The Business of Fishing: Managing Finances

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This publication looks at financial management systems and tools for a fishing operation.

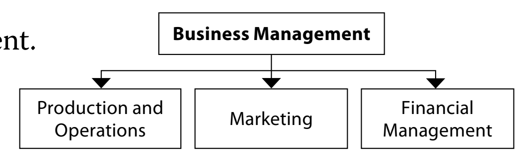
A commercial fishing operation is a busy business, typically employing one to four people. A great deal of work occurs before the fishing starts. Once underway, a vessel crew navigates treacherous waters, catching fish for hours and days on end. The operation must run smoothly and deliver the fish in time to reap the rewards.

Running a fishing business is unlike any other—demanding skills in operating a vessel at sea, knowing where the fish are, taking a high personal risk, etc. It is no wonder that the women and men who thrive in this industry are not always eager to hunker over a desk to analyze boring finances. However, managing the dollars is an important business function. If it is not done, it is a lost opportunity for reaping greater rewards from one's hard work.

What Is Financial Management?

Business management is a broad term that covers three business functions, including financial management. These functions are

- Production/Operations Management.
- Marketing.
- Financial Management.



Production and operations is job number 1 in a fishing operation. A fisherman is the ultimate jack-of-all-trades—part harvester, engineer, seaman, mechanic, weatherman, boss, and cook. A successful fisherman needs all these skills, either personally or through his crew.

While finding a good buyer is crucial, marketing activities are typically uncomplicated. Unless a fisherman launches into direct marketing her catch, marketing is a limited function.

Financial management involves developing accurate business records, controlling finances for better business decisions, and analyzing future opportunities. Effective financial management helps

- Pay bills on time.
- Reduce the need for borrowing and taking on debt.
- Identify high costs in your operation.
- Maintain the vessel and equipment in a timely manner.
- Minimize today's tax burden and for future investments.

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- Evaluate future investments.
- Plan for retirement.

Successful financial management requires

1. Information.
2. A record-keeping system.
3. An accounting method.
4. Financial statements.

Once these pieces are in place, an owner can work alone and/or with other professionals on more complex financial activities.

Work during a fishing season leaves little time for managing finances. Having a convenient in-season system to collect records is important.

Collecting Records

Early maintenance kicks off a season that does not stop until the boat is winterized and the crew safe and sound. There may be little time for a captain to manage finances in-season. Still, there must be a simple system in place for collecting and organizing in-season transactions.

According to the 2001 Fishing Information Newsletter from the Internal Revenue Service on collection tips for fishermen (http://www.irs.gov/businesses/small/industries/article/0,,id=112707,00.html), a good record collection system should

- Have supporting documentation for all transactions related to gross income, purchases made for resale (not too common in fishing), and operating expenses.
- Maintain records on asset transactions, including buying, selling, and depreciation.
- Keep business expenses separate from personal expenses.
- Separate personal and business activity for assets used in both functions, like a vehicle or home.

A fisherman needs good documentation in an IRS audit. Receipts, cancelled checks, bills, etc., should suffice. Certain expenses, like travel and food, require backup related to business purposes. Some fishermen throw all the business receipts into a shoebox during the season. A simple improvement is to put receipts into separate folders based on whether they are related to income, expenses, assets, or liabilities. The more you do to organize the books, the less it costs to pay a bookkeeper to do it.

Know the Basics: Commercial Fishing Accounts

Accounts are the building blocks of accounting. Accounts are categories or titles used to organize like business transactions. For example, fish sales to a processor are recorded in a "sales" account. The money received from the sale is recorded to a "cash" account. When money is earned for the sale of fish, the accounting world increases the "cash" account and increases the "sales" account.

Each business calls its accounts the "chart of accounts." Some accounts are common, while others are unique to a type of business. Here are a few accounts fishing businesses might use.

Asset Accounts	Liability/Debt Accounts	Income Accounts	Expense Accounts
• Cash	• Accrued taxes	• Sales—processor	• Fuel
• Fishing permit	• Permit loan		• Crew share
• Accounts receivable—from processor	• Vessel loan		• Bait and ice
• Vessel and equipment	• Crew share owed		• Permit fees
• Individual Fishing Quota	• Fuel payable		• Interest expense
• Investments	• Short-term debt		• Vessel insurance

Bookkeeping Systems: Single vs. Double Entry Method

With information in hand, a fisherman will do his own books or hire someone. In either case, it helps to know the two bookkeeping methods—single and double entry—to determine what method works best for you.

The *single-entry method* records to only one account for each transaction. The account is a revenue or expense account. (See above "Know the Basics: Commercial Fishing Accounts.") For example, a fuel purchase is recorded as an increase to the "fuel expense" account. Fish sold is recorded as an increase in revenues. No "cash" account is increased or reduced.

In the *double-entry method*, transactions impact at least two accounts. In the examples above, a "cash" account is decreased with the fuel purchase and increased with the fish sales.

The double-entry system makes use of two accounting terms—"debits" and "credits." There is nothing good or bad about debits and credits in an accounting sense—it is just a method for adding and subtracting accounts. Check out the next insert on debits and credits to see how they work.

Just like at the pump, fishermen have a choice in which kind of bookkeeping systems they employ.

Pros and Cons of Single vs. Double Entry

Single entry is simpler than double entry, and makes sense if the fishing operation targets a single species for a short duration. The single-entry method is okay for filing tax returns. If that is the extent you want to manage the finances, you do not need to go further.

A double-entry system develops a complete financial picture, encompassing income and expenses, and assets and liabilities. The accrual accounting method (discussed in the next section) requires double-entry bookkeeping.

To Debit or To Credit. That Is the Question.

As the title suggests, there is no mystique to debits or credits in the accounting world. Debits and credits help organize an accounting system.

Individual accounts classified as assets, expenses, or owner's withdrawals are "debit" accounts. Records list an increase in a debit account as a debit. Transactions that decrease a debit account are credits. Individual accounts classified as income, liabilities, or owner's equity accounts are "credit" accounts. Records list an increase to a credit account as a credit, while decreases to credit accounts are debits.

For example, fish is sold for $10,000 on July 10 and fuel is bought for $2,500 on July 11. Here are the recordings under a double-entry system.

Date	Transaction	Debit	Credit	Comments
July 10	Cash	$10,000		Cash is an asset and debit account. Increases in cash are recorded as debits.
	Sales		$10,000	Sales are an income and credit account. Increases in sales are recorded as credits.
July 11	Fuel expense	$2,500		Fuel is an expense and debit account. Increases in fuel expenses are recorded as a debit.
	Cash		$2,500	Decreases in cash are reflected as a credit.

Fishermen can choose between using the simple "cash" accounting method, or the more accurate "accrual" accounting method.

Accounting Methods: Cash vs. Accrual Methods

There are two accounting methods, cash and accrual. Deciding which method to use depends on how important it is to know when a transaction actually happens versus when the money actually changes hands.

A *cash accounting system* records transactions when money changes hands. An *accrual accounting system* records transactions when they are realized.

For example, fish is sold for $10,000 to a processor on June 25. The processor pays on July 10. In a cash system, the revenue is recorded when received—July 10. In an accrual system, revenue is recorded when the product is sold, June 25. It is money recognized as earned, even if it is not in hand.

Pros and Cons of Cash vs. Accrual

The cash method is simple. Several Alaska fishing operations target a single species and operate for only a few months of the year. For these operations, the simple cash method is sufficient.

Most fishing businesses do not carry several accounts owed on or due to, past a reporting taxable year. Without accounts that lapse from year to year, employing a time-sensitive accrual system is not as crucial. The cash method also provides an accurate picture of your cash position.

An accrual system is more timely, providing a realistic look at events for a time period. This may help a fisherman who fishes several permits and species throughout the year and wants to know the profitability of each fishery.

An accrual system is better for budgeting. For example, $5,000 of shipyard work is performed in April and not paid for until the end of July. Meanwhile,

Accountant Alert!

JoLynn Blancher, CPA with Thomas, Head & Greisen in Anchorage, reminds us it is critical to understand the tax implication behind cash and accrual methods.

Cash basis pays taxes on money when received, while the accrual basis pays taxes on money when earned, even if it is not yet received.

Under an accrual method, you may be paying taxes on money you have yet to receive. Generally this tax amount may be small, given that most commercial fishing financial transactions are complete by the end of the tax year.

Cash-basis taxpayers can prepay January bills if they wish to take the deductions in the current year. They will, of course, not be able to take those deductions the following year.

In a cash system, a transaction is recorded when cash changes hands, for example when cash payments are received from the processor.

the yard charges 15% interest, which totals $188. Using the cash method, records show a *Vessel Maintenance Expense* in July for $5,000 and an *Interest Expense* for $188. Yet for budgeting purposes, it's important to know the expense occurred in April with interest charges accruing each month thereafter. A more accurate picture of spending patterns may improve budgeting and help avoid interest charges in the future.

In an accrual system, transactions are recorded when there is an exchange of value whether it involves cash or not, for example when a fisherman sells his fish to the processor to be paid later in the season.

The Bottom Line

Beyond doing what is legally required by the IRS and other regulatory agencies, you can structure your business finances to meet your needs. Even if you opt for a simple accounting system today, knowing the strengths of other methods may lead to change down the road if it makes sense.

The IRS prefers the accrual method and even requires it for some businesses. The IRS accepts the cash method for fishing operations. However, the IRS does not allow a business to switch its reporting method back and forth without taking certain steps. If you want to switch from cash to accrual basis for tax purposes, you need to understand all the requirements to stay out of hot water with the IRS.

Financial Statements

There are three main reports that analyze business finances.

- Balance sheets.
- Income statements.
- Cash-flow statements.

Each is relevant for a fishing operation and lends insight into an operation's effectiveness. As owners become more familiar with these statements, the business will understand when money is scarce. They will also know how productive the assets are and whether the business is profitable.

Balance Sheets

Balance sheets show an owner's net worth in a business at a given point in time. As the name suggests, a balance sheet measures the assets (what is owned) against the liabilities (what is owed). The difference between the two is the net worth, or equity.

Balance sheets separate assets and liabilities as "current" or "long-term." Current accounts are realized within a year. This helps determine if there is enough cash on hand to pay upcoming bills.

Long-term assets are fixed assets, like equipment and vessels, or fishing permits and quota. Long-term debts are often remaining loan principal balances due beyond the next year.

If you do not currently make balance sheets for your business, determine if it makes sense to you.

Table 1. Sample Fishing Operation Balance Sheet.

ACME FISHING
Balance Sheet
For the Period Ending December 31, 200Y

Assets		**Liabilities**	
Current Assets		**Current Liabilities**	
Cash	**$5,870**	**Accounts payable—shipyard**	**$3,200**
A/R[a] from processor	$8,800	Crew share payable	$2,300
Prepaid mooring, boatyard	$600	Deferred taxes	$350
Short-term investments	$5,900	Current debt	$2,300
Inventory—finished product	$5,790		
Total current assets	**$26,960**	**Total current liabilities**	**$8,150**
Long-Term Assets		**Long-Term Liabilities**	
Vessel, equipment, gear	$156,000	Vessel and equipment loans	$99,680
less accumulated depreciation	$(109,800)	Permit/IFQ loan	$56,500
Net vessel	$46,200		
Permits and IFQ	$87,400		
Capital construction fund	$35,600		
Retirement investments	$125,900		
Total long-term assets	**$295,100**	**Total long-term liabilities**	**$156,180**
		Total liabilities	**$164,330**
		Equity	
		Capital contribution	$25,000
		Retained earnings	$132,731
		Total equity	**$157,731**
Total assets	**$322,060**	**Total liabilities and equity**	**$322,061**

[a]A/R = accounts receivable.

Income Statements

You know an income statement if you study your tax returns. Income statements take sales from normal operating activities and subtract expenses. This shows an operation's profits for a period of time, typically a month, quarter, or year. Although financing and investment activities generate and use money, they are not listed on an income statement, aside from interest expense.

An income statement has three sections. The first section shows money earned from normal business activity, generally called *sales or revenue*.

The second section contains *operating expenses*. Operating expenses directly relate to producing revenues and are variable based on the amount of activity. In a fishing operation, these expenses include fuel, bait, ice, crew share, grub, and fishing supplies. The level of activity directly impacts operating expenses. Operating expenses are low if the boat never leaves the harbor.

Ice is a typical operating expense along with crew share, fuel, and bait.

Table 2. Sample Income Statement.

ACME FISHING
Income Statement
For the Year Ending December 31, 200Y

Gross revenues	$135,980	
less sales discounts and allowances	$(550)	
Net revenues		$135,430
Cost of harvesting		
Crew shares	$20,250	
Provisions	$2,115	
Fuel and lube	$9,790	
Gear	$2,500	
Bait and ice	$500	
Taxes, fees, and assessments	$475	
Misc. operating costs	$1,790	
Cost of harvesting available for sale		**$37,420**
Gross profit		$98,010
Selling, general and administrative		
Port and harbor costs	$2,200	
Vessel maintenance	$6,000	
Permit and IFQ fees	$150	
Depreciation and amortization	$17,500	
Vessel insurance	$3,600	
Professional fees	$950	
Office expenses	$4,250	
Total selling, general, and administrative		**$34,650**
Operating profit		$63,360
Interest expense	$6,000	
Net income before taxes		$57,360
Taxes	$13,680	
Net income after taxes		$43,680

The third section of an income statement includes all the non-product expenses. These expenses are generally fixed expenses, and may include vessel insurance, permit fees, vessel maintenance, office expenses, marketing and selling costs, and storage.

Interest expense and income tax are deducted separately after operating and fixed expenses.

An income statement does more than show profitability. It helps identify excessive expenses such as ever-increasing interest charges. Income statements can also determine production break-even points by comparing revenues to operating costs.

A break-even point is the level of production necessary for a business to pay all of its expenses. A break-even point is calculated by determining the average fixed expenses, divided by the price per unit sold less the variable cost per unit sold. The resulting number is the required production necessary to break even.

The purchase of gear is one of the biggest recurring expenses in the overall cost of harvesting.

For example: A fisherman has $10,000 in fixed expense, and determines it costs $0.35 per lb on average to catch a pound of fish. The average ex-vessel price for fish is $0.75 per lb. The break-even point determines the fisherman must catch 25,000 pounds before she starts to make any money. The breakeven equation is

$$\frac{\text{Fixed Costs}}{\text{Ex-vessel/lb} - \text{Variable cost/lb}} = \frac{\$10{,}000}{(\$0.75/\text{lb} - \$0.35/\text{lb})} = \frac{\$10{,}000}{\$0.40} = 25{,}000 \text{ lbs}$$

Cash Flow Statement

Cash flow statements determine a business's real cash position by determining where cash came from and where it went. Cash flows, usually prepared monthly, detail all the uses and sources of cash from operating, investing, and financing activities. Statements are prepared under two different methods, direct or indirect.

This is important to assure there is enough money to pay the bills. Strong historical cash flow statements also help an individual budget or project for the future.

The first section contains cash flow from operations. The operating section eliminates all the noncash account transactions like accounts receivable and depreciation, leaving just the net cash effect. The *direct method* starts with the net sales and deducts all the real cash operating expenses. The *indirect method* starts with the net income and adds back noncash transactions. Regardless, either method results in the same measure of cash flows from operations.

The second section captures investment activities. Investment activities that increase the cash on hand include selling off investments like permits, vessels, or mutual funds. Investment activities that decrease cash, meaning the company is investing money, might include purchase of vessels, equipment, permits, certificate of deposits (CDs), stocks, or mutual funds.

The final section captures the payments and receipts from financing activities. Financing activities might include money increases from taking more loans out, sale of bonds, or capital contributions. Cash decreases might come from paying off loans and bonds, and buying partners out of the business.

Table 3. Sample Cash Flow Statement.

ACME FISHING
Statement of Cash Flows
For Year Ending December 31, 200Y
Direct Method

Cash Flow from Operating Activities		
Cash received from customers		$143,220
Less cash paid for:		
Inventory	$21,829	
Wages	$21,219	
Other operating expenses	$15,450	
Interest	$7,500	
Income taxes	$21,600	
		$87,598
Net cash provided by operating activities		**$55,622**
Cash Flow from Investing Activities		
Purchase of equipment	$(8,000)	
More money spent on investments	$(16,000)	
Increase (decrease) in capital construction fund	$(13,300)	
Increase in permits	$(8,200)	
Net cash from operating activities		$(45,500)
Cash Flow from Financing Activities		
Increase (decrease) in vessel loan	$(16,480)	
Increase (decrease) in current debt	$(1,530)	
Increase (decrease) in permit/ IFQ loans	$7,200	
Net cash used in financing activities		**$(10,810)**
Net increase in cash		$(688)
Cash position January 1, 200Y		$5,871
Cash position December 31, 200Y		$5,183

ACME FISHING
Statement of Cash Flows
For Year Ending December 31, 200Y
Indirect Method

Cash Flow from Operating Activities		
Net income		$33,272
Add (Deduct) Noncash Effects on Operating Activity		
Depreciation expense	$20,400	
Decrease (increase) in accounts receivable	$(2,300)	
Decrease (increase) in inventory	$4,400	
Decrease (increase) in prepaid rent	$100	
Increase (decrease) in accounts payable	$(2,650)	
Increase (decrease) in wages payable	$1,900	
Increase (decrease) in deferred taxes	$500	
		$22,350
Net cash provided by operating activities		**$55,622**
Cash Flow from Investing Activities		
Purchase of equipment	$(8,000)	
Decrease (increase) in investments	$(16,000)	
Decrease (increase) in capital construction fund	$(13,300)	
Decrease (increase) in permits	$(8,200)	
Net cash used in investing activities		$(45,500)
Cash Flow from Financing Activities		
Increase (decrease) in vessel loans	$(16,480)	
Increase (decrease) in current debt	$(1,530)	
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Net cash used in financing activities		**$(10,810)**
Net increase (decrease) in cash		$(688)
Cash January 1, 200Y		$5,871
Cash December 31, 200Y		$5,183

Final Thoughts

This publication outlines the basic building blocks for financial management. As time goes on, these topics will become more familiar to you. If you do not understand all the material in this Sea Gram, try rereading it in a few weeks. Even if you hire someone to take care of your books, it is important to understand these basic concepts.

Above all, think creatively about the kind of financial information you want to know about your business. With the essential systems and tools in place, you may start looking at your fishing operation in a new light.

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Net some savvy and greater profits by applying tips presented in these business management publications from Alaska Sea Grant.

Financial Statements and Business Calculations for Commercial Fishermen, & Alaska Fish Business Plan
http://seagrant.uaf.edu/bookstore/pubs/MAB-58.html

Developing Cooperatives for the Alaska Seafood Industry
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Tips for Direct Marketers: The Onboard DEC Inspection
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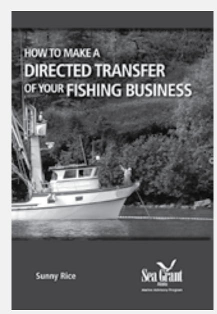
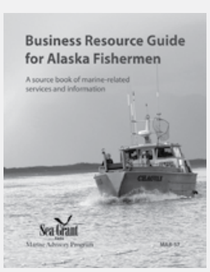


How to Make a Directed Transfer of Your Fishing Business
http://seagrant.uaf.edu/bookstore/pubs/MAB-59.html



Business Resource Guide for Alaska Fishermen
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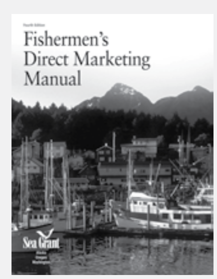

Fishermen's Direct Marketing Manual
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