Western Beef Resource Committee *Third Edition*

Cattle Producer's Handbook

Finance Section 951

Income Statement Preparation and Use

Alan E. Baquet, Extension Farm Management Specialist
Montana State University

The income statement is a summary of income and expenses over a given time period and is the second major financial statement needed for control and analysis of the ranch business. Sometimes the income statement is referred to as an operating statement or profit and loss statement. Its primary purpose is to compute net income for a given time period. An income statement is used to answer the question: "Did the farm or ranch business generate a net return and if so, how much?" For most ranch businesses an annual income statement covering a January 1 to December 31 time period is adequate.

The balance sheet (950) and the income statement are two different yet related records of farm or ranch business activities. While the balance sheet is a financial picture of the ranch at a point in time, the income statement provides information about the financial operation of the ranch over a time period.

In preparing an income statement, all income and expenses associated with the business need to be identified and recorded so they can be summarized at the end of the accounting period. Farm and ranch record books are available from many sources. They and provide a convenient and organized system for recording income and expenses.

Income can be received in two forms—cash and non-cash. Cash income is easily identified as payments received from selling commodities produced on the farm and from other farm or ranch-related income such as custom work performed for others.

Non-cash income can be received in the form of goods and services. Thus, it is only logical that payment in the form of grain or livestock or custom work performed for a neighbor should somehow be counted as income. Another non-cash ranch income is the value of raised products consumed by the ranch household.

The basic purpose of the income statement is to determine net income for a given time period. Thus, all production generated during that time period needs to be counted as income whether or not it was sold for cash during that time period. By the same token, the expenses used to generate that income need to be correctly allocated to that time period. To correctly determine and allocate income and expenses, changes in the values of inventory need to be included in the income statement. Thus, increases in crop inventory over the accounting period would be included as income under the non-cash income category, and reductions in inventory values need to be included as well.

On the expense side both cash and non-cash expenses need to be included. Cash expenses would typically include purchases of feed, fertilizer, seed, market livestock, fuel, etc. Non-cash expenses include depreciation on machinery, equipment, buildings, and breeding livestock. No annual cash payment is made to pay for depreciation. This decline in value, however, represents an expense to the business and must be included in the income statement.

Table 1 shows an example income statement. In addition to cash farm income generated from the normal production activities, the gain or loss from a sale of capital assets such as purchased breeding livestock, machinery, and equipment is also entered as a cash farm income. This entry would be the difference between the asset's selling price and its book value.

Two categories of cash farm expenses are shown in Table 1. Variable cash expenses include fertilizer, seed, feed, purchases of market or feeder livestock, hired labor, and so on. These represent the cost of input needed if production takes place.

The fixed cash expenses include property taxes, insurance, and interest, or those expenses that would still exist if no production took place. Notice the cost of any new capital assets such as machinery, purchased breeding livestock, buildings, etc., is not included as a cash