

Accrual Adjustments to IRS Schedule F Data Recording Sheet

The purpose of this spreadsheet is to facilitate the use of cash data prepared for IRS reporting and combine this with accrual adjusted financial statements and cow-calf reproduction data to provide business financial statements and cow-calf profitability and cost reports.

The source of cash data is the IRS Schedule F “Profit or Loss from Farming”. The Net farm profit or (loss) reported on line 34 of the IRS Schedule F “Profit or Loss from Farming” **is not intended to be the measure of ranch profit**. The Schedule F is used for the taxpayer to report taxable income which is acceptable to a taxing authority, consistent with the statutes and regulations of that taxing authority. The schedule F. **is not a business income statement**.

Measuring ranch or cow-calf profitability requires accrual adjustments **to match revenue with expenses during the fiscal year**. An accrual ranch expense is the amount of expense that is associated for the fiscal year. Revenue is recorded **when earned and expenses are recorded when incurred**. This is in contrast to the **cash basis of accounting** where revenue is recorded only when cash is received, and expenses are recorded when cash is paid. When using, cash accounting no attempt is made to match revenue against expenses. However, this cash data is a big part of developing useful accrual adjusted financial statements.

Adjustments to cash data (accrual adjustments) includes recording change in inventories, prepaid expenses, accounts receivable and payable, taxes and interest. End of year recording of accrual adjustment data is an additions task that must be completed in a timely manner which

For the purpose measuring ranch profit expenses, should include a cost equivalent to **compensation for unpaid operator and family labor and management if hired**. Owner wages and salaries are not included in the IRS Schedule F expenses for sole proprietorships expenses. Other forms of business entities may have owner compensation in operating expenses. Family living expenses/withdrawals is also a measure of compensation. If withdrawals are excess of a hired equivalent it means that capital draws are required to cover living costs.

Net Accrual Income or Profit is the accrual revenue earned minus the accrual expenses incurred during the operating year without regard to the timing of exchange of cash. **Profitability** is the ability of the business to generate income in excess of expenses. It is expressed as the net returns to capital used in production. **A business cannot be sustainable if it is not profitable**.

Key Definitions

- **Measuring ranch profitability** requires accrual adjustments **to match revenue with expenses during the fiscal year**. Ranch revenue is recorded **when earned and expenses are recorded when incurred**. This is in contrast to the **cash basis of accounting** where revenue is recorded only when cash is received, and expenses are recorded when cash is paid. When using, cash accounting no attempt is made to match revenue against expenses. However, this cash data is a big part of developing useful accrual adjusted income statements

- **Net Accrual Adjusted Income** - Revenue earned minus the accrual adjusted expenses incurred during the operating year including the interest expenses are subtracted from cash operating income. Net income is calculated after accounting compensation for owner operator labor and management. For operations that pay salary and wages, this cost is included in operating costs.
 - In the financial and economic calculations owner labor and management compensation is subtracted. If family living withdrawals exceed this compensation, it's a capital withdrawal. This is consistent with the way retained earnings are calculated in the total farm/ranch financial statements.
 - Financial performance ratios are normally pre-income tax for comparative purpose and to compare alternative investments.

- **Return on Assets (ROA)**. This ratio is an indicator of how productive the assets are being used by the enterprise. This percentage is calculated as net income from operations plus interest expense minus family withdrawal representing a payment to owner labor and management divided by average total assets. The reason interest is added back is interest paid represents a return the debt capital. **ROA is a return to capital invested irrespective of capital ownership.**
 - When examining ROA from a market value basis, the value for average total assets is determined by their current market value. The resulting percentage evaluates profitability based on current market value. In other words, this is an indication of profitability if one was to go into the market place and acquire the assets at their current market value.
 - If the market price of the product is below the financial cost of production, it means the producer is using equity to stay in production. If the market price of the product is below the economic cost of production, it means that the resources are producing a return less than their opportunity cost. This means the resources would generate more net income if they were invested in their next best use.
 - ROA indicates the profitability per dollar of assets, thus allowing comparisons over different size firms and different types of businesses or investments

- **Return on Equity (ROE)** - Is the net income after all interest charges. That is, the residual return to the owner's investment divided by the average equity investment. It is a measurement of the return the owners of the business receive on their money invested. ROE can be compared to rates of return in other equity or investment opportunities.

Reference:

Farm Financial Standards Council. “*Financial Guidelines for Agricultural Producers*”, Revised 2021. WWW.ffsc.org.

Texas A&M University – Department of Agricultural Economics Beef Cattle Decision Aids
<http://agecoext.tamu.edu/resources/decisionaids/beef>