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The Importance of Including Non-Cash Expenses

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When farmers are evaluating their farm profitability, many times, they will only include their cash expenses and they will ignore a very important component of their true profitability. It is very important to include non-cash expenses when determining farm profitability. In this article, we will look at some of these non-cash expenses and why they are important to include when determining true returns to the business.

First, what is a non-cash expense? A non-cash expense is an expense to the operation that does not require a cash outlay. For example, homegrown feed is a non-cash expense for a livestock operation. If a farmer did not grow their own feed, they would have to buy all of their feed and there would be a cash expense in the operation. By choosing to feed their homegrown grain/forage, this farmer is choosing to forgo the opportunity of selling their crop for a profit. Therefore, choosing to feed the grain/forage is an opportunity cost to the operation. Homegrown seed can be looked at the same way as the feed. The farmer chooses to forgo the profit they could receive by selling that seed. The farmer chooses to reinvest the seed into their operation by planting it for the next year's crop instead of purchasing their seed.

A second non-cash expense that is very important to an operation, but sometimes overlooked is depreciation. The purchase of a piece of equipment or building is a cash expense, but the true cost to the operation is the yearly depreciation on that capital item. While operating expenses (fertilizer, fuel, repairs, etc.) are a yearly expense, capital purchases last for several years and therefore are depreciated over a period of years. If the total cost of a capital purchase were applied to the year purchased, the years of large purchases would make the farm look extremely less profitable than those years where little or no capital purchases were made.

Another non-cash expense I want to focus on is unpaid labor. This is usually any labor provided by the farm operator or their family that is not paid. This is another opportunity cost of the farm. The

farmer chooses to work on the farm instead of getting a wage-paying job somewhere else. They also choose to do the work themselves instead of hiring someone else to do the farm work for them. The farmer would not be able to hire someone to do the job for free, nor would the farmer choose to go work at another job for free. Therefore, the farmer should account for the “free” labor they provide the farm and apply a cost to the farm.

One final non-cash expense I want to discuss is a charge for owned land. If Farmer A owns all of their ground and Farmer B rents all of their ground, Farmer B is out more cash expenses from the onset because they have to pay rent and Farmer A does not. If these two farmers are just comparing cash expenses, this automatically puts Farmer B at a disadvantage. Just as the other expenses mentioned above, there is an opportunity cost of Farmer A farming the ground they own. By farming their land, they are choosing to forgo the income they could make by renting their ground to Farmer B. They are also choosing to invest their money into land rather than invest it into something else.

It is very important for a farmer to understand that cash expenses are not the only expenses to a farming operation. There are other important expenses to their operation that do not require cash to exchange hands. If a farmer does not include these non-cash expenses, they will inflate the true earnings of their farming operation.

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