Testimony – Jeffrey Bushey, CPA

My name is Jeffrey Bushey, CPA. I am the Managing Principal of Nietzke & Faupel, PC, a CPA firm that serves a wide range of clients, specializing in tax and accounting for agricultural business, particularly the dairy industry. I have over 30 years of experience in serving the accounting needs of farmers in the Great Lakes region.

I graduated from Central Michigan University with a Bachelor of Science in Business Administration. I began working at Nietzke & Faupel after graduation and earned my CPA license in 1987. In 1992, I became an owner of the firm and now serve as Managing Principal. I am also a member and past president of the Farm Financial Standards Council (FFSC), a nation-wide organization committed to standardizing the reporting formats of agricultural entities. I currently serve as the Co-Chair of the Technical Committee for the FFSC. I am also a member of the Michigan Association of CPA's (MICPA) and the American Institute of CPA's (AICPA).

As the Managing Principal of Nietzke & Faupel, P.C., I lead a team of 14 accountants who provide accounting solutions to our clients. We offer a wide range of services to over 50 large dairies in the Great Lakes region, such as tax preparation and planning, specialized financial reporting, payroll, business valuation, estate planning, and more.

I have been asked by the National Milk Producers Federation to appear today to provide an overview of our dairy farm client operating trend information and answer any questions you may have.

You were provided with a sample dairy financial statement as well as a copy of the dairy industry averages that our firm has compiled. In this testimony, I will describe how we prepare the financial statements and compile these averages for our dairy clients.

The process begins by receiving the quarterly data from our dairy client. This usually comes in the form of a QuickBooks back-up. We perform various procedures to ensure the accuracy and completeness of the data provided, such as ensuring all material bank accounts are reconciled to the bank statements, confirming loan balances with the lenders, and resolving any errors or discrepancies in the transactions. This ensures that the data is accurate and consistent for the preparation of cash basis tax returns for the dairy farm. It also serves as the starting point for our financial statements.

We compile the dairy financial statements according to Generally Accepted Accounting Principles (GAAP) with one exception which I will explain later. GAAP is a set of rules and standards for accountants to prepare financials in a consistent and comparable manner. The main differences between a GAAP basis financial statement and the tax-basis data are as follows: 1) GAAP basis financial statements recognize income and expenses on the accrual basis when incurred; 2) GAAP basis financial statements recognize inventory on hand; and 3) GAAP basis financial statements depreciate capital assets at a different rate than the farm uses for tax preparation.

There are significant adjustments made when preparing GAAP financial statements from the cash basis of accounting to the accrual basis. The accrual basis of accounting requires adjustments to recognize revenues and expenses in the period in which they are earned and incurred, respectively, regardless of the timing of the cash flows. For example, a commodity receivable is recorded for milk checks that are earned for the current month but not deposited until the next month. Similarly, accounts payable are recorded as well as any prepaid or accrued expenses to correctly present expenses in the period incurred.

Another adjustment made when preparing GAAP financial statements is recognizing the feed inventory. For tax purposes, feed inventory is expensed when paid for. For the financial statements, forages are capitalized to assets at the cost of planting, harvesting, and storing the crops or at the cost of purchasing the forage from another producer. The capitalized cost of forages may also include costs such as interest, labor, and depreciation that is directly attributable to the raising of crops for forage. These costs are expensed over time as the forages are fed to cattle. Feed inventory is shown at the lower of cost or market value using the average cost method.

In addition, depreciation is adjusted to reflect a more accurate useful life. The tax basis depreciation is accelerated and allows for a higher expense recognition in the initial year of placing an asset in service. However, the GAAP standards require that depreciation should be distributed over the useful life of the asset. This results in a more consistent and reliable metric to match the cost of a capital asset to the revenue produced by that asset.

Generally accepted accounting principles (GAAP) maintain that livestock should be capitalized at the purchase price and depreciated similar to machinery and equipment and other capital assets. However, a well-maintained dairy herd does not lose value over time. Although individual dairy cows do depreciate, the herd as a whole does not. Lower performing cows are constantly replaced with higher performing cows. Therefore the dairy herd is valued at cost on the balance sheet. If the dairy purchases milking cows, the cost is the purchase price of the livestock. If the dairy raises their own heifers, any heifer raising input costs such as feed and breeding are capitalized to the cost of heifers until they first calve and begin milking. At that point, the heifers are transferred to dairy livestock at the cost to raise them to that point. When cows are sold or die, a “cull cow expense” is charged to operating expenses at the average cost per head of the herd. Revenue received from the sale of cull cows is reported separately under the label “cull cow revenue”. The financial statements value livestock at cost and are not depreciated – which constitutes a departure from GAAP.

These are the main accounting adjustments that are required to adjust from tax basis to GAAP financial statements. The final product each quarter is a financial statement which comprises a balance sheet, statement of income, and a statement of changes in members’ equity. Additionally, a statement of cash flows and notes to the financial statements are included at year-end.

One of the greatest services we offer to clients is comprehensive dairy financial benchmarking and averages. The dairy averages provide a reliable data set clients can use for benchmarking their own financial results to their peers. This allows them to compare their performance with the industry standards and identify areas for improvement. We publish the dairy averages every quarter, after the preparation of the financial statements. These averages contain both financial and non-financial metrics. Below is a table showing key non-financial information for selected years 2007 through 2022.

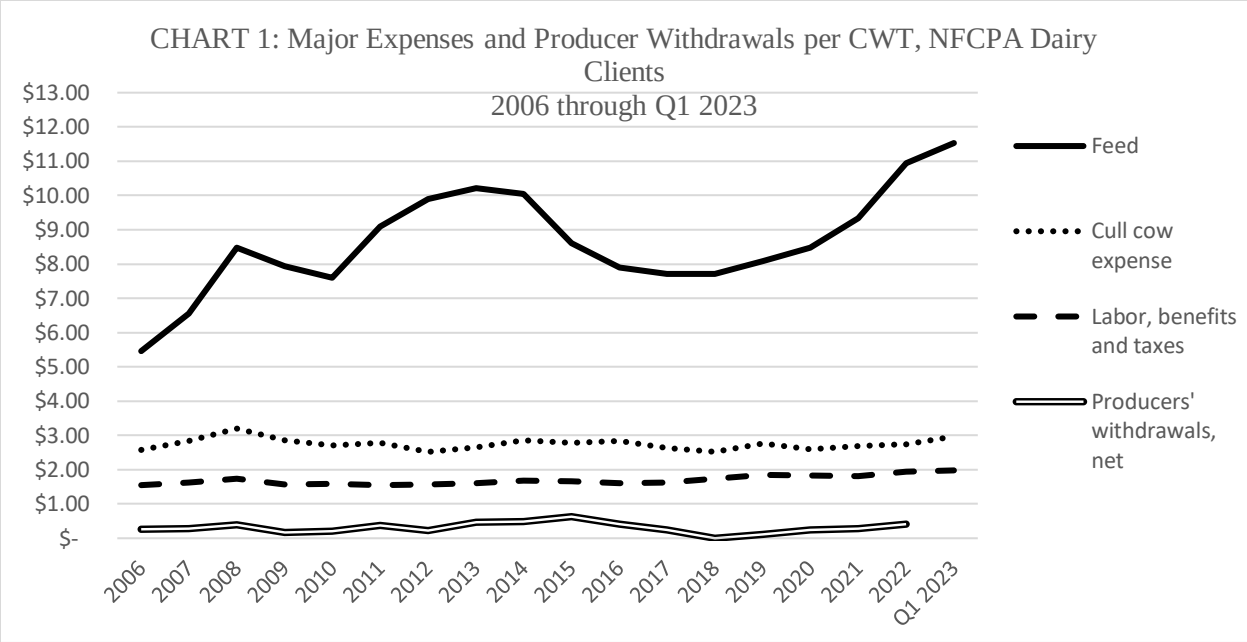
Average Non-financial Metrics for selected years, NFCPA Dairy Clients

Metric	2007	2010	2013	2016	2019	2022
Quantity of Milk in CWT	331,845	396,304	523,944	620,115	762,163	995,115
Average Number of Cows Milked Per Day	1,181	1,468	1,865	2,139	2,638	3,354
Pounds of Milk Per Cow Per Day	77	74	77	79	79	81
Number of Cull Cows	543	624	888	977	1,242	1,523
Annualized Herd Turnover Rate	38.27%	35.72%	40.87%	39.27%	40.46%	38.73%
Average Cows on Farm for the Period	1,419	1,747	2,173	2,481	3,070	3,932

The dairy averages consist of each operating revenue and expense calculated per hundred pounds (CWT) of milk produced and per cow per day. Each client receives this schedule in the supplementary information of their financial statements showing their actual performance compared to the latest averages.

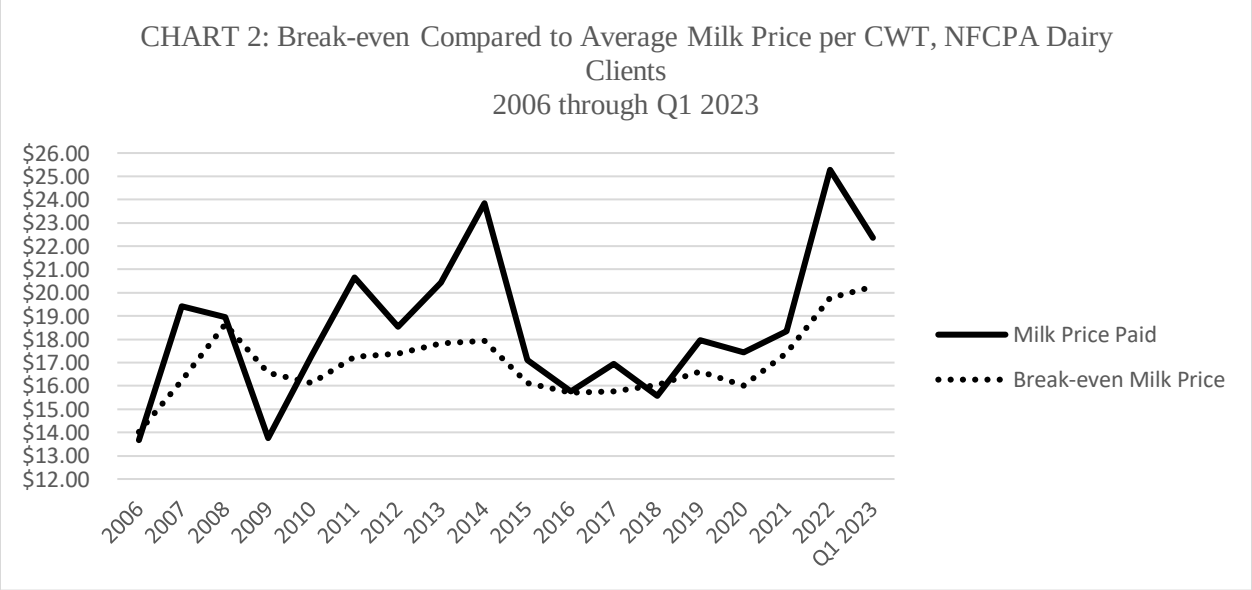
The per CWT transactions are used to analyze trends in expenses. The three largest expenses are feed, labor, and cull cow expense (herd replacement cost). Breaking these down per CWT produced reveals the change in costs over the years. Chart 1 shows this information from 2006 through the first quarter of 2023.

Most of our dairy clients are family-owned limited liability companies (LLCs). LLC members do not take a wage for the work they perform. Instead, they take a withdrawal to cover family living costs. Included in Chart 1 is also the average withdrawals per CWT taken by owners, net of any capital they contributed to their farm in each year. These withdrawals are not reflected in the net income from operations, but still may be taken into consideration when looking at how industry decisions will impact producers' ability to provide for their living.

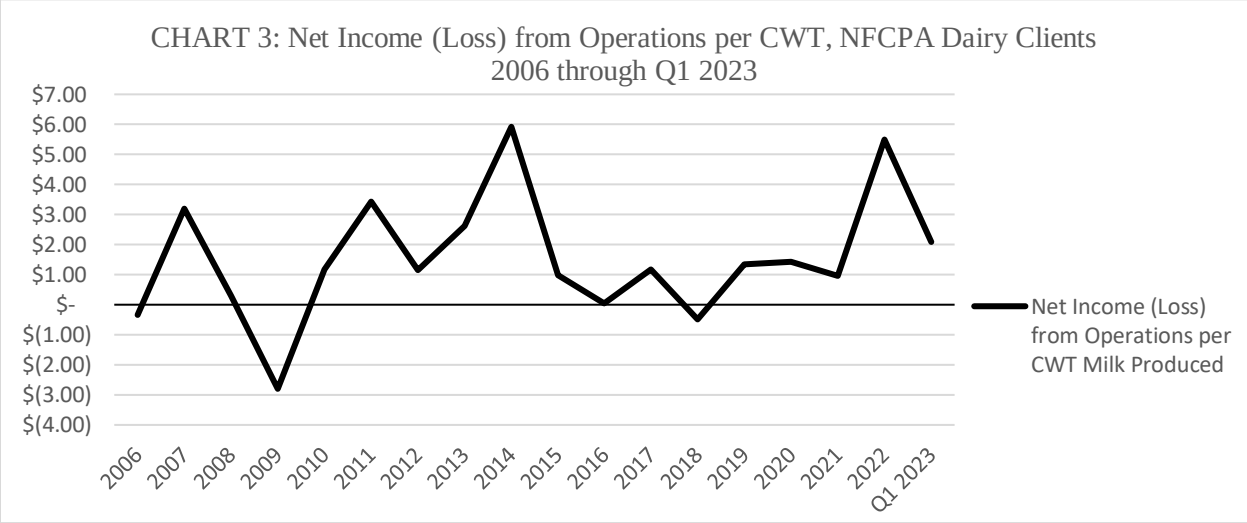


As shown in Chart 1 above, feed expense per CWT has increased every year since 2018, jumping dramatically from 2021 to 2022. As the largest and most volatile expense account, feed expense greatly impacts the profitability of the producer. Labor has also seen an upward trend per CWT.

The trends in in per CWT revenues and expenses reveals how the milk price received compares to the price needed to 'break even'. Break-even milk price is the calculated price at which the farm's operating revenues would equal their operating expenses, holding other revenues, expenses, and production constant. At the break-even milk price they would have shown neither profit nor loss from operations. The following Chart 2 compares the average milk price paid to producers to the average breakeven price from 2006 through first quarter of 2023.



The difference between the actual milk price and the calculated break-even price shows the average profitability per unit of output for each year. Chart 3, below, presents the average net income or loss from operations per CWT over the same range of years as before. The average net operating income from 2006 and 2022 was **$1.54 per CWT of milk produced**. Consider also that this number is before any withdrawals by the producers to compensate their labor and provide for family living expenses. The average net withdrawals from 2006 through 2022 was **$0.31 per CWT of milk produced**. This leaves **$1.23 per CWT of milk produced** remaining after family living.



As shown, these dairy averages are not only valuable for producers, but also for understanding profitability and trends in the industry. By providing accurate and reliable financial information and meaningful benchmarks, our data can help inform you as you consider these proposals. I thank you for your time and attention on these matters and look forward to answering to your questions.