Profit & Loss Statements: Measuring Profitability and Net Worth Growth

Anastasia Meyer
Extension Educator, Center for Agricultural Profitability
ameyer71@unl.edu

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What We Will Cover

- Why go beyond tax records?
- Anatomy of a P&L statement
- Cash basis vs accrual basis (and accrual-adjusted)
- Connecting P&L to net worth change
- Linking performance to long-term goals

Why Measuring True Profitability Matters

- Tax records (Schedule F, etc.) may not reflect full operational performance.
- Profitability drives capacity to invest, reduce debt, build net worth.
- Operational insights (input use, marketing, scale) come from more detailed analysis.

What a Profit & Loss (P&L) Statement Is

Also called Income Statement or Operating Statement.

- Shows revenues minus expenses over an accounting period.
- Typical structure:
  - Revenue (sales, program payments, insurance, custom work)
  - Operating expenses (inputs, labor, repairs, etc.)
  - Non-cash/adjustments (inventory changes, depreciation)
  - Net farm income or loss

Accounting Methods: Cash, Accrual & Accrual-Adjusted

- Cash basis: revenue when cash received; expenses when paid.
- Accrual basis: revenue when earned; expenses when incurred.

- Accrual-adjusted: cash records plus inventory changes, accounts receivable/payable, true depreciation.
- Why accrual adjustments matter: improve accuracy of profitability measurement.

You'll need the following

- Most recent Schedule F (IRS 1040F)
  - Revenue (sales, program payments, insurance, custom work)
  - Operating expenses (inputs, labor, repairs, etc.)
- Current Beginning Balance Sheets (Net Worth Statements)
- Current End of Year Balance Sheets (Net Worth Statements)

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Walk-through: Accrual Adjustments in Practice

- Net Farm Profit (or Loss) on 1040F is $6,500

- How profitable is the farm or ranch really?

Walk-through: Accrual Adjustments in Practice

- 1040F Depreciation = $53,000
- Large purchases like land or machinery?

Inventory Changes	1-Jan	31-Dec
Prepaid & Supplies	$ 15,000	$ 4,600
Hedging Gains or Losses	$ 1,500	$ 500
Crops & Feed	$ 80,000	$ 105,000
Market Livestock		$ 25,000
Breeding Livestock	$ 30,000	$ 30,000
Other Assets	$ 3,200	$ 3,300
Accrued Interest	$ 5,200	$ 3,600

Actual Depreciation	1-Jan	31-Dec
Machinery & Equipment	$ 320,000	$ 292,000
Titled Vehicles	$ 38,172	$ 32,446
Buildings & Improvements	$ 42,574	$ 40,446

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Profit & Loss Statement: Accrual Adjustment Example

Profit & Loss Statement is also known as Income Statement

Schedule F Net Farm Profit (or Loss)	Sch F Line 34			$ 6,500
Add back tax depreciation	Sch F Line 14			$ 53,000

Accrual Adjustment

Inventory Changes	**1-Jan**	**31-Dec**	**Change**	
Prepaid & Supplies	$ 15,000	$ 4,600	$ (10,400)	
Hedging Gains or Losses	$ 1,500	$ 500	$ (1,000)	
Crops & Feed	$ 80,000	$ 105,000	$ 25,000	
Market Livestock		$ 25,000	$ 25,000	
Breeding Livestock	$ 30,000	$ 30,000	$ -	
Other Assets	$ 3,200	$ 3,300	$ 100	
Accrued Interest	$ 5,200	$ 3,600	$ (1,600)	
Total Inventory Changes				$ 37,100
Net Operating Profit (Sch F Net Farm Profit + Back Tax Depreciation + Total Inventory Changes)				**$ 96,600**

Actual Depreciation	**1-Jan**	**31-Dec**	**Change**	
Machinery & Equipment	$ 320,000	$ 292,000	$ (28,000)	
Titled Vehicles	$ 38,172	$ 32,446	$ (5,726)	
Buildings & Improvements	$ 42,574	$ 40,446	$ (2,128)	
Total Actual Depreciation				$ (35,854)

Accounts Payable	(current bills that need payed)		$ 5,000	
Accounts Receivable	(money owed to you)		$ 1,200	
Net Farm Income (Net Operating Profit + Total Actual Depreciation -Acc. Payable + Acc. Receivable)				**$ 56,946**

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Walk-through: Accrual Adjustments in Practice

- Net Farm Profit (or Loss) on 1040 is $6,500
- How profitable is the farm or ranch really?
- **Accrual Adjusted Net Farm Income: $56,946**

From Profit to Net Worth: Reconciliation Matters

- Profit & Loss = True Profitability of the Operation
  - Over a period of time
- Balance Sheet = Snapshot at a point in time.

- Net worth (owner's equity) = Assets – Liabilities.
- Change in net worth = retained earnings + asset value changes.
- Why reconciliation matters: you want profit to translate into growth of net worth, not just cash flow.

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Walk-through: Net Worth in Practice

- January 1 Net Worth = $450,100

Personal Income	Yearly		$ 32,000
Family Living Expenses	Yearly		$ 46,000
Taxes	Yearly Income + Self Employment		$ 10,132

Personal Changes	**1-Jan**	**31-Dec**
Non-Farm Accounts Payable	$ 2,000	$ 2,850
Personal Assets		
Market Value of Capital Assets	$ 250,000	$ 259,475

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Statement of Owner Equity: Change in Net Worth

January 1 Net Worth	Balance Sheet			$ 450,100
Net Farm Income (NFI)	P&L Statement			$ 56,946
Personal Income	Yearly		$ 32,000	
Family Living Expenses	Yearly		$ 46,000	
Taxes	Yearly Income + Self Employment		$ 10,132	
Personal Changes	**1-Jan**	**31-Dec**	**Change**	
Non-Farm Accounts Payable	$ 2,000	$ 2,850	$ (850)	
Personal Assets			$ -	
Market Value of Capital Assets	$ 250,000	$ 259,475	$ 9,475	
Total Personal Asset Change				$ 8,625
Total Change in Net Worth (NFI + Personal Income - Living Expenses - Taxes + Personal Asset Change)				**$ 41,439**
December 31 Net Worth	(January 1 Net Worth + Total Change in Net Worth)			**$ 491,539**

Using the Data to Drive Decisions

- Use multi-year data to predict future performance.
- Link P&L results to operational changes (e.g., input reductions, marketing strategies).
- Avoid one-time distortions (asset sales, unusual events) when interpreting results.

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From Annual Performance to Strategic Growth

- Align financial results with your strategic objectives (growth, sustainability, succession).
- Use P&L & net worth trends to set realistic targets.
- Build continuous improvement: review annually, adjust, repeat.
- Example: If you want to increase net worth by X% in 5 years, what profits are required now?

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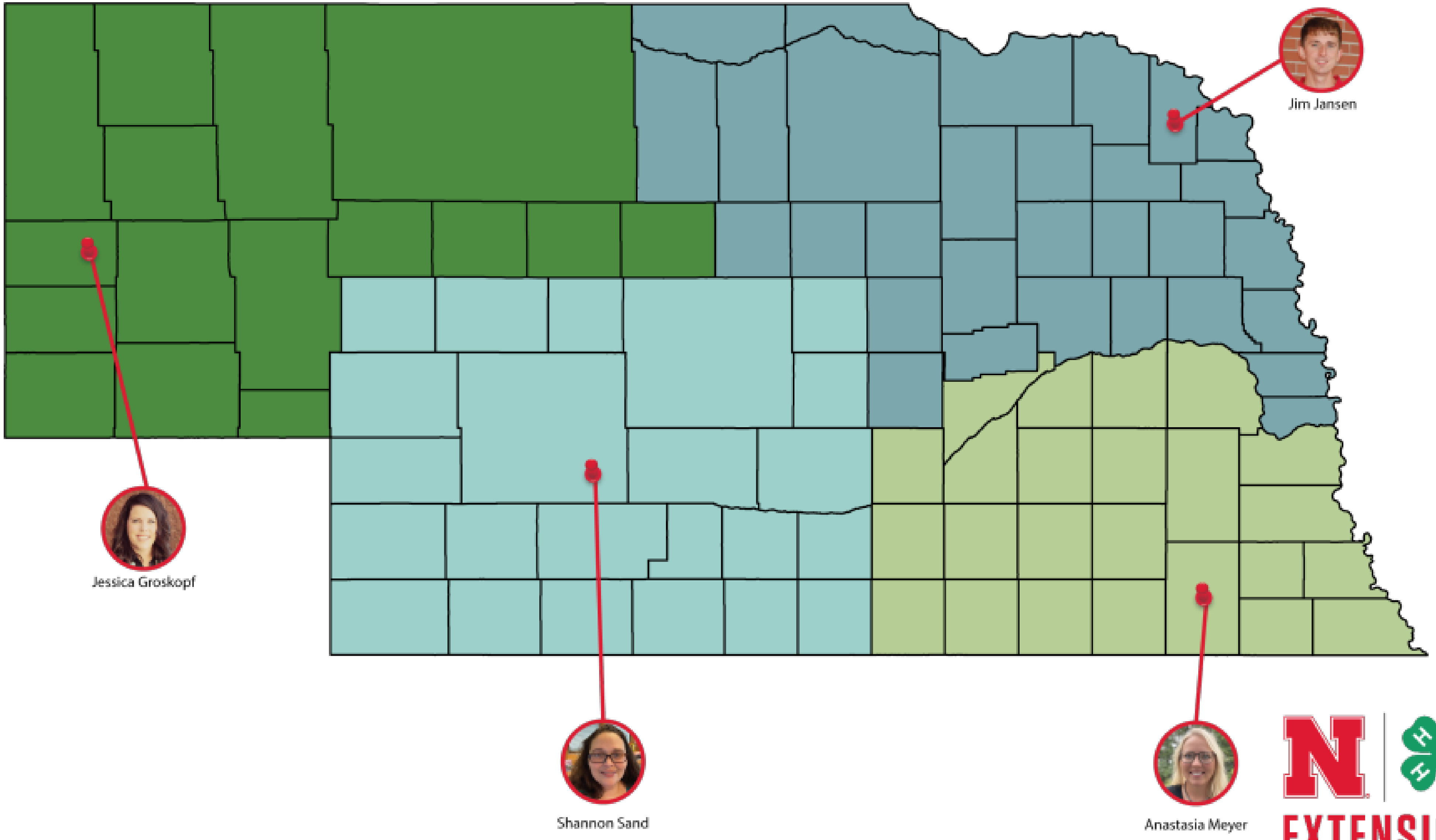
Summary: What to Remember

- A tax-based income figure is a starting point — but not enough.
- Accrual adjustments (inventories, payables/receivables, depreciation) reveal true profitability.
- Link P&L results to balance sheet/net worth for full financial perspective.
- Use margins, efficiency metrics and trend analysis to drive operational improvement.
- Connect annual performance to long-term strategic goals.

AGRICULTURAL PROFITABILITY ACCOUNTABILITY REGIONS



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Resources:

Iowa State University Extension & Outreach, *Your Farm Income Statement* (AgDM C3-25). Iowa State University Extension

University of Nebraska, Center for Agricultural Profitability, *Net Farm Income Impacts Net Worth Growth*. Center for Agricultural Profitability

Mississippi State University Extension Service, *Farm Financial Analysis Series: Income Statement (P3707)*. MSU Extension

University of Arkansas Extension, *Measuring Profitability: Understanding the Ins-and-Outs of a Farm Income Statement (FSA95)*. Arkansas Extension Service

University of Wisconsin Extension, *Preparing an Income Statement – Farm Management*. Farm Management

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