



Accounting System

An accounting system is a set of actions and methods designed to collect, store, and process financial transactions into management reports for decision-making.

Explanation:

Traditional practices of financial record keeping have largely been informal, simple, and vary from the generally accepted accounting principles (GAAP), which have long been used in other businesses. A primary reason for collecting and organizing records was for satisfaction of Internal Revenue Service (IRS) tax reporting requirements.

METHODS:

Most farmers utilize cash basis accounting to report income (revenues) and expenses (costs) when cash is exchanged. *Cash accounting* method is an acceptable method for reporting taxable farm income. However, additional information may be needed for informed management reports and decision-making.

Accrual accounting recognizes income and expenses when they occur, not necessarily in the year received or paid. Income and expenses are more appropriately matched in a production year and provide a more accurate evaluation of profit (loss). Income tax records for production businesses are required by the IRS to be based on accrual accounting.

JOURNAL ENTRY:

Business transactions are recorded in a journal and may be listed for specific accounts or grouped and summarized by accounts.

A *single-entry* accounting system is characterized by only one entry made for each transaction, much like a check register. For most farm businesses a single-entry system will suffice. However, a single-entry system does not track accounts like inventory, accounts payable/receivable, nor create a balance sheet or income statement. It also does not coincide with GAAP.

A *double-entry* accounting system provides the most detailed accounting of farm business transactions, but requires a significant amount of time to learn and implement. For every transaction going out, there must be a corresponding transaction coming in (debit/credit). This double entry method provides a cross check and ensures that errors are minimized. It is the best option and is the accepted accounting system in use for most businesses today.

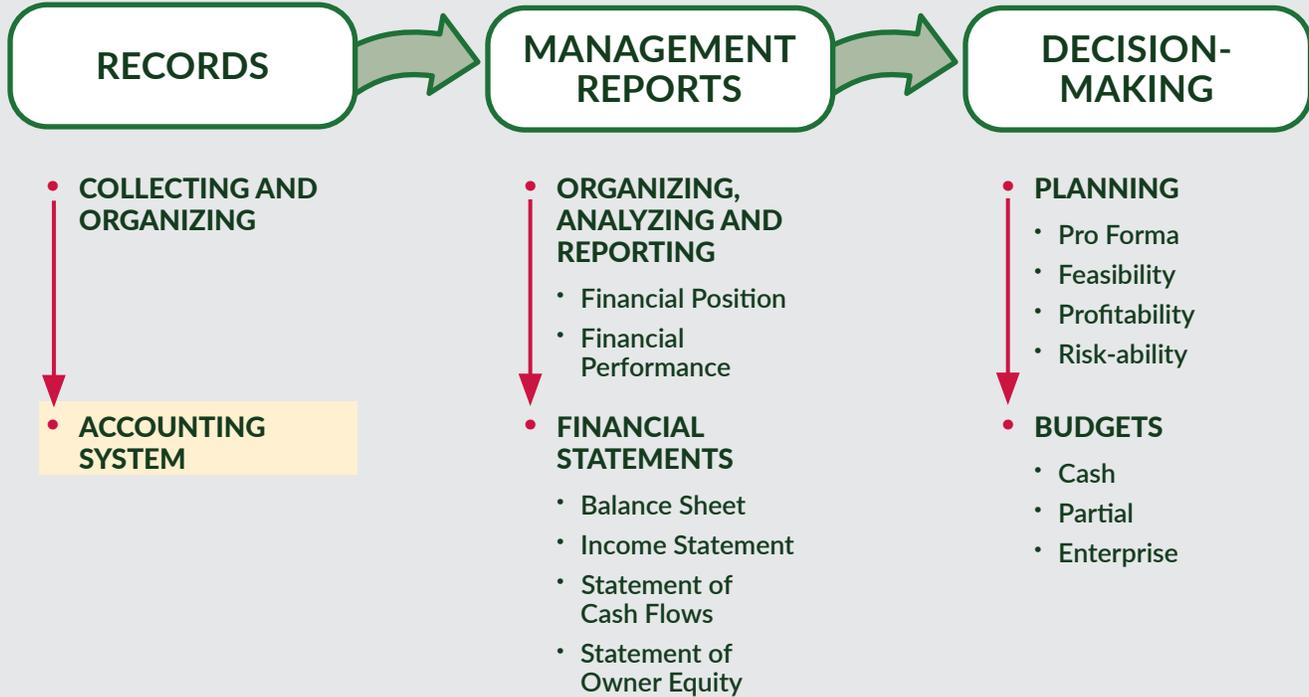
Summary:

Farm business records are important for tax planning but are also utilized to generate management reports that will enhance the long-term profitability of the farm business. Financial management does not mean the producer has to use an accrual accounting system, but it does mean accrual adjustments must be made in order to achieve financial statements (required on an accrual basis) for financial management (i.e. determining financial performance). Overall management includes both financial management (accrual basis) and tax management (cash basis). Both management approaches need to be understood and reconciled.

References: Farm Financial Standards Council. (2021, January). *Financial Guidelines for Agriculture*.



FARM BUSINESS FINANCIAL MANAGEMENT MODEL



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