

Importance of Accrual-based Financial Statements

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AgBiz Masters 
A Learning Series for Young & Beginning Farmers

Purpose of financial accounting

“Have to” Reasons

- Meet requirements of tax laws
 - TAXES - Income, Self-employment, Payroll

“Should do” Reasons

- **Make decisions**
 - Internal owner, manager, and employee team
 - External accountant, lender, and consultant team
- **Benchmarking**
 - Foundation to business financial decisions



Financial Accounting Methods

Cash Basis



Image by [NikolayF.com](https://www.pexels.com/photo/rolled-up-us-dollar-bills/) from [Pixabay](https://www.pexels.com/)

Accrual Basis



Image by [Pexels](https://www.pexels.com/photo/laptop-computer-on-desk/) from [Pixabay](https://www.pexels.com/)



Cash accounting

- Just as it suggests, transactions follow the cash
- Income reported when realized (received)
 - Milk check is deposited
 - Cash from vegetable sale is received
- Expenses reported when paid
 - You write a check for the feed bill
 - Electronic transfer for loan payment



Accrual accounting

- A little more complex
- Income reported when items/services are sold
 - You deliver hay to a neighbor and send them an invoice
 - You harvest corn and store it until next year
- Expenses reported when incurred
 - A bill for feed that is delivered by not paid
 - Custom operator harvests your corn and sends you a bill



Cash: Why a poor profit indicator?

- Inventory
 - Which Schedule F line(s) indicate(s) a change in inventory?
- Accounts Payable/Receivable/Prepays
 - Which line(s) shows accounts receivable or payable or how much was prepaid for next year?
- Capital
- Depreciation
 - Which line reports a cost for depreciation?
- **These have a big impact on profit and credit decisions**





Profitable Porkers Case Study



Profitable Porkers



- Objectives:
 - Discover importance and benefits of accrual accounting
 - Gain understanding of creating an accrual:
 - Balance Sheet
 - Income Statement
 - Learn how to construct market value balance sheet





Profitable Porkers Highlights

- Poor Cash performance
 - Business change in 2023
 - Tax return shows \$1,060,000 loss
 - Lender requests accrual statements
- 2023 Year end balance sheet
 - Loan statements
 - Transactions around Dec. 2023 & Jan. 2024
- Depreciation





Profitable Porkers Homework

- 1. Complete the 12/31/23 accrual balance sheet** using the provided data
- 2. Calculate the difference between the 12/31/23 and 12/31/22** balance sheet accounts and record amounts under the difference column
- 3. Use the differences calculated #2 to determine adjustments** that need to be made to the cash (tax) basis income statement to convert it to accrual basis



Let's Do One Together:

Financial Data #2: Paul uses \$100,000 to get 24 feed incentive

- 2023 Balance Sheet & Difference



Profitable Porkers, LLC Accrual Balance Sheets December 31 2023 and 2022

	2023	2022	Difference
Assets			
Cash	25,000	75,000	
#3 Accounts Receivable		20,000	
Inventories:			
Feed	85,000	40,000	
#6 Livestock		650,000	
#2 Prepaid Expenses	100,000	-	100,000
#4 Machinery and Equipment		20,000	
#4 Accumulated Depreciation		(11,000)	



Let's Do One Together:

Financial Data #2: Paul uses \$100,000 to get 24 feed incentive

- 2023 Accrual Income Statement



Profitable Porkers, LLC Income Statement For the Year Ended December 31 2023

	Cash (Tax)	Adjustments	Accrual
Sales	1,560,000		
Expenses			
Purchased Feed	1,780,000	-100,000	1,680,000
Change in Feed Inventories	0		
Change in Livestock Inventories	0		



Profitable Porkers Exercise Due: February 27



Thank you!

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