

## Grain Farm IRS Tax Compliance to Accrual Adjusted Financial Statements

The farm business accounting system first must provide the data for compliance for the Internal Revenue Service (IRS) “Tax Profit or Loss from Farming” Schedule F, reporting on a cash basis. The challenge is to first meet IRS compliance needs. Then add additional data to provide report the business accrual adjusted financial statements and use the Farm Financial Standards Council (FFSC) standardized measures of financial position and performance (see Appendix A). This Excel™ spreadsheet decision aid will report the accrual adjusted financial statements and calculate FFSC’s measures values. Crop income and cost reports are also provided.

The following is a list are some of the areas that need to be addressed.

- a. Lack of accrual income and expenses adjustments prevents reporting business profitability.
- b. No balance sheet is required to complete the IRS Schedule F. A key report for managers and lenders.
- c. IRS does not deal with debt payment necessary to calculate business repayment capacity.
- d. Accelerated IRS depreciation overstates depreciation cost (See Appendix B).
- e. **Crop total unit cost (TUC)** that combine production and financial data cannot be calculate with IRS Schedule F data.

This decision aid can use data in any completed IRS Schedule F filing. The purpose of this guideline is also facilitate setting up Intuit’s QuickBooksPro™ (QB) accounting software to meet IRS compliance needs and also provide more financial statements preparation data.

### QuickBooksPro™ Implementation

1. Farm bookkeeping and reporting needs can be accomplished using (QB) software when it is set up with the proper chart of accounts. This requires:
  - Communicate with CPA in set up and implementation to ensure compliance with tax reporting needs spelled out by the CPA.
  - Define a chart of accounts that provides more detail on revenue and expense items than required by IRS reporting.
  - Identify costs and revenue by activity in QB for cost analysis using classes in QB.
2. Bookkeeping activities to accomplish (See appendix B for job description):
  - Payment of all bills, record revenue in timely manner.
  - Reconcile bank statements monthly.
  - Ensure payroll compliance and reporting to employees.
  - Provide cash P&L statements monthly to the owners.
  - Combine the P&L with other financial and production reports using Excel.
  - Coordinate preparation of monthly and quarterly cash reports with CPA.
  - Facilitate annual tax reporting and managerial financial statement preparation.

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Follow the IRS Schedule F “Profit or Loss From Farming” required select accounts for reporting to IRS. Sub accounts can be added to address management needs. Aim to limit added sub accounts. Good definition of what is recorded in each account is important.

**Exporting QB P&L report to Excel™ is great for analysis while not “messing up” QB revenue and expense transactions.**

Listed below are the IRS Schedule F revenue report and list of expense accounts. Selected details or sub-accounts are added under IRS cost items such as depreciation, repairs and hired labor and management to facilitate monitoring cost and reporting.

IRS lumps all sales and adjustments into three accounts. Add detail subaccounts to the chart of accounts categories by grain crop to accomplish this.

### **Part I Farm Income – Cash Method – IRS Schedule F Accounts**

Print out the IRS Schedule F “Profit or Loss from Farming” form and work with the business CPA on what revenue and subaccounts fits the farm business. Having details in the chart as subaccounts of IRS accounts is valuable information for cost calculation and projections. Add an account for Futures or Options (+/-) Risk Mgmt. if used.

When setting up assets, liability and equity accounts **be sure to get the business CPA involved.** The lender can also be helpful. Explain to the accountant that management information is needed in addition to IRS compliance. The business CPA will assist in making entries to maintain these accounts and maintain the depreciation schedule.

QB reports can be exported the Excel™ for calculation of costs and net income by activity without changing accounting transactions or compliance with IRS rules. QB software is available to address payroll accounting requirements.

The following show what the chart of accounts is required when complying with the data needs using the IRS Schedule F. Tax “Profit or Loss from Farming”, reports for a crop farm.

### **IRS Expenses Accounts and Sub-accounts Account Numbers are from the IRS Schedule F.**

- 10 Car and Truck Expense
- 11 Chemicals
  - By Crop
- 12 Conservation Expense
- 13 Custom Hire (machine work)
- 14 Depreciation
- 15 Employee Benefits Programs
- 17 Fertilizer & Lime
  - By Crop**

- 18 Freight & Trucking
  - 19 Gasoline, Fuel, & Oil
  - 20 Insurance
  - 21 Interest Expense
    - a. Mortgage - Real Estate Interest
    - b. Other Interest - Non-Real Estate
  - 22 Hired Labor & Management – (sub accounts are added detail)
    - Salary
    - Payroll Expenses
    - Contract Labor
  - 23 Pension & Profit-sharing Plans
  - 24 Rents or Leases
    - Vehicles, Machinery, & Equipment
    - Land - (Cash Lease)
      - By Crop**
  - 25 Repairs & Maintenance (sub-accounts are added to give more detail on expenses)
    - Vehicles
    - Machinery & Equipment
    - Buildings & Improvements
  - 26 Seed & Plants
    - By Crop**
  - 27 Storage and Warehousing
  - 28 Supplies Purchased
  - 29 Taxes (non-IRS)
  - 30 Utilities
- 32 Other Cash Expenses Specify see list below
- a. Professional Fees
  - b. Office (user defined subcategory details)
    - Supplies
    - Utilities
    - Administrative Wages & Payroll
  - c. through f. Other (user defined)

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Second level is a **sub-account** to add detail useful for management cost accounting.  
 Feed (16) and Veterinary, breeding and Medicine (31) removed from IRS list.

### **Cost and Profit Report Organization**

When thinking about cost accounting always keep the final content in the report in mind. Cost reporting in the grain crop sector is often incomplete. Reporting only cash cost leaving off depreciation and owner compensation two of the most significant cost is wrong and misleading. Costs are organized for each crop to report total costs, net income and profit.

Of course, invoices and receipts organized in a consistent and standard way are very desirable. Getting the chart of accounts defined is the starting point. Accurate expense labeling and allocation of costs between different activities or classes is critical and time consuming by the bookkeeper. Clarity in definitions of costs helps for all involved from data collecting to reading reports.

### **Bookkeeper, Data Collectors and Report Providers**

**Reward your bookkeeper** and all the data collectors as they help you and your CPA avoid IRS auditors and keep a focus on the business performance. Monitor and use revenue and expense reports information at least monthly will lead to cost savings and more informed decision making.

QB reports can be memorized so requesting reports is on call. Meet with the business tax accountant no later than October in a calendar fiscal year for tax planning.

Increased complexity of tax and regulation reporting compliance requires a greater amount of time. In this volatile decision environment knowing cost and net income by activity have never been more important. Timely use of accounting data in decision making **is a cost-effective activity.**

Using the IRS Schedule F “Profit or Loss From Farming” to measure and report cash and depreciation costs of production and Farm business profitability is possible with some **serious adjustment.** Just always keep in mind what the IRS labels as “Net farm profit or (loss) is **not a good measure of profitability** or change in business equity.

Accrual adjusted income differs from IRS cash profit or (Loss) for the following reasons:

1. **Compensation** for owner operators labor and management or family living withdrawals. Recall in a sole proprietorship this **is not a tax-deductible expense.**
2. **Accrual adjustments** are required for changes in revenue from grain sales and crops in storage ready for sale, accounts receivable and change in expenses for change in grain inventories or supplies, prepaid expenses, accounts payable and accrued taxes, interest and investment in growing crops.

### **Appendix A: Copied from the “FFSC Guidelines” 2021**

**What is Measured Financial analysis of a producer encompassing both the “financial position” and “financial performance.”**

**Financial position** refers to the total resources controlled by a producer and total claims against those resources, at a single point in time (a stock concept). Measures of financial position indicate the producer’s financial strength, capacity to withstand risk and provide a benchmark against which to measure the results of future decisions.

**Financial performance** refers to the results of production and financial decisions contributing to financial strength, over one or more periods of time (a flow concept). Measures of financial performance show factors that contribute to profitability and include external effects (i.e., drought, grain embargoes, etc.), and the results of operating and financing decisions made in the ordinary course of business.

**Financial Criteria** **Financial** measures are grouped into five criteria: liquidity, solvency, profitability, repayment capacity, and financial efficiency. All measure either financial position or financial performance.

**Liquidity** measures the ability to meet financial obligations as they come due in the ordinary course of business, without disrupting the normal operations of the business.

**Solvency** measures the amount of borrowed capital (or debt), leasing commitments, and other unpaid expense obligations used by a producer in relation to the amount of owner equity invested in the business. Debt capital is interest-bearing and/or has a date by which debt must be paid. Therefore, solvency measures provide (a) an indication of the producer's ability to repay all financial obligations if all assets were sold (for the prices indicated), and (b) an indication of the ability to continue operations as a viable business upon experiencing various financial adversities (e.g., drought, market collapse, expense overrun) which typically results in increased debt or reduced equity.

**Profitability** measures the extent to which a producer generates a profit from the use of land, labor, management, and capital.

**Repayment capacity** measures the ability of a borrower to repay term debt from farm and non-farm income. Principal payments on term or non-current debt come from net income (with depreciation added back) after owner withdrawals, income taxes, and Social Security taxes.

**Financial efficiency** measures the intensity with which a producer uses the assets to generate gross revenues and the effectiveness of production, purchasing, pricing, financing, and marketing decisions.

## **Appendix B: Depreciation Cost Calculation Alternative to IRS Reporting**

Provided here is a brief description of depreciation and alternatives to IRS Schedule F. A sheet in this decision aid provides an alternative to estimate "management" depreciation cost.

**Depreciation** is the accounting procedure used to allocate a capital investment to the annual use cost of the capital asset. Capital assets are purchases that have a productive life of more than one year. The number of years the cost on an asset is allocated each year depends on the "productive or economic life" of the asset less the **salvage value** or what the asset is worth after the **economic life** is over.

**Internal Revenue Service (IRS) Depreciation** is the procedure that IRS requires a business to follow to calculate tax-deductible depreciation. It should be clear that the rules followed to calculate IRS depreciation **are not good estimates** of depreciation for production cost calculation.

**Recovery period** for trucks, trailers, computers, tractors, machinery, equipment and breeding stock is 5 years and fences its 7 years.

### **Expensing option - Section 179**

Accelerated depreciation using Section 179 and zero salvage value for IRS depreciation distorts year to year depreciation cost when calculating total unit cost. IRS rules allow write off or expensing asset purchases in the year they are purchased. Using section 179 can really distort depreciation for management purpose. Many framers can write off all capital replacements in the year purchased overstating depreciation expense and under reports management profitability. This may be prudent "tax management" if there are taxable income to offset the depreciation.

### **IRS Depreciation Asset Recovery Life**

IRS depreciation rules define recovery period (life) and the calculation method but the methods have little to with economic or management useful life of assets or the rate the assets are really used. Some produces are using 150% declining balance. Short recovery period (useful life) with no salvage value means current year depreciation can be overstated for the purpose of development management financial statements and estimating total unit cost.

### **Depreciable Basis or Acquisition Cost**

This is the total cost of the asset placed in service. It's important to check IRS rules on a trade in as trade in will reduce the cost basis of depreciable assets and annual depreciation.

**Sheet 4 titled Capital Asset Replacement Cost Calculation** in the decision aid capital asset recovery cost calculation is provided in this spreadsheet can provide a good estimate depreciation. It should be clear that "**book**" depreciation or the **capital asset replacement cost** sheet used in the **decision aid does not replace the IRS depreciation.**

These alternatives just give a better managerial depreciation cost value. The following describes depreciation. The purpose of this spreadsheet is to calculate capital asset recovery cost to replace IRS annual reported depreciation to more closely reflect the cost of depreciable assets for management cost calculation.

The capital assets include vehicles, machinery, equipment and improvements. Cost of replacing these assets is a major annual cash flow requirement. It's always addressed in the business plan. Not replacing these assets is referred to as living on depreciation.

The user defines the economic life and salvage value. Assets include are recorded in the business depreciation schedule. Values of assets will have to be updated to reflect current replacement costs. The same assets listed for the IRS depreciation should be included.

The added assets in the fiscal year are information that should be reported to the ranch tax CPA.

When an asset reaches the end of its useful life frequently there it can be sold and the amount received is the salvage value. **Depreciable Basis or Acquisition Cost** is the total cost of the asset placed in service.

**Always involve the business CPA when addressing the IRS compliance issues.**

### **Appendix C: Job Description for Farm/Farm Bookkeeper**

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#### **Title Bookkeeper, Full-time or part-time and reporting to Owner or Manager**

##### **SUMMARY OF RESPONSIBILITIES**

Bookkeepers assist management by providing bookkeeping, payroll, accounts payable management and basic analytical work for the owners or managers. Bookkeepers may also be responsible for tracking land leases and landowner relationships.

##### **ESSENTIAL FUNCTIONS**

1. Become familiar with the organization's policies and procedures.
2. Perform bookkeeping and basic payroll services for the organization.
3. Manage and maintain accounts payable ledgers always mindful to take advantage of early pay discounts.
4. Prepare and submit accounts payable payments as needed with the approval of owners or managers.
5. Prepare and maintain trial balances, depreciation schedules, and debt amortization schedules. Will work closely with the organization's CPA on this task.
6. Maintain the organization's filing system.
7. Update analytical spreadsheets to assist management in decision making. Will work closely with owners and management on this task.

##### **EXPERIENCE**

Individuals at this level normally have a basic understanding of bookkeeping principles, but may not have obtained a college degree that includes a significant concentration of accounting. A basic understanding of QuickBooks Online and Microsoft Excel is crucial.

This job description does not list all the duties of the job. You may be asked to perform other assignments and duties. You will be evaluated in part based on performance of the tasks listed in this job description.

The firm's management has the right to revise this job description at any time. The job description is not a contract for employment, and either you or the firm may terminate employment at any time, for any reason.

**References:**

**Farm Financial Standards Council:** “Financial Guidelines for Agricultural”. 2021, Farm Financial Standards Council, website [www.FFSC.org](http://www.FFSC.org).

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

**Iowa State University** <http://www.extension.iastate.edu/agdm/wholefarm/xls/c3-56comprfinstatement.xlsx>

**University of Minnesota** for Financial Management (CFFM) **FINBIN** and **FINPACK**  
[www.extension.umn.edu](http://www.extension.umn.edu)

**Oklahoma State University – Department of Agricultural Economics**  
<http://www.ageco.okstate.edu/livestockbeefextension>

**Kansas State University and Kansas Farm Management Association -**  
[agmanager.info/KFMA](http://agmanager.info/KFMA)

**Farm Business or Management Associations** have web sites in a number of states including: ND, NE, IA, IL and MN.