texts to help reinforce the objective. The *Financial Management Plan* section in Chapter 6 of *Agribusiness* may prove useful.

**Objective 7:** Describe how production control records are used.

**Anticipated Problem:** How are production control records used?

- VII. Production control records are used to determine the actual unit cost of an item. This determination is necessary to account for variations in labor and raw material costs.
- A. Production control records usually include information on the raw material used, employees labor time, and a summary of the overall job cost.
  - B. Business managers use the information in production control records to set a profitable selling price for their merchandise.

TM: B3–4G, *Production Control Records*, outlines the types of production control records most businesses keep. Refer to the recommended texts for additional information as needed. LS: B3–4A Manager Profile can be used to review the material covered in this lesson.

**Review/Summary.** Summarize the lesson by reviewing the students learning objectives. The anticipated problems can be used as student review questions. Chapter reviews from the books listed on the resource list may also be useful.

**Application.** The following student activity can be used to apply the student learning objectives:

LS: B3–4A Manager Profile

**Evaluation.** Evaluation should be based on student comprehension of the learning objectives. This can be determined using the attached sample written test.

## Answers to Sample Test:

### Part One: Matching

1. a
2. f
3. g
4. c
5. e
6. d
7. h

8. b

**Part Two: Completion**

1. Accounting
2. invoice
3. Current liabilities
4. accounts receivable
5. Long-term liabilities

**Part Three: Short Answer**

1. Revenue, expenses, taxes, other
2. Operating budget: used to summarize the expected sales and production costs for the year
3. Cash flow budget: a summary of when and how much income will flow into the business in the coming year
4. Cash expenditure budget: a list of capital expenditure items the management intends to purchase along with their expected price.

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# Test

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## Lesson B3–4: Using Financial Statements in Business Decisions

### Part One: Matching

*Instructions.* Match the term with the correct response. Write the letter of the term by the definition.

- |                  |                |
|------------------|----------------|
| a. balance sheet | e. budget      |
| b. expense       | f. accountant  |
| c. capital       | g. transaction |
| d. journal       | h. revenue     |

- \_\_\_\_\_ 1. A financial statement that summarizes the assets, liabilities, and net worth of a business.
- \_\_\_\_\_ 2. A person who inspects, keeps, and adjusts accounts and financial records.
- \_\_\_\_\_ 3. A business deal or agreement.
- \_\_\_\_\_ 4. Properties owned by the business and money borrowed by the business.
- \_\_\_\_\_ 5. A financial statement that makes plans for the future.
- \_\_\_\_\_ 6. A book used to record all business transactions with reference to the account to which it belongs.
- \_\_\_\_\_ 7. The increase in capital resulting from business activities.
- \_\_\_\_\_ 8. A cost related to producing a good or service.

### Part Two: Completion

*Instructions.* Provide the word or words to complete the following statements.

1. \_\_\_\_\_ is the practice of recording, presenting, and interpreting financial accounts and information.
2. An \_\_\_\_\_ is an itemized list of goods or services rendered.
3. \_\_\_\_\_ are those liabilities due within a one-year period.
4. \_\_\_\_\_ are money claims due to the business by others.
5. \_\_\_\_\_ include bonds, secured and unsecured long-term notes, and debentures.



# **BASIC ACCOUNTING PRINCIPLES**

- ➔ **Expenses**
- ➔ **Record**
- ➔ **Taxation**
- ➔ **Transaction**
- ➔ **Asset**
- ➔ **Equity**
- ➔ **Liability**
- ➔ **Capital**

# **FLOW FOLLOWED IN PROCESSING FINANCIAL RECORDS**

**Business  
Transaction** → **Prepare  
Document** →

**Record  
in Journal** → **Post to  
General  
Ledger** →

**Classify into  
Financial  
Statement**

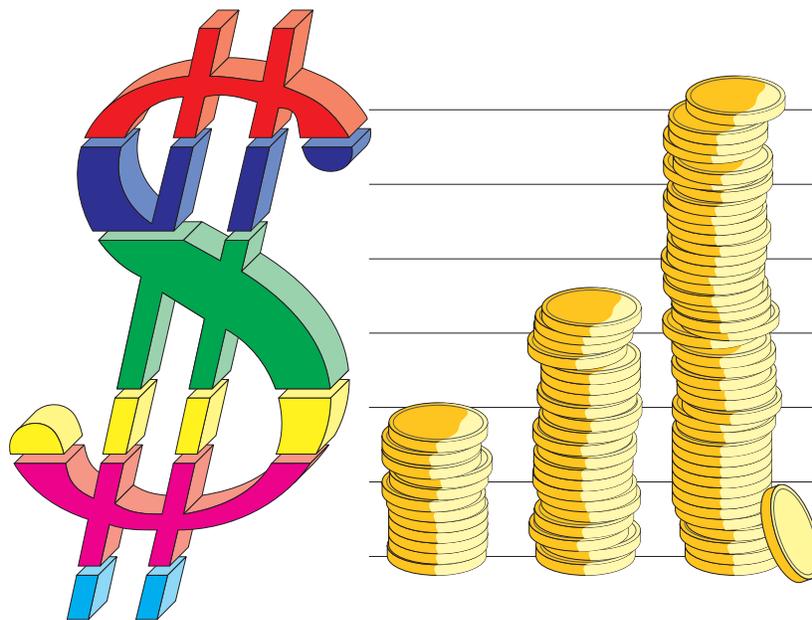
TM: B3-4C

**Balance Sheet for Fenix Farm Supply Co.  
As of December 31, 20—**

Cash	\$263,000	
Net Receivables	349,000	
Inventory	493,000	
Other Current Assets	14,000	
<b>Total Current Assets</b>		<b>1,119,000</b>
Investments	365,000	
Fixed Assets (Net)	1,177,000	
Other Assets	18,000	
<b>Total Long-Term Assets</b>		<b>1,560,000</b>
<b>Total Assets</b>		<b><u>\$2,679,000</u></b>
Accounts Payable	300,000	
Notes Payable	600,000	
<b>Total Current Liabilities</b>	<b>900,000</b>	
Long-Term Debt	835,000	
<b>Total Liabilities</b>		<b>1,735,000</b>
Capital	489,000	
Retained Earnings	455,000	
<b>Net Worth</b>		<b>944,000</b>
<b>Total Liabilities and Net Worth</b>		<b><u>\$2,679,000</u></b>

# FOUR SECTIONS OF THE PROFIT AND LOSS STATEMENT

- ➔ Revenue
- ➔ Expenses
- ➔ Taxes
- ➔ Other



**A Summary of the Sources and Uses of Cash for  
Fenix Farm Supply’s Balance Sheet Using the Changes  
Given in the Example**

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**Statement of Cash Flow  
for the Fiscal Year Ending December 31, 20—**

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**SOURCES OF CASH (Cash Provided [Used])**

**Operating Activities**

<b>Net Income from Operations</b>	<b>\$16,000</b>
<b>Non-Cash Charge to Operations—Depreciation</b>	<b><u>20,000</u></b>
	<b>36,000</b>
<b>Increase of Accounts Receivable</b>	<b>(25,000)</b>
<b>Decrease of Inventory</b>	<b>10,000</b>
<b>Increase of Accounts Payable</b>	<b><u>12,000</u></b>
	<b>(3,000)</b>
<b>Total Sources of Cash from Operations, Net</b>	<b>\$33,000</b>

**Investing Activities**

<b>Purchase of Additional Securities</b>	<b>(20,000)</b>
<b>Purchase of Equipment</b>	<b><u>(15,000)</u></b>
<b>Total Uses of Cash from Investment</b>	<b>(35,000)</b>

**Financing Activities**

<b>Retirement of Debt</b>	<b><u>(8,000)</u></b>
<b>Total Uses of Cash from Financing</b>	<b>(8,000)</b>

<b>NET INCREASE (DECREASE) TO CASH</b>	<b><u><u>(\$10,000)</u></u></b>
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## **TYPES OF BUDGETS**

**Budget:** a formal financial statement that makes plans for the future.

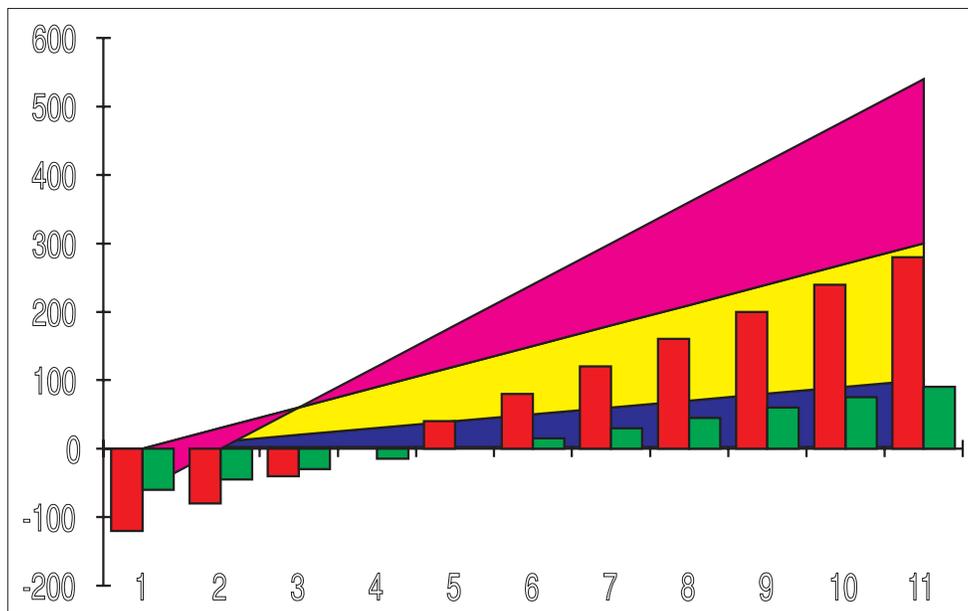
**Operating budget:** used to summarize the expected sales and production costs for the year.

**Cash flow budget:** a summary of when and how much income will flow into the business in the coming year.

**Cash expenditure budget:** a list of capital expenditure items the management intends to purchase along with their expected prices.

# PRODUCTION CONTROL RECORDS

- ➔ Raw material used
- ➔ Employee labor time
- ➔ Summary of the overall job cost



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# **Lab Sheet**

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## **Manager Profile**

*Instructions:* Interview the manager of a local agribusiness. Determine the types of financial statements used in making their business decisions. Find out how these statements improve the decision making process. Prepare a written report on your findings.