



Heart of the Farm

Financial Management Factsheet Series



Understanding the Farm Income Statement Part I

The Income Statement is a report of the farm business' financial performance during a given time frame.
 What is the Concept and Structure of the Income Statement?

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Farm performance is measured using the Income Statement. The Income Statement answers the question, *did the farm generate an adequate return on the investment of your money, labor and management?* Net Farm Cash Income, Net Farm Income from Operations (NFIFO), and Net Farm Income (NFI) are calculated from the Income Statement.

The Income Statement is also known as a Profit and Loss Statement. It may also be called an Earnings Statement or Farm Earnings Statement.

Every farm business produces a product. Product sales generate a return to the expenses incurred when making the product. The Income Statement measures the cash income, cash expenses, and the monetary value of non-cash income and expense used during one production

cycle. Accrual adjustments to both cash income and expenses are made.

Depreciation and changes in capital assets are also accounted for. The result is a statement of the monetary value of the farm's production for the year, and the cost of that production.

The statement has two categories, income and expenses. Accrual adjustments are made to both categories. Depreciation and capital adjustments are factored in.

The year's Profit or Loss from Farming (IRS Form 1040, also known as the Schedule F and the Record of Business Property Sold (IRS Form 4797) may be used when creating the Income Statement. The current beginning and ending year Balance Sheets are also useful in to constructing the Income Statement. The

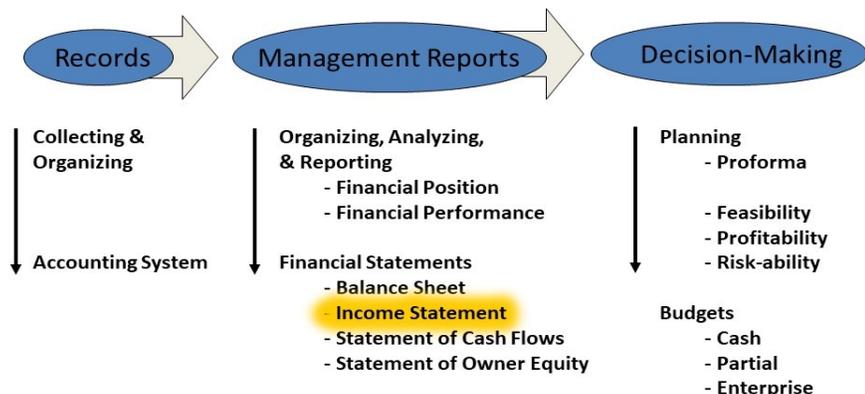
accrual adjustments are made from the asset and liability items listed on the Balance Sheet, and the change in capital assets listed on Form 4797.

Structure: Step 1: Cash

The Income Statement begins with recognizing the farm's income. All cash receipts representing income for the year are categorized and totaled. These items are found on the Schedule F and Form 4797 and include the sale of both raised livestock and market livestock purchased for resale, and the sale of breeding livestock before capital adjustments are made. Loan proceeds are not counted as income. Nonfarm sources of income are also not recorded here.

Next, all cash operating expense categories and interest paid are listed and

Farm Business Financial Management Model



The **Financial Model** illustrates the management-to-decision-making process, and the tools used to make decisions. Beginning with collecting and organizing financial information (records) through an accounting system, the information is then transformed into financial statements for analysis and interpretation of the farm's financial position and performance. Through the budgeting process, analysis for feasibility, profitability and risk-ability, allow for making the best decisions for the farm business.

totalled. Again, these items are found on the Schedule F. Subtraction of the totaled expense from totaled income yields the *Net Cash Farm Income*.

Structure: Step 2: Non-cash items

Adjustments to cash income and expense are made to gain an accurate measure of farm performance during the annual production cycle. The process of accounting for all transactions to the year the item was produced is known as accrual accounting.

Net Farm Income from Operations (NFIFO), also known as Net Operating Profit or Net Profit from Operations is calculated as noncash adjustments are made to income and expense. The beginning and ending year Balance Sheets are used to make these adjustments to the Income Statement.

The non-cash *income adjustments* include the changes in inventories of grown crops and feed, market and breeding livestock, accounts receivable, and unpaid cooperative distributions. They represent an increase or decrease in earned income.

Income Statement Farm Name _____ Fiscal Year _____

Total Cash Income = sum of all cash farm income
Total Adjusted Income = Total Cash Income +/- Accrual Adjustments to from changes from
 Crop changes
 Raised breeding livestock
 Accounts receivable, unpaid cooperative distributions
Total Cash Expenses = sum all cash farm expense categories and interest paid
Total Adjusted Expense = Total Cash Expense + Depreciation +/- Accrual Adjustments from changes in
 Purchased inventories
 Prepaid expenses
 Accounts payable
 Accrued interest

Net Cash Farm Income = Total Cash income – Total Cash expense

Net Farm Income from Operations (NFIFO) = Total Adjusted Income – Total Adjusted Expense

Net Farm Income (NFI) = NFIFO + gain (or loss) of capital assets.

The non-cash *expense adjustments* include changes in purchased inventories, prepaid expenses, and accounts payable and accrued interest. Net Farm Income from Operations (NFIFO) is calculated once these adjustments are made and depreciation is accounted for.

Net Farm Income (NFI) is calculated after changes in capital assets are accounted for. Net Farm Income is the last calculation made, after gain (or loss) of capital assets is recognized.

What do NFIFO and NFI tell us?

NFIFO represents the accrual adjusted gross income minus expenses, including depreciation. It does not include the sale

or purchases of capital assets. NFIFO represents the profit resulting from a typical year of farming operations.

NFI considers all accrual adjusted income and expenses including those that resulted from extraordinary changes, such as sales of capital assets, i.e. sales of equipment or buildings.

Summary

NFI should be increasing and returning an economic return that makes sense for continuing to invest money (yours and others), labor and management in your farming business. Benchmarking your NFI to previous years and to other similar farms gives insight to indicate your performance.

Next up....

Part II: Accrual Adjustments and Interpretation of the Farm Income Statement

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The Heart of the Farm – Women in Agriculture program addresses the needs of farm women and men by providing education on pertinent topics, connecting them with agricultural resources, and creating support networks. <http://fyi.uwex.edu/heartofthefarm>

For other farm financial information and resources contact: Center for Dairy Profitability: <http://cdp.wisc.edu>

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