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Accounting Assumptions and the Farm Business

Tim L. Meyers

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10-4-19Market Report	Year Ago	4 Wks Ago	
Livestock and Products, Weekly Average			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight.	*	*	110.00
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb.	183.35	170.01	159.39
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb.	164.80	148.65	152.82
Choice Boxed Beef, 600-750 lb. Carcass.	202.68	229.51	214.12
Western Corn Belt Base Hog Price Carcass, Negotiated	NA	*	*
Pork Carcass Cutout, 185 lb. Carcass 51-52% Lean.	78.02	72.64	76.74
Slaughter Lambs, wooled and shorn, 135-165 lb. National.	137.49	154.62	147.18
National Carcass Lamb Cutout FOB.	376.01	395.99	396.39
Crops, Daily Spot Prices			
Wheat, No. 1, H.W. Imperial, bu.	4.69	3.46	3.68
Corn, No. 2, Yellow **Columbus**, bu.	3.41	3.51	3.83
Soybeans, No. 1, Yellow **Columbus,** bu.	7.67	754	8.41
Grain Sorghum, No.2, Yellow Dorchester, cwt.	5.41	5.23	6.13
Oats, No. 2, Heavy Minneapolis, Mn, bu.	3.32	3.00	3.21
Feed			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton.	*	*	*
Alfalfa, Large Rounds, Good Platte Valley, ton.	102.50	*	107.50
Grass Hay, Large Rounds, Good Nebraska, ton.	87.50	105.00	100.00
Dried Distillers Grains, 10% Moisture Nebraska Average.	141.50	137.50	147.00
Wet Distillers Grains, 65-70% Moisture Nebraska Average.	48.75	42.50	50.00
*** No Market**			

Farmers in Nebraska and the surrounding area have been slow to adopt accrual accounting methods. This is no surprise; the alternative, cash accounting, is simple, provides a real-time analysis of the cash position of the firm, and works well with income tax preparation. However, cash accounting has no methodology for the special timing of agricultural production or specific processes to evaluate profitability, liquidity, or solvency. Accrual accounting, GAAP (Generally Accepted Accounting Principles), and finally the FFSC (Farm Financial Standards Council) rectify these shortcomings. Adoption of GAAP, and subsequently the FFSC "tweaks" will allow farmers and ranchers in Nebraska to make more informed decisions, contributing to greater short and long-run profit. This article will look at GAAP accounting assumptions as they apply to agricultural production. Subsequent articles will tackle specific accounting methodology.

Going Concern

The *going concern* assumption means the business entity has no end date. Even if the farm business is organized as a sole proprietorship or partnership (where the business ends when the proprietor or either partner passes), this assumption is easily met by farmers and ranchers. Decisions farm and ranch managers make usually address long-run consequences. Whether explicitly stated in mission statements, or tacitly implied, one common goal shared by producers is preserving the land for future generations.

Time Period Assumption

The *time period* assumption follows as the most basic assumption. This assumption dictates that financial records be kept in real time, and evaluated consistently. Monthly, quarterly, and annual reporting are common time periods in and outside of agribusiness. While some

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farmers who are owed income tax from the government are lax at record-keeping, this assumption falls under the category of due diligence. Farmers and ranchers who are serious about financial analysis will have no issue understanding the importance of this assumption.

Monetary Unit

The *monetary unit* assumption confers that activities that can be valued and measured in dollars are the only transactions to record. It also dictates that inflation not be considered as an adjustment at any point. Here, the FFSC's recommendations are important. For instance, the FFSC dictates specific rules regarding how to record/measure assets on the balance sheet. One example would be the liability "deferred income tax." This liability (which is likely to never be paid) is included on the balance sheet of a farm/ranch that values land at market value, which may be much higher than its cost basis. Other specific examples would include how to value growing crops or high-value breeding livestock. While the monetary unit is basic, the extension of FFSC rules to GAAP helps elaborate this assumption in cases where ag production causes complex issues.

Economic Entity

The *economic entity* assumption is one with which many family farm operators struggle. The economic entity establishes the farm business as a separate entity from the owners and stakeholders. This is a challenging assumption given the ties between the farm and the operator. For example, most operators live on the farm and drive business vehicles as their own personal vehicles. Adherence to this rule would not result in operators owning two vehicles (a truck for the farm, a sedan for personal use). Instead, it would dictate that the operator divide the use of such assets between their business and personal use. I would argue the economic entity assumption is more important from a theoretical framework standpoint. While positive farm performance will likely cause personal financial changes, it should not work in reverse. The goals of the business should not be dictated reflexively by the needs of the operator's sons and daughters. Instead, these needs should have preemptively guided management decisions long before personal financial needs increased or decreased. Mentally separating the farm business from personal finances helps to unclutter decision making. While family values can certainly be part of the mission of the business, the day to day financial needs of the family should not dictate important decisions regarding economic resources.

Cash Versus Accrual

None of these assumptions actually highlight the difference between cash and accrual accounting methods. While the rules and processes of accrual accounting can become tedious and specific, the general difference and conceptual frameworks of cash and accrual accounting are very simple and easy to understand.

Cash accounting recognizes only events whereby an explicit cash transaction occurs. Accrual accounting recognizes all economic events, whether cash is exchanged or not. One example to highlight the difference would be the exchange of goods and services for each other without cash. Within a cash accounting framework, there is no specific method to value the "revenue" produced through this trade. Accrual accounting, on the other hand, has a specific technique to recognize the revenue.

Going Forward

While the differences between the two accounting systems are basic, the sheer number of non-cash economic events that happen in a business are numerous, leading to a system that can be intimidating. It is worth it; any time more information is available, better decisions can be made. Analytics in both production and finance will result in more profit and greater success throughout the industry. Going forward, the revenue recognition principle, the matching principle, and how the concept of opportunity cost within the economic entity assumption will be evaluated.

Tim Meyer
Associate Professor of Practice
Department of Agricultural Economics
University of Nebraska-Lincoln
tmeyer19@unl.edu