



Financial Fitness for Farmers Part 2 Balance Sheets

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Today's Presenter



Kate Painter, presenter

Extension Educator- Agriculture
University of Idaho Extension, Boundary County



Colette DePhelps, facilitator

Area Educator, Community Food Systems
University of Idaho Extension, Northern District



What is an Income Statement?





Income Statement Defined

- Summarizes the revenue and expenses for a given accounting period
- Also called a profit-and-loss statement





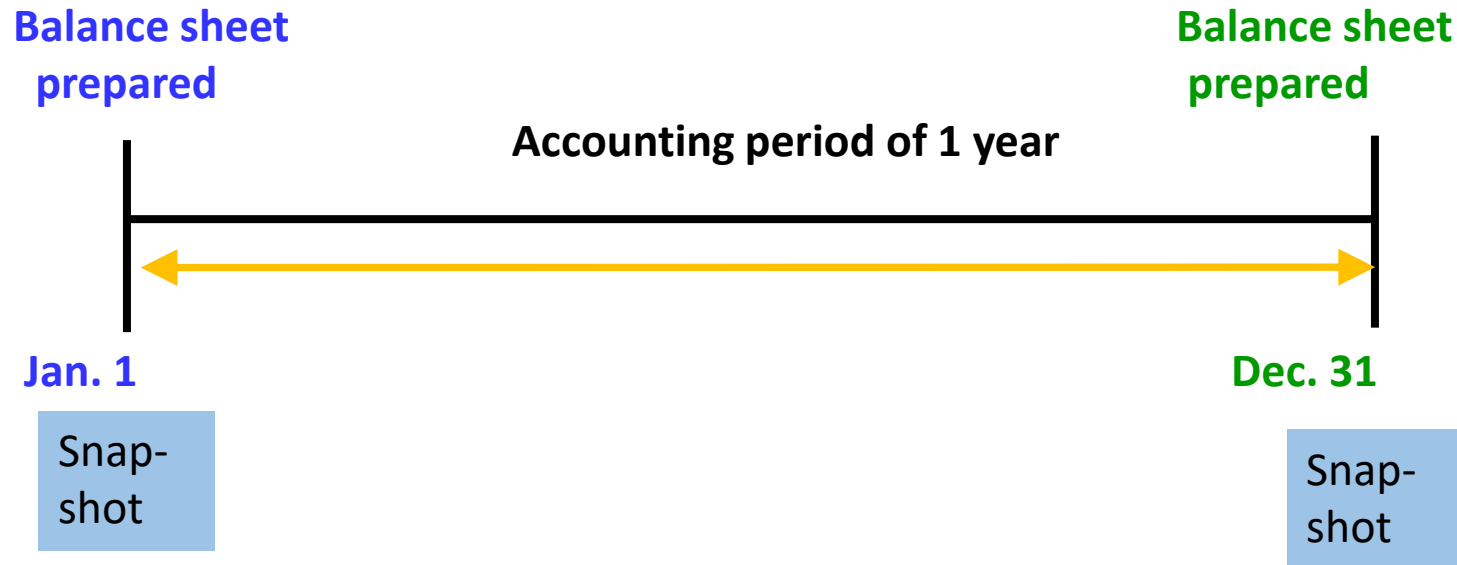
What is the purpose of an Income Statement?

- It measures the difference between revenue and expenses:
 - A **positive** difference indicates a profit.
 - A **negative** difference indicates a loss.





Relationship between the Balance Sheet and the Income Statement



**Income statement =
Income, expenses, and profit for a period of time**



Definitions: Revenue

- Income from production of goods and services
- Can be non-cash, such as an increase in inventories
- Can be money owing to you (accounts receivable)
- It is NOT income from an unrelated business, like off-farm income





Definitions: Expenses

- Cash expenses
 - Feed, fertilizer, seed, fuel
- Non-cash expenses
 - Depreciation, accounts payable, accrued interest, accrued taxes
 - Depreciation refers to the loss in value of capital goods from use, age and obsolescence
 - Accrued means “accumulated”



Income statement format

- Total revenue
- Less total expenses
- ***Equals net farm income from operations***
- Plus or minus gain/loss on sale of capital assets
- ***Equals net farm income***





Definition: Net farm income

- Revenue less expenses plus any gains or losses on the sale of assets.
- Represents returns to the operator for unpaid labor, management, and equity capital.





Cash or accrual?

- Cash accounting methods only track what was actually spent or received during the accounting period





Cash or accrual?

- Accrual accounting methods track what was actually spent or earned from a particular enterprise, whether or not it occurred during the actual accounting period





Definitions: Accrual adjustments

- Takes into account taxes owing, accounts receivable, accounts payable and other accounts at the beginning and end of the accounting period





Definitions: Accrual adjustments

- For example, expenses you've already incurred for this enterprise before the start of the accounting period need to be added to the expense for that year





Cash vs accrual?

- Cash accounting methods are simpler
 - Just track what you've earned in and what you've spent for the accounting period
 - The main disadvantage is poor information on what you actually earned from your enterprise
 - There might be some tax advantages (or disadvantages), depending on the method you choose



Cash vs accrual?

- Accrual methods more actually portray earnings and expenses for production of a particular enterprise
 - For a livestock enterprise, you'd track the cost of all the feed you used to produce the market animals for that year, regardless if you purchased it prior to the start of the accounting year



Accrual adjustments

- Accounts payable/receivable
- Beginning or ending inventory
- Prepaid expenses
- Investment in growing crops
- Investment in next year's crop





Profitability

- Based on the income statement
 - Accrual or cash
- Whether it's acceptable or not will depend on the size and goals of the business





Profitability measures

- Measures of profitability include
 - Net farm income
 - Rate of return on farm assets
 - Rate of return on farm equity
 - Operating profit margin ratio



Opportunity costs

- Opportunity costs are calculated as what those assets would have earned had they been used for the next best alternative
 - For example, your wages if you worked elsewhere
 - Another example would be land rent if you didn't farm



Operating Profit

- Net farm income from operations
- Less opportunity costs of unpaid labor & management
- Equals operating profit





Operating Profit Margin Ratio

Operating Profit



Total Revenue

X 100%



Example:

- Profit from operations = 25,000
- Total revenue = \$150,000
- Operating profit margin ratio = $(25,000/150,000) \times 100 = 17\%$



Change in owner equity

- Retained farm earnings: This is the portion of farm earnings that is kept for use in the farm business
- If living expenses and taxes are higher than total earnings, then owner equity will fall



Summary

- An income statement summarizes revenue and expenses for an accounting period
- Net farm income, or profit, is a dollar amount
- Profitability is a relative measure depending on the size of the business



Income Statement		Fiscal Year
	Kate's Rambouillets	2019
Cash Farm Income		
	Fleece sales	\$ 1,200.00
	Lamb sales	\$ 7,800.00
	Cull ewe sales	\$ 480.00
	Guard dog puppies	\$ 2,000.00
Gross Farm Income		\$ 11,480.00



Cash Farm Expense			
	Grain		\$ 1,500.00
	Hay		\$ 2,500.00
	Straw		\$ 300.00
	Dogfood		\$ 500.00
	Fertilizer		\$ 600.00
	Salt		\$ 150.00
	Wormer		\$ 200.00
	Other veterinary supplies		\$ 100.00
	Veterinary expense		\$ 200.00
	Shearing		\$ 350.00
	Labor		
	Fuel		\$ 200.00
	Repairs		\$ 500.00
	Utilities		\$ 300.00
	Miscellaneous		\$ 150.00
	Interest on loans		\$ 3,806.00
Total Cash Farm Expense			\$ 11,356.00



Income Statement		Fiscal Year
	Kate's Rambouillets	2019
Cash Farm Income		
	Fleece sales	\$ 1,200.00
	Lamb sales	\$ 7,800.00
	Cull ewe sales	\$ 480.00
	Guard dog puppies	\$ 2,000.00
Gross Farm Income		\$ 11,480.00
Cash Farm Expense		
Total Cash Farm Expense		\$ 11,356.00
Net Cash Farm Income		\$ 124.00



Net Cash Farm Income		\$ 124.00
Accrual Adjustments		
Feed		\$ 1,200.00
Accounts receivable		\$ (200.00)
Fleece inventory		\$ 800.00
Market livestock		\$ 1,000.00
Prepaid expenses		\$ (500.00)
Total Inventory Change		\$ 2,300.00
Net Operating Profit		\$ 2,424.00



Ownership costs			
Depreciation			
	Purchased livestock	\$	180.00
	Working dogs	\$	200.00
	Machinery	\$	300.00
	Vehicles	\$	600.00
	Barns and fences	\$	1,250.00
	<i>Total Depreciation</i>	\$	<i>2,530.00</i>
	<i>Interest on retained livestock</i>	\$	<i>325.00</i>
Total Ownership Costs		\$	2,855.00



Net Operating Profit		\$ 2,424.00
Ownership costs		
Depreciation		
	Purchased livestock	\$ 180.00
	Working dogs	\$ 200.00
	Machinery	\$ 300.00
	Vehicles	\$ 600.00
	Barns and fences	\$ 1,250.00
	<i>Total Depreciation</i>	\$ 2,530.00
	<i>Interest on retained livestock</i>	\$ 325.00
Total Ownership Costs		\$ 2,855.00
Net Farm Income		\$ (431.00)



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?



Questions?



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