How do producers gather information for financial records?

Do they have an accountant on staff, with a complete purchasing department? Do they pay cash for all farming expenses and then throw the receipt in the trash when they walk out the store doors? Agricultural producers generally fall between these two extremes when talking about bookkeeping, but most will fall closer to the “throwing the receipt away after paying cash” scenario. They will say, “I don’t have time to do bookwork,” and that the only reason to keep records is for filing income taxes. Producers think they can do little to change prices, and that they are already producing as cheaply as possible, so what’s the use in bookkeeping?

Reality is that the majority of producers really do not know exactly what it costs to produce one unit of product. They know the whole-farm expenses and income, and they can tell you the profit margin (income less direct expenses), but rarely can producers segregate **all costs** of the business (including indirect) into responsible enterprises.

**Direct costs** are those that can be easily identified with the production of a specific commodity. For example, the cost of corn seed is a direct cost of the corn enterprise. **Indirect costs** are those that cannot be easily identified with the production of a specific commodity. For example, farm utilities and property taxes.

The commodities sold by an agriculture business are responsible for paying **all costs** associated with their production, both direct and indirect. Only when all business costs are “absorbed”, can producers accurately identify those enterprises that are losing money or those that are making money. Keeping a transaction log (examples and blanks provided) helps the producer organize bookkeeping information so that it can be formed into useful analysis information. It is the 1st step in the bookkeeping system provided in this curriculum.

What is a transaction?

A transaction is an exchange of resources. An expense transaction occurs when a producer gives a resource (money) in exchange for another resource (seed, fertilizer, labor, etc.) Resources gained by the producer (seed, labor, etc.) are necessary inputs to producing a commodity. Some resources will be used in the current growing season (seed), and some resources will be used (expended) over time (tractor). Other resources, although utilized, are never expended (land). Resources that are expended over time are **depreciated**. See below for discussion on depreciation.

Transactions can have many identifiers, and should be classified accordingly. The Transaction Log includes forms for each type of cash transaction. The following should help identify and classify each transaction:

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Duckworth, Brenda, Stan Bevers, Rob Borchardt, and Blake Bennett. Department of Ag Economics, Texas Cooperative Extension, Texas A&M University. May 2003.
Breaking the transactions into enterprises/ centers

An agricultural business usually involves several commodities. To effectively manage an agricultural business, each commodity should be evaluated separately, and costs specific to producing a given commodity should be “matched” to the income produced. Financial transactions should be separated into one of three types of “Centers”- Profit Centers, Cost Centers, or Support Centers.

**Profit Centers:** Transactions (income and expenses) associated with producing a product that will be ready to sell at the end of the production cycle. All income and expenses of the business will eventually be funneled to a profit center. Examples of profit centers are onions, corn, tomatoes, and calves (if sold at weaning.)

**Cost Centers:** Transactions associated with “adding value” to commodities for sale. Cost centers represent a different phases of production for commodities. They should be used when no product will be available for sale at the end of the production cycle or if the production cycle will not complete by year-end. For example, winter wheat is planted in the fall, and producers who graze wheat do not know by December whether calves will graze the crop out or if it will be harvested. If the wheat is grazed out, it becomes an input (feed) for another enterprise (stockers).

Likewise, a cow enterprise can either sell calves at weaning or transfer calves into a stocker phase. The producer should decide to which type of center the cow enterprise belongs according to the intentions of the business. If the intention is that the calves will be sold at weaning, the cow enterprise is a profit center. However, if the intention is to keep the calves through a stocker phase then the cow enterprise should be classified as a cost center. If the producer is undecided, start the cows as a cost center; if at the end of the year the producer decides to keep the calves, simply change the heading to profit center.

**Support Centers:** As the heading suggests, support centers simply “support” the operation. There are 4 typical support centers- machinery & equipment, finance, general & administrative, and labor. Costs accumulated in the support centers are usually overhead costs that are hard to charge at the time of purchase. For instance, the entire cost of a tractor repair cannot be charged to the Onions Profit Center when the same

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* The transaction log is specifically set up for cash (including checking account) transactions so that it flows directly into the Cash Flow Statement. Non-cash transactions are recorded directly to the Income Statement by Enterprise Worksheets.
tractor is used in the production of several other commodities. The repair cost, along with fuel cost, depreciation expense, etc. should be recorded on the “Cash Outflow: Machinery & Equipment Support Center” transaction log form. At the end of the year, all costs accumulated in these support centers are allocated to responsible cost and profit centers. See the Allocations Lesson of this curriculum.

**Recording Income Statement Transactions**

Income and expenses that can be directly associated with a profit center are recorded on the correct profit center form at the time the transaction was made. Seed, fertilizer, feed, vet expenses, etc. are all considered *direct expenses*. See Transaction Log Example #1.

Other expenses, like irrigation, fuel, some labor, although directly associated with production, cannot be easily charged at the time of purchase. These transactions are recorded on the corresponding cost or support center forms of the transaction log. At the end of the year, these costs will be allocated to the responsible profit centers. *Indirect costs*, like utilities, interest, depreciation, etc. are also allocated at the end of the year to the responsible profit centers. See Transaction Log Example #2. See also, the section on Allocations.

- Please note the difference between cash and non-cash transactions. The cash transactions (cash & checking account) are recorded on the transaction log and the non-cash transactions are recorded directly on the income statement or balance sheet worksheets.

**Recording Balance Sheet Transactions**

Some cash transactions are for balance sheet items. For example, the producer gets a loan (cash inflow) and then uses the money to buy a tractor (cash outflow). These two transactions increase both liabilities and assets on the balance sheet.

The transaction log provides different forms for balance sheet transactions and income statement transactions. When a tractor (asset) is purchased, it should be recorded on the “Cash Outflow: Balance Sheet” form under the appropriate account description. Descriptions along the top of the Transaction Log forms represent “Accounts.” New accounts are discouraged, so try to fit all transactions into accounts represented.

**What if the asset was purchased on credit (loan)?**

In a case where the lender writes the check directly to the vendor, the producer’s cash is not affected. However, the liabilities section of the balance sheet increased. A debt is a liability - the business has *received* resources (loan proceeds) for a promise to *give* resources (money) at a later date. No cash has affected the producer (he didn’t gain or lose any cash) at this point, so
both sides of the transaction should be recorded directly to the balance sheet worksheet, as presented below.

(1) The fixed assets section should be increased by the purchase price, and
(2) the liability section should be increased by the amount of the loan.

* If the producer gave cash, like a down payment, that amount should be recorded on the “Cash Outflow: Balance Sheet” form. (Subtract the down payment from the liability; the asset is recorded at full purchase price.) *Any cash inflow or outflow should be recorded on the Cash Transaction Log.* The down payment plus the loan amount should total the purchase price.

**How do producers expense the asset?**

Most machines last longer than one growing season, and are utilized for many different commodities. For instance, tractors are typically used for many years. It is not wise to hold the commodities produced in the year of purchase responsible for paying for the entire tractor. A “useful life” should be assigned to each piece of machinery, and the purchase price is allocated over the number of years assigned. Although the cash was actually spent in year 1, the asset is expensed in each of the 10 years of useful life; the expense is reported as “depreciation expense”.

Depreciation is the method of reporting the portion of the resource (asset) used in the given production cycle. There are many different depreciation methods, so this is one area an accountant should be involved. Your tax accountant has a program designed specifically for calculating depreciation. However, there is one point of discussion on this topic. Tax laws allow producers to accelerate the depreciation expense, which results in a lower taxable income. Accelerated depreciation does not accurately reflect how the resources (assets) are expended, and thereby creates a management dilemma.

For management purposes, the depreciation expense should be figured over a “useful life” assigned by management. The most common method of management depreciation is called **Straight-line Depreciation**. Accelerated depreciation can still be used for tax purposes, but straight-line depreciation should be used for management purposes. Tax accountants have the capability to calculate depreciation using several methods simultaneously, so they are best suited for providing producers with the current year’s depreciation expense.

**How do producers record depreciation?**

Current year’s depreciation expense is the portion of the asset’s purchase price that is paid (expensed) in the current year. Only the current depreciation is recorded on the Income Statement, and is therefore absorbed by the commodities produced. It should be recorded directly to the “Machinery & Equipment” *allocation worksheet*. This expense, along with repairs, etc., is then allocation as specified in the Allocations section of this curriculum.
Since assets reported on the balance sheet must be recorded “net of accumulated depreciation,” the balance of depreciation (total accumulated for all years) is reported just below the asset it represents as a negative number. The net effect of the two accounts is the “Book Value” of the asset (purchase price less accumulated depreciation).

**What about non-farm (personal) transactions?**

It is recommended that personal transactions be kept separate from business transactions. However, most agriculture businesses co-mingle personal and business finances, so personal transactions that are co-mingled with business should be included in the Cash Flow Statement. Including these transactions will allow the producer to reconcile beginning and ending cash.

Any off-farm income (salaries from off-farm jobs) is recorded on the “Cash Inflows- Personal” form; non-farm expenses (groceries, child care, etc.) are recorded on the “Cash Outflows- Personal” form. These personal forms will flow to the business Cash Flow Report, but only the expenses, not personal income, are included in the business Income Statement in the form of “management labor expense.”

**Good Management Practices**

- Management is imperative to longevity; bookkeeping is key in management.
- Write **everything** down, and then organize it into useful information.
- Consistency is the key to having comparable information.
- Do not try to “hide” income or “inflate” expenses for tax purposes- you will only be distorting management information and it just might land you jail!
- Look at the BIG picture- which enterprises are growing the business, and which are killing the business?
- Attend workshops, and seek the help of extension personnel.
- Times have changed- Granddad’s production and bookkeeping practices simply will not work in today’s agricultural environment.