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EC71-848 Revised Your Income Statement

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YOUR INCOME STATEMENT

PREPARATION AND INTERPRETATION
A FINANCIAL MANAGEMENT SERIES FOR NEBRASKA FARMERS & RANCHERS

EC 71-846 YOUR PLANS FOR PROFIT
EC 71-847 YOUR BALANCE SHEET
EC 71-848 YOUR INCOME STATEMENT
EC 71-849 CASH FLOW PLANNING WITH THE AID OF YOUR INCOME TAX RETURN
EC 71-850 CASH FLOW PLANNING WITH THE AID OF YOUR RECORD BOOK AND BUDGETING
EC 71-851 ESTIMATING YOUR FAMILY LIVING EXPENSES
EC 71-852 CASH FLOW PLANNING FORM
EC 71-853 BALANCE SHEET
EC 71-854 INCOME STATEMENT

THIS SERIES WAS DEVELOPED THROUGH THE COOPERATION OF THE FOLLOWING SUBCOMMITTEES:

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YOUR INCOME STATEMENT

by

Philip A. Henderson, Extension Economist (Farm Management)
Thomas L. Frey, Assistant Professor
in Agricultural Finance and Farm Management

INTRODUCTION

Many farm families have the same problem as people in town — they just can’t quite make ends meet. And worse yet, they don’t really know just what the problem is. Records kept on the farm business are all too often barely adequate for income tax purposes (cash basis) and family living expense records are virtually non-existent. So it’s not clear whether the problem is one of: 1) low net income; 2) excessive spending for family living; or 3) large investments in the farm business.

It’s important that you be able to identify the problem. You need to know and understand your income situation. How much was your net income from farming? And how much did you have from other sources? How much did you spend for family living? And how much could you spend for family living without hindering growth in the farm business?

These are questions which annual income statements coupled with annual balance sheets can answer.

WHAT IS AN INCOME STATEMENT?

An income statement is a summary of the cash and non-cash income and expenses incurred during a given period of time, normally a calendar year.

The income statement described in this publication provides for identification of net income from: 1) your farm business, 2) your non-farm activities, and 3) any unrealized gains or losses resulting from a change in real estate value. These three are then combined to show your total net income.

Most other income statements allow you to determine only Net Farm Income. Net Farm Income is no doubt the major portion of your income for the year, but if your balance sheets reflect gains resulting from off-farm work or increases in land value, it would be impossible to reconcile your income statement (EC71-854) and balance sheets (EC71-853) without considering these other sources of income. This is true because any increase in your net worth is the result of income. We probably need to think in terms of a broader definition of “income” than we are accustomed to. For example, the gain in land value during a year is unrealized “income”. This income does not go into the bank, but it does increase your assets.

WHAT IS ITS PURPOSE?

The main purpose of the income statement is to determine whether you’re making money and how much.

A second objective is to determine the sources of net income, i.e., how much came from farming operations, how much from non-farm activities, and how much from unrealized gains or losses in the value of farm real estate.

The third objective is to show what became of your Net Income.

FILLING OUT THE INCOME STATEMENT

The discussion which follows assumes a calendar year as the time period, since most farm records are kept on this basis.

You’ll need a complete record of cash receipts and expenses as well as beginning and closing inventories.

An example of a completed income statement on EC 71-854 is shown. As you read through the instructions for completing an income statement, you may want to refer to the example for a better understanding of where information is to be recorded.
# INCOME STATEMENT

**Name:** John Farmer  
**Address:** Central, Nebraska  
**For 12 Month Period Ending:** 26th, 1981

## Cash Farm Income
- Grain and hay sales  
- Livestock sales (including breeding animals)  
- Livestock product sales  
- Government payments  
- Custom work  
- Other cash farm income (including refunds on purchases)  
- **Gross Cash Farm Income:** $148,181

## Cash Farm Expenses
- Cash operating expenses (see Schedule I-1 on reverse side)  
- Breeding livestock purchases  
- **Gross Cash Farm Expenses:** $125,457

## Adjustments
- Inventory change (see Schedule I-2 on reverse side, column 3, line a)  
- Depreciation on machinery and equipment (see Schedule B1.-Bal. Sheet)  
- Depreciation on fixed farm improvements (see income tax depreciation schedule)  
- Capital gain or loss on machinery & equipment:  
  - Gross sales of machinery and equipment  
  - Less remaining cost (as per depreciation schedule)  
  - Capital gain or loss (a-b)  
- Adjustment for real estate sold during the year:  
  - Gross sales $, less costs of selling $  
  - Less net beginning-of-year value from Balance Sheet  
  - Net adjustment for real estate sold  
- **Gross Adjustments to Net Cash Farm Income:** $5,179

## Non-Farm Income
- Operator's wage off farm minus expenses incurred  
- Wife's wage off farm minus expenses incurred  
- Interest and dividend income  
- Gifts or inheritances  
- Gain or Loss on securities (see Schedule I-3 on reverse side)  
- Non-farm inventory change  
- **Net Income – other farms owned:**  
- **Net Income – non-farm real estate:**  

## Unrealized Income from Change in Real Estate Value
- Net end-of-year value of farm real estate (from Balance Sheet)  
- Plus real estate sold this year (Net value from beginning Balance Sheet)  
- Minus net beginning-of-year value of all farm real estate (from Balance Sheet)  
- Minus cost of real estate (land or improvements) purchased this year  
- Net gain or loss in real estate value  
- Plus depreciation on fixed farm improvements (Same as in "Adjustments" section above)  
- **Net Unrealized Income from Change in Real Estate Value:** $4,220

## Net Income (Farm + Non-Farm + Unrealized Change in Real Estate Values)  

## Distribution of Income
- **Change in Net Worth:** $8,415  
- Income and SS Taxes (paid past yr.)  
- Family Living Expenses  
- **Total (should agree with Net Income above):** $22,465
### Schedule I-1 — Farm Operating Expenses

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labor Hired</td>
<td>$6,355</td>
</tr>
<tr>
<td>Repairs and Maintenance</td>
<td>$3,790</td>
</tr>
<tr>
<td>Rents and Leases</td>
<td>$2,320</td>
</tr>
<tr>
<td>Feed Purchased</td>
<td>$16,717</td>
</tr>
<tr>
<td>Seeds and Plants</td>
<td>$2,043</td>
</tr>
<tr>
<td>Fertilizer, Lime, and Chemicals</td>
<td>$5,123</td>
</tr>
<tr>
<td>Machine Hire</td>
<td>$2,702</td>
</tr>
<tr>
<td>Supplies</td>
<td>$2,934</td>
</tr>
<tr>
<td>Livestock Expense</td>
<td>$1,233</td>
</tr>
<tr>
<td>Gas, Fuel, Oil</td>
<td>$3,470</td>
</tr>
<tr>
<td>Storage and Warehousing</td>
<td>$6,109</td>
</tr>
<tr>
<td>Taxes (Real Estate and Personal Property)</td>
<td>$3,924</td>
</tr>
<tr>
<td>Insurance (Property &amp; Liability)</td>
<td>$2,845</td>
</tr>
<tr>
<td>Utilities</td>
<td>$4,710</td>
</tr>
<tr>
<td>Freight and Trucking</td>
<td></td>
</tr>
<tr>
<td>Auto (Farm Share)</td>
<td>$2,570</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>$9,405</td>
</tr>
</tbody>
</table>

### Schedule I-2 — Inventory Changes in Farm Items From Beginning to End of Year

<table>
<thead>
<tr>
<th>Item</th>
<th>Beginning Inventory</th>
<th>Ending Inventory</th>
<th>Change (+ or -)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prepaid expenses</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Notes and accounts receivable (good)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Feed, seed, supplies (Schedule B3 — Balance Sheet)</td>
<td>44,325</td>
<td>49,818</td>
<td>$5,493</td>
</tr>
<tr>
<td>Grain and feed</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Livestock to be sold</td>
<td>100,794</td>
<td>106,641</td>
<td>$5,847</td>
</tr>
<tr>
<td>Cash investment in growing crops</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>$180,529</td>
<td>$185,170</td>
<td>$+4,641</td>
</tr>
<tr>
<td>Farm accounts payable</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accrued interest, taxes and cash rent</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total, less farm accounts payable and accrued expenses</td>
<td>$167,702</td>
<td>$173,852</td>
<td>$+6,151</td>
</tr>
</tbody>
</table>

### Schedule I-3 — Gain or Loss on Marketable and Not Readily Marketable Securities

<table>
<thead>
<tr>
<th>Dollar Value at Beginning of Year</th>
<th>Dollar Purchases During Year</th>
<th>Dollar Sales During Year</th>
<th>Dollar Value at End of Year</th>
<th>Gain or Loss During Year (3+4) - (1+2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
<td>(b)</td>
</tr>
<tr>
<td>$300</td>
<td>$</td>
<td>$</td>
<td>$300</td>
<td>None</td>
</tr>
</tbody>
</table>

Prepared by Thomas L. Frey, Asst. Professor of Agricultural Finance and Farm Management, and Philip A. Henderson, Extension Economist (Farm Management).
Cash Farm Income

Cash farm income as defined here encompasses all cash income to the farm business, except that derived from the sale of machinery, equipment, and improvements which have been carried in the depreciation schedule and land. If all costs of selling grain, livestock, and livestock products are included under expenses, be sure to include the gross amount of sales, and not the amount left after selling expenses have been deducted.

Government payments include all types of farm program payments, such as soil conservation payments, feed grain payments, and wheat certificates.

Custom work refers to work done for others with your farm machinery. Assuming all expenses on such equipment will be included as cash operating expenses, the gross income should again be used.

Other cash farm income allows for all items not shown elsewhere. It will include rebates on fuel purchases, cash patronage refunds, and such things as rents received for the use of machinery.

Cash Farm Expenses

Cash farm expenses are divided into two categories — cash operating expenses and breeding livestock purchases. Schedule I-1 on the reverse side of the Income Statement allows for summarizing expenses by principal categories. Note that a place is provided for recording the cost of animals purchased for resale during the year. This would include all feeder pigs and feeder cattle, regardless of whether they were sold during the year or were still on hand at the end of the year.

With the exception of the cost of feeder animals purchased and still on hand at the end of the year, the amounts of cash expenditures can be taken from your income tax form 1040F, if you have it completed. Otherwise you will need to refer to your record book, cancelled checks, or receipts for bills paid. Wherever the figures come from, be sure all cash outlays for farm operating expenses during the year are included.

Any animals bought for breeding purposes should be included in the amount entered on the "Breeding livestock purchases" line.

Net Cash Farm Income

Net cash farm income is simply the difference between cash farm income and cash farm expenses.

Adjustments

Net cash farm income is not an accurate measure of farm earnings. Consequently, several adjustments are necessary.

Net Changes in Inventory

The amount and value of grain and feed you have on hand is seldom the same at the end of the year as it was at the beginning. Similarly, numbers and value of livestock usually change during the year. Schedule I-2 on the reverse side of the Income Statement is provided to summarize the changes which took place in these and other inventory items during the year. If you have balance sheets both at the beginning and end of the year, this inventory information can be taken from them. Otherwise, you will need an inventory of the items shown in the schedule I-2, both at the beginning and end of the year.

If the value of your inventory at the end of the year is greater than at the beginning, you had an inventory increase, or a positive adjustment. In other words, part of your year's earnings was in the form of a growing inventory. If your business is growing you'll probably find yourself in this situation frequently.

A smaller inventory at the end of the year would mean a decrease in inventory and therefore a downward (minus) adjustment to net cash farm income.

The "inventory" of prepaid expenses, notes and accounts receivable, farm accounts payable and accrued expense items in Schedule I-2 possibly needs some explanation. Individually, these are normally not large items, but are sometimes confusing. They often result from year-end income tax management decisions. If they have been correctly identified on the balance sheet, transfer them to Schedule I-2. The
following examples are presented to clarify your thinking if you are still not sure how to treat an item.

1. A prepaid expense occurs when you have shown an item as a farm expense for the year (Schedule I-1), but you have not received the item.
   For example, you buy $300 worth of seed corn in the fall, for spring delivery, and enter it as a farm expense in November. The $300 worth of seed corn should be shown as a prepaid expense in your December 31 inventory.

2. A note or account receivable exists when you have not been paid for an item which has left your business. This represents income which has been earned, but not received.
   For example, you sell $500 worth of hay to a neighbor in December. He takes the hay before December 31, but does not pay you until January. As of December 31, you do not have the hay or the payment for it. Thus you should show a $500 account receivable on your December 31 inventory.

3. An account payable exists when you receive an item, but have not paid for it yet. And, this item either has been used on your farm, resold, or shown on the closing inventory.
   For example, you have $1000 worth of feed delivered to your farm late in December. As of December 31, the cattle have eaten half of it and you show the other half in your December 31 inventory. But, if you have not paid for it, it will not show in your farm operating expenses (Schedule I-1). So, you must show a $1000 account payable for feed in your December 31 inventory.
   Do not confuse an account payable with a loan. In the example immediately above, if you had borrowed $1000 and paid the feed bill, the $1000 would show as a farm operating expense (Schedule I-1), your accounts payable would be zero, and your loans outstanding would be $1000 higher. Do not include loans in Schedule I-2, however.

Depreciation
Most machinery and equipment is purchased with the intention of using it for several years. Its value declines from year to year as a result of use and obsolescence until ultimately it has little value left. Hence it is reasonable to charge a portion of this decrease in value to each year's business rather than to charge the entire purchase price as a cost in the year the machine was purchased. This allowance for decreasing value is called depreciation and must be subtracted from net cash farm income.

Capital Gain or Loss on Machinery and Equipment
If you sold any machinery or equipment during the year, a capital gain or loss may be involved.

  You can't always estimate accurately the useful life of a particular piece of machinery or equipment when you first get it. Because of this, it's very probable that the amount you get from the sale of a machine will be more or less than its depreciated value when you sell it. For example, let's say a machine has depreciated to $3,000. You sell it for $2,000. You have taken a $1,000 capital loss compared to its depreciated (book) value. This should be deducted from net cash income. The opposite could also happen; you might sell it for more than its depreciated value. This would result in a capital gain, which should be added to net cash income.

  When a depreciable item is traded in, no capital gain or loss occurs, so no adjustment is necessary; you simply generate a new basis for the new machine.

Adjustment for Real Estate Sold During the Year
Sales of real estate occur only infrequently — possibly only once in the life of a farm business, but when they do occur they should be handled as described here. This adjustment procedure is not a computation of capital gains, and should not be mistaken for the computations which are necessary in preparing your income tax return. Since this income statement provides for treating increases in real estate value as "unrealized income" on a year-to-year basis during the period of time which the property is owned, you are only interested in determining the difference between your current estimate of its value (on the balance.
sheet at the beginning of the year) and the gross selling price. In addition, if you have been estimating the selling costs and the accrued capital gains tax, you must adjust for the difference between these estimates and what they actually turned out to be.

For example, if you had a farm with an estimated gross value of $50,000, and you estimated the selling cost at 5 per cent of the gross value, and the capital gains tax at 15% of the gain (assume a $40,000 purchase price), it would appear in your beginning balance sheet as follows:

| Gross value | $50,000 |
| Less: estimated selling cost | $2,500 |
| estimated capital gains tax | $1,500 |
| Net value | $46,000 |

Then, if you sell this farm for $52,000, incur an actual selling cost of $2,600, and a capital gains tax of $1,300, you would complete this portion of the “Adjustments” section of your income statement as follows:

| Gross sales | $52,000, less costs of selling $2,600 | $49,400 |
| Net adjustment for real estate sold | $46,000 (+) $3,400 |

Your capital gains tax will not be paid until the year following the real estate sale. But it is a liability at the close of the year of the sale and should be listed under “accrued taxes” in the liability column of your balance sheet. Thus, in Schedule 1-2 on the reverse side of the income statement, you would include it in the accrued expense items at the end of the year. In this example, it would show as $1,300 of accrued expense, and would have the effect of decreasing your total inventory change for the year by $1,300. When the total inventory change is carried to the face of the income statement, the effect of the accrued capital gains tax is a negative $1,300, and would offset some of the $3,400 gain as computed above. Thus, the net effect of the real estate sale on net farm income would be $2,100.

What actually happened here is that you had been carrying the value of your real estate on the balance sheet at what you thought it would “Net”, after paying the costs of selling it and the income tax on any capital gains. The net adjustment computed here reflects the “total” of errors in your estimates of: 1) real estate value, 2) selling costs, 3) capital gains tax, and 4) any changes in value which occurred during the year of sale.

**Net Farm Income**

Your real net farm income can now be calculated. It is the net cash farm income plus or minus the sum of the adjustments just discussed.

**Net Non-farm Income**

This section of your Income Statement will show all net non-farm income, including: 1) net wages received by you and your spouse; 2) interest and dividend income; 3) amounts received from gifts and inheritances; 4) the change in value of securities during the year; 5) net income from other farms owned (those not included in the farm business operation being analyzed); and 6) any net income you may have from non-farm real estate or non-farm business.

Be sure to record only net profits from the various activities, since no provision is made to deduct expenses. For example, the correct entry for wages from off-farm work would be the amount of wages received less the cost of travel to and from work. Similarly, the entry for income from non-farm real estate would be the amount actually realized after expenses associated with the property had been deducted.

**Net Unrealized Income from Change in Real Estate Value**

Your third possible source of income is a gain in real estate value (see the portion of the example entitled Unrealized Income from Change in Real Estate Value). The income is unrealized until such time as the real estate is sold; but, the gain or loss in value has probably occurred in a gradual manner with some
change taking place each year. Therefore, if all the income attributable to a given year is to be determined, you need to estimate the accrued gain or loss in real estate value during the year and the amount of income tax (on the capital gain) which would be associated with the increased value.

By calculating an annual net unrealized gain in real estate, it is possible to reflect this income in the year when the value increase actually occurs. Any increase in the net worth resulting from an increase in land values, is then supported with net income, on the income statement, from unrealized gain in real estate values.

Your estimate of the net end-of-year value of land and improvements which you own and which are used in this farming operation should be entered on line (e). If land and/or improvements were sold during the year, record their net value from the balance sheet at the beginning of the year on line (f). Now record the net beginning-of-year value of land and improvements (including those sold during the year) on line (g). If you bought land and/or improvements during the year, enter their purchase cost on line (h). Add lines (e) and (f). Subtract lines (g) and (h) from that total to determine your net gain or loss in real estate value for the year. If the total of lines (e) and (f) is greater than the total of lines (g) and (h), you have a gain. If the opposite is true, you have a loss.

The task of determining the unrealized gain in real estate value is complicated by the fact that fixed farm improvements are normally carried on a depreciation schedule. Their value is decreased annually by the amount of depreciation charged against the business. Yet, you probably estimate the value of land and improvements as a package. In reality, the land is increasing in value by the amount that you estimate the total package is increasing plus the amount that the fixed improvements are declining in value. Thus, you should add the amount of depreciation on fixed buildings and improvements to the estimated increase in value of the total package (line j) in order to determine the actual gain in value.

The depreciation on fixed farm improvements was obtained from your income tax depreciation schedule and was entered in the "Adjustments" section of the income statement. Transfer this figure directly to line (j).

The Net Unrealized Income from Change in Real Estate Value can be determined by adding the amount on line (j) to line (i).

Net Income

Your total Net Income is the sum of your income from farming (Net Farm Income), your income from non-farm sources (Net Non-farm Income), and the amount of Unrealized Income from Changes in Real Estate Values.

INTERPRETATION

How Much Did You Make During the Year?

Too frequently, people rely on their income tax report (1040 F) as a measure of whether they are making money. But for people reporting on the cash basis (and this includes most farmers) the income tax figure is an inaccurate measure of farm earnings because it ignores inventory changes. The calculations outlined in this circular have been designed to assist you in determining your net farm income, as well as your net non-farm income and net unrealized income. These three types of income are then combined to form your total net income earned.

Net Farm Income

Net farm income as calculated on the income statement form is a true reflection of how well your farm business is doing. This figure shows the net return from the farming business only, which is a return to unpaid labor, operator labor, operator capital in the business, and management. An analysis of the entire farm business begins with the net farm income figure.

Total Net Income

Some of your labor, capital and management may be employed off-farm. Total net income measures
the total return from all sources to unpaid labor and to you and your wife for labor, management, and the use of your capital.

Effect of Using Cash Expenses vs Accrued Expenses

If you do not choose to include accrued expenses, such as accrued interest, accrued taxes, and accrued cash rent on your balance sheet or income statement, your Net Income as calculated on the income statement will be slightly inaccurate. Net Farm Income (and Net Income) will be in error to the extent of the difference between these accrued items at the end of the year and at the beginning of the year. This error would be small in most cases, but it is most accurate to show these accrued items, which allocates them precisely to the year in which they apply.

Where Did Earnings Come From?

The Income Statement (EC 71-854) is largely self explanatory on this question. It summarizes your year’s income according to source. The amount derived from your farming operation is shown as Net Farm Income.

Similarly, the amount which came from non-farm sources is shown separately as Net Non-farm Income. Remember though that the individual items and the total non-farm income are in terms of net income, unlike the figures under Cash Farm Income.

The third source of income is change in real estate values. If you happen to be one of those who bought land back in the 1940’s, the increase in farm real estate values which has occurred since that time has had a tremendous effect on the present value of your assets. It should be kept in mind, of course, that a sale of real estate which has experienced a substantial increase in value will be subject to capital gains tax.

Where Did Income Go?

The income you earned last year (Total Net Income) is distributed among the three categories indicated at the bottom of your Income Statement (EC 71-854) under “Distribution of Income.”

You probably spent part of it for income and social security (self-employed) taxes during the year and you probably know or can easily determine how much this amounted to.

If you made out a balance sheet at the beginning of the year and another at the end of the year, you can readily determine whether your net worth went up and how much (see Your Balance Sheet, EC 71-847). If your net worth was higher at the end of the year than at the beginning, you had an increase in net worth and this amount should be entered in the space provided. If your net worth was smaller at the end of the year, you had a decrease in net worth and the amount entered on the Change in Net Worth line should have a minus sign in front of it.

Assuming that you have completed your income statement, you know the amount of your Total Net Income which is the same as the “Total” under Distribution of Income. By subtracting the amount paid for taxes and the amount of your increase in Net Worth from your total Net Income, you can determine the amount spent for family living. (If the change in Net Worth was negative, subtract it from the amount paid for taxes). Net Income is always equal to the sum of these three things — the amount spent for income and social security taxes, the amount spent for family living, and the amount of increase in net worth during the year.

Living on Depreciation

Suppose you worked out your income statement and found that your Net Income was actually zero. And yet you managed to buy groceries during the year; how could this be?

Remember that one of the adjustments to Net Cash Income was a downward adjustment because of
depreciation. In other words, depreciation was subtracted from Net Cash Income.

Let's say you had a Net Cash Income of $5,000. You didn't sell any machinery or improvements, so there was no capital gain or loss on capital items; and for the sake of simplicity, let's assume there was no change in the value of inventory. But you did have depreciation on buildings and machinery amounting to $5,000. Let's also assume that there was no non-farm income and no change in the value of real estate. So your Net Farm Income and your Total Net Income under these circumstances would be zero (Net Cash Income of $5,000 less depreciation of $5,000).

The non-cash business deduction for depreciation offset your Net Cash Income for purposes of determining the year's earnings, but this $5,000 was available for spending and was actually spent on family living. Such a situation is entirely possible and can continue until the machinery and buildings need to be replaced.

At that point, the business may have to be liquidated if the operation has consistently failed to make money and the allowance for depreciation has been used for family living. There will be no money available to replace the machinery or buildings unless a part of the remaining assets are liquidated. Not a desirable situation, but unfortunately, it does happen.

Prorating Net Farm Income

Net farm income is a return to several resources. But to be most useful the returns must be prorated to the various resources. To do this the concept of "opportunity cost," i.e., the return a resource could earn in its best alternative use, is utilized. Unpaid labor, as well as your labor, management, and equity in capital could all be used elsewhere to earn a return. So estimate the return each of these resources could earn elsewhere. The analysis can then proceed as follows:

Net farm income

- Less unpaid labor
- Your (operator's) labor, capital, and management earnings
  - Less interest on your equity in capital at opportunity cost rate of ___%
- Your (operator's) labor and management earnings
  - Less value of your (operator's) labor at opportunity cost of
- Your (operator's) return for management

Once your net farm income has been allocated to the appropriate resources, valid comparisons can be made from one year to the next, and with other farms for a given year. You can also better evaluate your returns in relation to other alternative uses of your resources.

SUMMARY

The income statement reveals the financial success of your farm business for a period of time, normally a calendar year. It also shows your income from all sources during the same period of time, including amounts received from non-farm sources and from unrealized gains in the value of real estate. When used in conjunction with beginning and ending balance sheets, the distribution of net income can also be determined.

Further analysis of the net farm income offers you insight into the returns which your resources are earning in farming compared to what they could earn elsewhere.
The Cooperative Extension Service provides information and educational programs to all people without regard to race, color or national origin.