

**Risk Management Training
for Diversified Family Farmers**

Workbook 3

Managing Financial Risk

Managing Financial Risk

Financial Strength Quiz

- ___ Q 1. What letter grade (A, B, C, D, or F) would you give to judge the financial strength of your farm?
Put the number of points indicated below, "A" being the best.
A = 5 B = 4 C = 3 D = 2 F = 1
- ___ Q 2. How likely is it that your farm could survive a year of bad yields or bad prices?
A. Very Likely B. Somewhat Likely C. Very Unlikely
Put minus 1 point if you answered "Very Unlikely." Otherwise put zero.
- ___ Q 3. How much would the following affect your farm?- "a lot," "some," or "not much."
Put minus 1 point for each time you answer "a lot," otherwise put zero.
___ a 3% point rise in interest rates
___ a 5% drop in revenues
___ a 5% increase in expenses
- ___ Q 4. Do you worry about whether you'll be able to pay back the debt you own?
If yes, put minus 1 point, otherwise put zero.
- ___ Q 5. Do you always pay off the balance on your credit cards on time to avoid paying a finance charge on the outstanding balance?
If no, put minus 1, otherwise put zero.
- ___ Q 6. Compared to other farms, is your farm successful?
If no, put minus 1 point, otherwise put zero.
- ___ Q 7. Over the next five years, do you expect your earnings to increase?
If no, put minus 1 point, otherwise put zero.
- ___ Q 8. What were your farm's total profits after expenses last year? Put in the number of points below.
1 = Lost money 4 = \$25,000 to \$49,999
2 = Less than \$10,000 5 = \$50,000 to \$99,999
3 = \$10,000 to \$24,999 6 = \$100,000 or more
- ___ Q 9. What is your farm's debt-to-asset ratio? That is, your total debt/your total assets? ___%
Subtract the number of points indicated below.
1 = Zero (no debt) 2 = 1 to 10% 3 = 11 to 40% 4 = 40 to 60% 5 = > 60%

_____ TOTAL POINTS

SCORING SYSTEM

Zero or less = ☆

One to three = ☆☆☆

Four to six = ☆☆☆☆

Seven or more = ☆☆☆☆☆

How to Choose and Use a CPA

You look to your CPA at tax and audit time, of course. But your CPA can promote personal and professional financial security year round.

Do you need personal financial planning advice? A business consultant? Software guidance? Are you getting married? Coming into sudden wealth? Your CPA can assist you.

How Do You Know If You Need a CPA?

You should consider seeking the advice of a CPA if you:

- Have lost property in a flood, earthquake, or other natural disaster.
- The California Society of CPAs has a free brochure entitled *Picking up the Pieces* that offers tax and financial information for disaster victims. To order, call (800) 922-5272.
- Marry, separate, divorce, or your spouse dies. experience sudden wealth. have sold or are planning to sell inherited real estate or securities.
- Are self-employed and want to take all the deductions to which you're entitled.
- Need advice on handling stock options.
- Move into or out of California and you owe taxes in two states.
- Aren't sure whether or not to itemize deductions or take the standard deduction.
- Pay foreign taxes or hold an investment that is subject to foreign tax.
- Support a child, grandchild, or parent who may qualify as a dependent, and/or your spouse are nonresident aliens.
- Have work that takes you out of the United States.
- Have a "SEP" IRA or Keogh account.
- Need to choose from your employer's "cafeteria" plan.
- Are or are about to become a trustee, executor, legal guardian or conservator.
- Are nearing retirement and own property or other assets that generate low income relative to their worth.
- Wish to sell or transfer an asset in a way that minimizes your exposure to capital gains tax and leaves you more proceeds for reinvestment and higher retirement income.
- Retirement income production.
- Hold an IRA with significant value.
- Are nearing age 70 and approaching the time when you must begin taking distributions from your IRA.
- Wish to consider estate taxes and other variables in determining the size of your IRA distributions.
- Win a large prize in a lottery or sweepstakes and receive a Form 1099.

Services CPAs Provide

Business Financial Services

- Conducting special studies on financing, inventory management, cost control, credit, and collection for business, government and nonprofit organizations.
- Consulting on accounting aspects of business problems.
- Developing budgets and forecasts.
- Auditing financial statements and reporting on them for the client's use with investors, creditors, and management.

- Setting up accounting systems.
- Performing compilation and review services.
- Assisting clients in obtaining financing.

Management Consulting

- Reviewing and setting up management information systems that meet a company's needs.
- Evaluating the results of operations and forecasting the effects of alternative plans to facilitate management decisions.
- Analyzing operations and suggesting changes in structure and individual responsibilities.
- Helping clients institute a corporate planning process to control current operations, manage risk, translate long-range plans into attainable goals.
- Increase profits and market share.
- Helping businesses improve the use of their resources, increase their efficiency, and achieve their objectives.

Personal Financial Services

- Devising savings and investment strategies.
- Providing personal financial planning advice regarding such things as saving for a child's education, buying a new home, planning for retirement.
- Estate planning.
- Assisting clients in securing loans and credit by gathering information required by a lending agency.
- Projecting future income and expenses.

Tax Advisory Services

- Suggesting short-term and long-term strategies for lowering tax liabilities.
- Helping clients comply with tax laws.
- Providing retirement and estate planning to reduce the impact of estate and inheritance taxes.
- Preparing tax returns.
- Assisting clients with federal, state and local tax problems.
representing individuals before government agencies.

Human Resources Consulting

- Providing recommendations for compensation policies and practices.
- Designing compensation, fringe benefit and retirement plans for businesses.
- Assisting in the development of job descriptions, personnel policies, systems and manuals.

Litigation Consulting

- Assisting attorneys in litigation situations by analyzing financial data, developing damage studies or business valuations and serving as expert witnesses.
- Assisting with court appearances.
- Dealing with attorneys and bankers in business mergers or expansions.

Auditing and Accounting Services

- Preparing, compiling, reviewing, and auditing financial statements.
- Examining a company's financial records, transactions and reporting procedures to ensure a company's financial position is reported fairly to its stockholders.

Factors to Consider When Choosing A CPA

Trust

It's important to establish a practitioner's credentials before you retain his/her services. You need to feel that this person has integrity and honesty before you will trust him or her with your financial information. Ask friends and colleagues for references and interview the practitioner. Be aware that fee structures vary and that different types of practitioners have different levels of training and experience. CPAs are the most highly educated and trained tax professionals and are distinguished by their state certification, which allows only CPAs to be called "accountants" in California.

Chemistry

Keep in mind that you are looking to establish a long-term relationship. You want someone who will learn your business inside and out, who will become a trusted advisor on major business and financial decisions and transactions. Look not only for technical competence but also for interpersonal and communication skills.

The Future

Defining your objectives and expectations will help you ask the kind of specific questions necessary for finding the CPA best suited to your needs.

Think about the services you will need not just today but farther down the road. Will you need someone familiar with compensation issues, government compliance, and/or international business?

Experience

CPAs act as advisors to individuals, businesses, financial institutions, nonprofit organizations, and government agencies on a wide range of financial matters. CPAs can provide help with tax preparation, building college funds, planning for retirement, and creating estate plans.

Versatility

CPAs wear many hats: auditor, personal financial planner, tax advisor, management consultant, corporate financial advisor.

Affiliation

One of the best methods for finding a CPA is to get a referral from friends, family, or business associates. You can also use the California Society of CPAs' Find a CPA Service, which allows you to search for a CPA by location, specific services, languages spoken and experience.

Questions to ask before choosing a CPA

Does the individual hold an active CPA license?

To earn the CPA designation, accountants must pass a rigorous two-day professional examination and meet stringent licensing requirements. To assure that they stay current on developments in the field, the California Board of Accountancy requires all licensed CPAs to meet certain education requirements.

Are you comfortable with the CPA's personality and communication style?

Keep in mind that a long-term working relationship between you and your CPA can help you take an informed, consistent approach to personal financial and business problems and may help you meet your financial goals.

Does the CPA have the expertise you need?

During your interview, let the CPA know clearly the kinds of assistance you need. Then ask about his or her qualifications, profiles of typical clients, and availability to work with you.

How much should you expect to pay for the CPA's services?

Be sure to talk openly about how the CPA will be compensated for his or her services.

Normally, CPAs base their fees on the amount of time they spend performing services on your behalf. The services you need, the complexity of your financial situation, the experience level of the CPA, and where you live will all impact the level of fees your CPA charges.

To what professional organizations does the CPA belong and how active is he or she in those organizations and in your community?

CPAs who are members of the California Society of CPAs and the American Institute of CPAs (AICPA) must meet additional continuing education requirements and are obliged to adhere to stringent ethical guidelines.

How to get the most value from a CPA's services

- Be prepared to discuss your plans and objectives. CPAs are in the best position to advise you and serve your interests when they understand your goals.
- Gather information about business or personal financial decisions under consideration so you can ask the CPA specific questions.
- Clearly explain what you expect from the CPA's services.
- Save yourself unnecessary fees by keeping good records and not using professional time for routine work.
- Let your CPA know about your attitudes toward spending and saving, your tolerance for risk, and whether you prefer to take an aggressive.
- Conservative approach to tax-saving strategies.
- Keep your CPA informed of changes in your personal and professional life (such as marriage, divorce, the birth of a child, a new home, death of a spouse, or a career change) that may impact your tax liability and personal financial goals.

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Loss Payment Example

Assumptions

Approved AGR of \$94,900

AGR 5-year average expenses of \$63,480.

Adjusted gross income of \$21,000 (revenue to count).

80 percent coverage level and 90 percent payment rate.

Determining Loss:

Approved AGR of \$94,900 x 80 percent coverage level = \$75,920.

\$75,920 – \$21,000 revenue to count = \$54,920 loss of revenue.

\$54,920 x 90 percent payment rate = \$49,428 indemnity due the insured.

If a 75-percent payment rate had been selected, the indemnity due would be \$41,190.

Note: If the insured's allowable expenses for the current crop year fall below 70 percent of the approved expenses ($\$63,480 \times 70 \text{ percent} = \$44,436$), the approved AGR will be reduced.

This summary is for general illustration purposes only. Please contact a private crop insurance agent to learn more about AGR.