Preparing the Income Statement

The Income Statement is a report of the farm business' financial performance during a given time frame. It measures profit or loss in a given time period and is also known as the profit or loss statement.

Explanation:

Every farm business produces a product. Product sales generate a return to the expenses incurred when making the product. The income statement is used to measure the cash income (revenues), cash expenses, and the financial value of non-cash income and expenses used during one production cycle, usually a calendar year for farmers. Accrual adjustments to both cash income (revenues) and expenses are made; depreciation and changes in capital assets (gain or loss) are also accounted for. The result is a statement of the financial value of the farm's production for the year, and the cost of that production. The income statement is also known as the *profit and loss statement* or *statement of earnings*.

Most of the information needed to prepare an income statement can be found in the farm business' records. Internal Revenue Service (IRS) form 1040F (Profit or Loss from Farming), also known as Schedule F, and IRS form 4797 (Sale of Business Property) may be used when creating the cash income statement. The tax return, although useful for verification purposes, is not a substitute for the income statement. The current beginning and ending year balance sheets (net worth statements) are also needed for determining accrual adjustments. 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.

The Farm Financial Standards Council (FFSC) provides the specific standards and structure for the income statement. This paper provides a concise presentation of the income statement that follows the FFSC guidance.

STRUCTURE:

The income statement is structured into two parts: revenues (income) and expenses (costs); and includes three presentations of profits – Income from Operations, Net Farm Income and Net Income. Each of these parts include cash transactions and non-cash (accrual) adjustments.

Revenues (income):

- *sum of all cash farm income (Schedule F and Form 4797)*
- *+/- accrual adjustments for realized income from inventories raised/ harvested for sale or to be used in the production process*

= Gross Farm Revenues (Total Farm Income)

Operating expenses (costs):

- *sum all cash farm expense (Schedule F), excluding interest expenses*
- *+/- accrual adjustments from inventories purchased for resale or used in the production process*
- *+ accrual adjustments from accounts payable*
- *+ economic or real depreciation (not tax depreciation as reported on Schedule F)*

= Total Farm Operating Expenses

Income from Operations = Gross farm revenues – Total farm operating expenses

- *– Interest adjustments = interest expense +/- accrual adjustments from accrued interest*
- *+/- capital gains (losses)*
- *+/- Other farm income/expenses*

= Net Farm Income

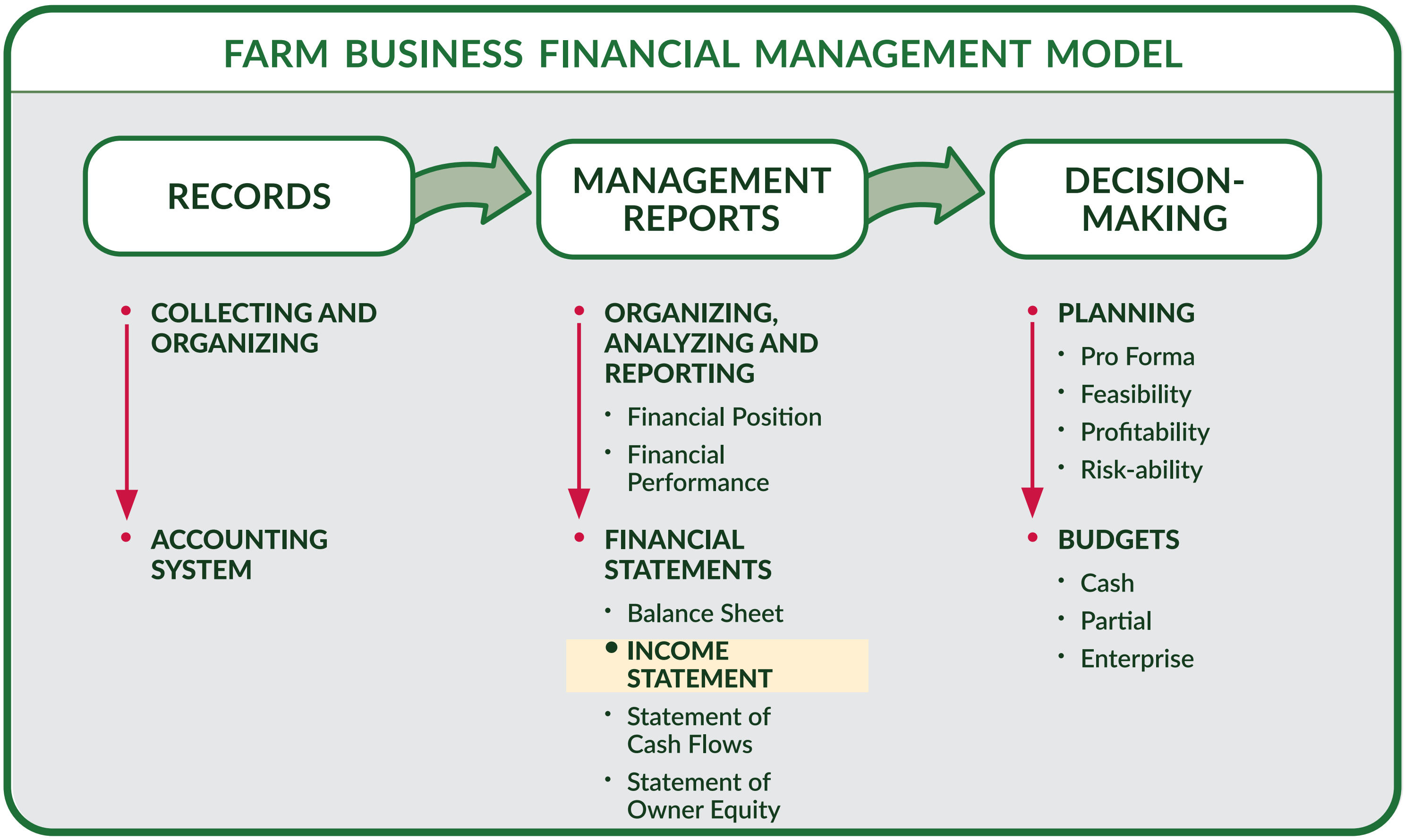
- *– Taxes = cash taxes paid and +/- accrual adjustments for taxes payable or refunds*

= Net Income

Summary:

Net farm income (NFI) is a standard measure of profitability for the farm business. Generating a profit provides an opportunity for the farm business to expand, replace capital, reduce debt obligations, build working capital, and cover unpaid family living expenses. NFI should be increasing and providing an economic return for the owner's equity, labor, and management in the farm business. Comparing and benchmarking NFI to previous years and to other similar farms gives insight to the farm business' performance.

References: Farm Financial Standards Council. (2021, January). *Financial guidelines for agriculture.*



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