**Income Statement Exercise**

Accrual-Based Income Statement for 2019:

The income statement summarizes all the revenue and expenses for the year. As you can see, cash farm income includes fleece sales worth $1200, lamb sales of $7800, cull ewe sales of $480, and sales of guard dog puppies totaling $2,000. Gross farm income was $11,480. Cash farm expenses totaled $11,356, consisting mainly of interest on loans, feed, fertilizer, repairs, utilities, and veterinary expenses. The net cash farm income was $124.

Accrual adjustments include the following. The value of the feed inventory was $1,200 higher at the end of the year than at the beginning. The value of the fleece inventory was $800 higher at the end of the year. The market livestock was estimated to be $1,000 higher at the end of the year. Accounts receivable were $200 less, and prepaid expenses and supplies were $500 less. After adjusting for these items, net operating profit was $2,424.

Ownership cost adjustments include depreciation on breeding livestock of $180. Only purchased breeding livestock can be depreciated; if you raise them on-farm, you can’t depreciate them. This ram cost $1000 and has an estimated salvage value of $100. It’s expected useful life is 5 years. Annual depreciation on a purchased trained border collie was $200, based on a $1200 price and a 6-year life. Annual depreciation on machinery was calculated as $300, based on a $4500 market value, $1500 salvage price, and a 10-year life. Annual depreciation on titled vehicles was estimated at $600, based on a $8500 market value, $2500 salvage value, and a 10-year life. Annual depreciation for the barns and fences was calculated as $1250, based on a $25,000 current value and a 20-year life, no salvage value. Interest on retained livestock is calculated as the total value of the breeding livestock multiplied by your opportunity cost on capital, estimated at 5% per year.

Discussion Questions:

1. Would you be happy with the bottom line on the income statement? Why or why not?
2. Do you think this is a common situation on a small farm? How would you explain the economic situation to Kate? Is her equity eroding, given her current operation?
3. How does the status of the farm differ from Jan 1 2019 to Jan 1 2020?
4. Is the farm in a stronger position or a weaker position on Jan 1 2020? Why?