



Income Statement

The objective of the Income Statement as a coordinated tool is to generate a net income that reconciles the change in owner equity during the year.




Cash vs. Accrual Basis Net Income

- Cash Method
 - Income is reflected by the amount of “cash receipts” constructively received in the accounting year.
 - Expenses are recorded only in the year they are actually paid.




Cash vs. Accrual Basis Net Income

- Accrual Method
 - Income is recorded in the year it is earned, regardless of whether payment is received.
 - Expenses are recorded in the year they are actually incurred, whether paid or not.




Cash vs. Accrual Basis Net Income

- Expense:
 - Reflects the cost of goods and services used in the process of earning revenue for the period. Can be cash or non-cash.
- Expenditure:
 - Reflects any cash outlay




Cash vs. Accrual Basis Net Income

- University of Illinois study of 151 farmers over a 6-year period
 - Found an 85% average annual difference in net farm income when measured on an accrual basis vs. a cash basis.
- Other studies have shown cash basis income accounting can result in lags of 2 years or more in recognizing profitability problems.




Structure of Income Statement

- Revenue
 - Cash sales and changes in inventory
 - Custom work
 - Hedging
 - Change in accounts receivable
 - minus Feeder livestock and feed purchases
- Value of farm production (VFP)




Structure of Income Statement

- Expense – 3 categories
 - Operating expenses
 - Financial expenses
 - Capital adjustments
- Non-farm income
- Net income



Accrual-Based Income Statement

- Requires two specific types of information
 - Cash revenue and expenditures that actually occurred during the year
 - A summary of non-cash details that affect net income
 - Reflect changes in inventory
 - Typically get from beginning and ending balance sheet



Accrual-Based Income Statement

- Changes in Inventory/Balance Sheet Items
 - I. Accrual Adjustments to Revenue—feeder livestock and poultry, crops and feed, A/R
 - Ending – Beginning
 - => increase in inventory is “+” or added to revenue

Accrual-Based Income Statement

- Changes in Inventory/Balance Sheet Items
 1. Accrual Adjustments to Expenses:
 - a. Unused Assets—prepaid, supplies, investment in growing crops
 - Beginning – Ending
 - => increase in inventory is “-” or reduction in expenses

Accrual-Based Income Statement


- Changes in Inventory/Balance Sheet Items
 2. Accrual Adjustments to Expenses:
 - b. Unpaid Items—accrued interest or taxes, A/P
 - Ending – Beginning
 - => increase in inventory is “+” or added to expense

Accrual-Based Income Statement

- Example: Hay Inventory

Beginning inventory = \$10,000
 Ending inventory = \$17,500

Change in inventory = 17,500 – 10,000
 = +7,500 added to revenue




Accrual-Based Income Statement

- Example: Fertilizer Inventory

Beginning inventory = \$2,000
Ending inventory = \$5,000

Change in inventory = 2,000 – 5,000
= - 3,000 (reduction in expenses)




Accrual-Based Income Statement

- Example: Accounts Payable


Beginning inventory = \$5,000
Ending inventory = \$8,000

Change in inventory = 8,000 – 5,000
= + 3,000 (increase in expenses)




Expenses

- Capital asset account adjustments
 - Sold at amounts different from their adjusted basis
 - A deduction for the value of raised feeder livestock transferred into the breeding herd is also necessary




Expenses

- Capital asset account adjustments
 - Death loss or casualty loss
 - Use a zero sales value or amount collected from the insurance reimbursement
 - Remember how to value a trade
 - Capital loss from cooperative stock



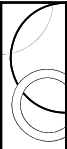
Net Income

- Measures the profit generated by the farm operation.
- Income and self-employment taxes have not been deducted yet.
- Frequently referred to as the return to the owner for unpaid labor, management and equity.



Non-Farm Income

- Income that is available to the operation and that contributes to farm business owner equity.
 - Off-farm wages
 - Interest and dividends
 - Royalties and mineral lease income
 - Sales of non-farm assets



Extraordinary Items

- Unusual and nonrecurring events that affect net income and cannot properly be classified anywhere else in the statement.
 - Lawsuit
 - Liability claim
 - Legal settlement

- Net Income is then determined after taxes are accounted for.
