

MANAGEMENT ACCOUNTING GUIDE

HOW TO CONVERT PROFIT AND LOSS ACCOUNTS INTO
A DECISION-MAKING TOOL FOR YOUR FARM BUSINESS



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FOREWORD – GRACE REID

PROGRAMME MANAGER, MONITOR FARM SCOTLAND

Keeping track of your farm's financial performance can sometimes seem like an impossible task, and when it feels like that, it's often seen as the easiest option to hand over responsibility for all of it to your accountant.

But how much better and more useful would it be if you were able to identify problems earlier – costs which are out of line, enterprises which are struggling or chances to learn from what is working best at an earlier stage? Having control and understanding what's going on means you can take action, tackle problems and make the most of things that are going well.

Monitor Farm Scotland's aim throughout our current four-year programme and beyond is to improve the productivity, profitability and sustainability of Scottish farming businesses. Being able to make the right financial decisions is a crucial part of that, and it's something that our Monitor Farms, management groups and wider community have discussed at length and found great value in.

With our focus on being 'Farmer Led, Farmer Driven', this Management Accounting Guide is designed as a useful, practical workbook, helping to convert your profit and loss accounts into a decision-making tool. It's not about adding more paperwork and office time to already busy businesses, but about getting much more from the figures and data you already have to make informed decisions about the future.

Working through this guide will take time initially, and it's probably best done over a few shorter sessions, but the information provided will highlight any problems, show what's doing well and mean you can better plan for the future. Don't expect perfection – this guide is your starting point, use it to take control of your figures and shape the future of your farm business.

As you work through this process, be honest, open-minded and willing to challenge the way things have always been done. It is easy to fall into the trap of justifying the way things have been done, but this is about finding real opportunities for change. The more you embrace the process, the bigger the impact you'll see.

Farming is never straightforward, and there will always be issues to contend with, whether they are political, weather-driven or something else. But having better vision and control of your financial situation and how it fits into the bigger picture can make a real difference. It will help ensure your business is more productive, more profitable, more sustainable and more resilient, whatever comes your way.



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**LAURENCE
GOULD**
RURAL BUSINESS SOLUTIONS



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GUIDE OVERVIEW

This guide supports farmers in using their profit and loss (P&L) accounts as more than just a tool for tax compliance. It shows how to turn financial records into powerful decision-making tools that can improve profitability, manage risk and enhance the long-term sustainability of farm businesses.

Whether you are an upland sheep farmer, a lowland beef finisher or running an arable unit, understanding your income, costs and gross margins is essential. Knowing where money is made or lost gives confidence to make better decisions about inputs, investment, staffing and enterprise mix.

A management accounting template is supplied with this guide and can also be found on the Monitor Farm website (www.monitorfarms.co.uk). This will help you analyse your own accounts and generate the key metrics discussed.

To get the most value from this guide, keep your own accounts to hand and work through the template as you read the guide.



WHY ANALYSING YOUR ACCOUNTS MATTERS

FROM COMPLIANCE TO CONTROL

Many farmers prepare annual accounts to meet legal requirements. These are vital, but they are historical and often lack the detail needed to drive business decisions.

Analysing accounts is about using the information in the accounts to:

- Identify trends over time (e.g. gross margins improving or falling)
- Understand cost structures and enterprise performance
- Identify where money is made or lost
- Benchmark against others in the sector
- Make pro-active business decisions based on facts, not gut feelings

You can then look at your more recent on farm accounting records and see if these trends or issues affecting your business continue into the present and need action.

Good management accounting isn't about adding more paperwork – it's about getting more from the figures you're already collecting. Even basic analysis done quarterly can flag up problems early, highlight success stories and help with forward planning.



COMMON BARRIERS & MISUNDERSTANDINGS

Even with good intentions, many farmers don't get the most from their accounts – often due to how the information is presented or perceived.

HERE ARE A FEW COMMON EXAMPLES:

“ I already have an accountant who looks after the books. ”

That's a common setup, but the focus is usually on compliance. Reviewing figures from a management point of view helps identify patterns and opportunities during the year, not just at year-end.

“ The accounts show a profit – things must be fine. ”

Profit on paper doesn't always match cash in the bank. Personal drawings, repayment of borrowings/hire purchase and taxation all affect cash but not profit, while investments, e.g. in new machinery, will affect future profits for several years. If more cash is being spent than earned, then over time this will erode the net worth of the business.

“ I can't influence most of my costs. ”

While some costs like rent or market prices are fixed, others – such as labour use, machinery efficiency and feed budgeting – can be reviewed and managed. This might mean isolating the cost and testing it in the marketplace (e.g. insurance) or improving technical efficiency (e.g. reducing feed costs) by using benchmarks and taking specialist advice.



Management accounting isn't about finding faults, it's about gaining clarity, control and confidence.

WHY IT MATTERS

CLARITY – Know exactly where money is made and lost.

CONTROL – Manage costs and spot issues before they escalate.

CONFIDENCE – Make better decisions, from buying feed to investing in kit or negotiating with the bank.



The clearer your understanding, the quicker you can act – and the less likely you are to be caught out by rising costs or falling prices.



KNOWING YOUR PROFIT & LOSS ACCOUNT

A profit and loss (P&L) account is a straightforward way of showing your income, variable costs and fixed costs. Understanding each part is the first step to using it as a decision-making tool.

INCOME/OUTPUT

Income in a farm profit and loss account refers to all the money the business earns from its activities. Income in farm accounts includes:

- Sales of livestock, crops and produce
- Contracting or diversification income
- Support payments, such as BPS or AECS
- Other income, such as property lets, wayleaves, grants, renewable income, etc.

EVALUATE YOUR INCOME STREAMS

| INCOME | YOUR OWN FIGURES (OUTPUT VALUES) | YOUR OWN FIGURES (% OF OUTPUT) |
|--------------------|-------------------------------------|-----------------------------------|
| Sales of livestock | | |
| Sales of crops | | |
| Sales of produce | | |
| Support payments | | |
| Other income | | |
| Total income costs | | |

Breaking the income down in this way shows how important each part of the business is in terms of income generation.



Additional space for
workings/notes on p28-29.

NET OUTPUT = SALES + CLOSING STOCK – PURCHASES – OPENING STOCK

Net output is obtained by adjusting the income for opening and closing valuations and, where livestock is concerned, livestock purchases.

The closing and opening stock values are essential, as they reflect the change in value of livestock or crops still on farm at year-end. For example, if you rear lambs that aren't sold by the end of the year, their value is still counted as output.

This gives a more accurate picture of what the business has produced. Livestock purchases are also essential as you need this to account for replacement costs or the purchase cost of store cattle. This is important as it gives a standard comparable figure for enterprise output to use as an initial benchmark either on a per head basis or per hectare.

VARIABLE COSTS

Variable costs rise or fall with the scale of activity on the farm — such as the number of livestock kept or the area of land cropped. Common examples are:

- Fertiliser
- Sprays
- Seed
- Feed
- Vet and medicine
- Livestock sundries

A good rule of thumb: if you reduced livestock or cropping area, would this cost reduce? If yes, it's a variable cost. Tracking variable costs per unit (e.g. per ewe or per hectare) helps you spot inefficiencies. In most farm businesses, variable costs should make up 30-35% of output.

Comparing yourself against industry benchmarks (such as those provided by Quality Meat Scotland [QMS], Farm Advisory Service [FAS] or the Farm Management Handbook [SAC]) is one of the most effective ways to check performance and spot outliers, **while comparing year-on-year with your own figures is the best way to track trends and measure progress over time.**

Benchmarking highlights:

- Whether your output is in line with similar systems
- Where costs are creeping above average
- Opportunities to improve efficiency without sacrificing output



TABLE SHOWS AN EXAMPLE FORMAT FOR BENCHMARKING LIVESTOCK ENTERPRISES

| CATEGORY | YOUR OWN FIGURES (£/ENTERPRISE) | YOUR OWN FIGURES (£/EWE, £/COW) |
|---|------------------------------------|------------------------------------|
| NET OUTPUT | | |
| (Sales + closing valuation – opening valuation) | | |
| Replacement or livestock purchases | | |
| Total net output | | |
| VARIABLE COSTS | | |
| Feed | | |
| Forage (fertiliser, sprays, seed) | | |
| Vet and med | | |
| Livestock sundries | | |
| Total variable costs | | |
| Gross margin | | |

Additional space for workings/notes on p28-29.

GROSS MARGIN

Gross margin is the amount of money left after you subtract your variable costs from your net output. Gross margin is calculated before you account for fixed costs like labour, machinery and rent. Total gross margin also includes all other income.

GROSS MARGIN = NET OUTPUT – VARIABLE COSTS

This is the most useful figure to assess the performance of individual enterprises. It tells you what each enterprise contributes towards covering your overheads and making a profit.

- Break gross margin down by:
- Enterprise (sheep, beef, cereals, diversified activity, etc.)
 - Per head or per hectare basis
 - Compare results annually to see whether enterprise performance is improving or slipping and quarterly to compare against budget to ensure costs are on track

Farm businesses should aim for a gross margin of 65–70% of output for any enterprise, but benchmarking against published figures will give a more accurate target for a specific enterprise.



OTHER INCOME

Other income is added to the net output (to give total net output) and to total gross margin (to give total gross margin) after other income.

The aim is to show the importance of the other income, which includes subsidy and diversification income relative to both the farming income and the farming gross margin. It is also important to think about whether the overhead costs, most of which are typically associated with the farming operations, look low in situations where there are high levels of diversified income.

FIXED COSTS/OVERHEADS

Fixed costs (also called overheads) are the costs of running the farm that don’t change much with small changes in level of production. Whether you have 100 or 150 cows, grow 200 or 300 acres, these costs mostly stay the same in the short term. These are the costs of keeping the business running regardless of production levels.

LABOUR: This refers to the cost of people working on the farm and is classed as a fixed or overhead cost because it generally remains the same regardless of changes in livestock numbers or crop area – at least in the short term.

- It includes:
- Wages and salaries of farm employees
 - National Insurance contributions
 - Pensions and staff benefits
 - Casual labour or contractors/self-employed labour
 - Unpaid family labour (this can be calculated to reflect the true cost of labour)

Even if labour isn't a direct cash expense (e.g. family members working for free), it's still important to assign a notional cost to reflect their time.

This gives a more accurate picture of business performance and makes comparisons with similar farms fairer.

Where labour costs appear high, attributing a notional salary to family members' work can highlight the true cost of labour and improve decision-making.



Labour is often one of the largest overheads on livestock farms – understanding how much labour is used per ewe, per cow or per hectare gives a metric which can then be used for benchmarking against similar farm types. The Scottish Farm Business Income Survey is a useful source of data and can be found on the Scottish Government website (www.gov.scot).

POWER: Costs covering the energy and machinery costs needed to run the farm's day-to-day operations. These are fixed costs because they're required regardless of how much is produced.

They include:

- Fuel (diesel, petrol) for tractors and machinery
- Electricity and heating for sheds and workshops
- Machinery repairs, servicing and maintenance
- Contracting and machinery hire
- Tyres, oils and parts
- Depreciation of plant and machinery – an estimate of the annual machinery cost in place



Keeping track of power and machinery costs per hectare or per livestock unit can help identify savings and improve efficiency.

OTHER OVERHEADS: Also known as miscellaneous overheads or general overheads, these are the fixed costs which don't easily fall into specific categories like labour, power or land, buildings and finance. They cover a wide range of indirect expenses necessary to keep the farm business running.

Common examples include:

- Telephone and broadband
- Office costs and stationery
- Subscriptions and licences
- Training and professional development
- Legal, professional and accountancy fees
- Sundry expenses

These are often grouped together because they are individually small or hard to allocate directly to a particular enterprise. However, when added up, they can form a significant portion of total fixed costs.

LAND, BUILDINGS AND FINANCE: These are overhead costs associated with owning, leasing, maintaining and financing the land and infrastructure of the farm.

They typically include:

- Rent or land lease payments (for tenanted or seasonal ground)
- Repairs and maintenance of buildings, fences, tracks and drainage
- Business or water rates
- Bank charges/interest, hire purchase interest or loan interest
- Depreciation of buildings and fixtures – an estimate of the annual buildings and fixtures costs



Keeping buildings well maintained and ensuring finance is structured sensibly can help manage these overheads in the long run.

WHAT IS DEPRECIATION?

Depreciation is the accounting method used to spread the cost of machinery and buildings over their useful working life. Use the straight-line method for sheds and buildings (e.g. £120,000 shed over 40 years = £3,000/year). Use the reducing balance method for machinery, reflecting higher reductions in value in the early years associated with machinery. Machinery depreciation should be included in power costs and buildings and fixtures depreciation in land, buildings and finance costs.



Including depreciation gives a more realistic view of business performance – even though it's not a cash cost.

SUMMARY OF FIXED COSTS

Fixed costs are often seen as unchanging, but in reality they can be managed and can significantly impact profitability if not regularly reviewed.

Many farms carry high machinery costs or under-utilised labour, especially where the scale of the business has reduced but overheads have remained the same.


Understanding how your fixed costs compare to output is a useful management tool. The table below provides benchmark figures to use as a guide.


These are expressed as a percentage of total farm output and offer a useful starting point for identifying where your costs might be out of line with industry norms.

BENCHMARK FIGURES TO USE AS A GUIDE

| CATEGORY | INDUSTRY GUIDE (% OF OUTPUT) | YOUR OWN FIGURES (% OF OUTPUT) |
|-----------------------------|---------------------------------|-----------------------------------|
| Net output | 100% | |
| Variable costs | 30-35% | |
| Gross margin | 65-70% | |
| FIXED COSTS | | |
| Labour | 15-17.5% | |
| Power and machinery | 15-17.5% | |
| Other overheads | 5% | |
| Land, buildings and finance | 10-15% | |
| Total fixed costs | 45-55% | |
| Net profit | >15%* | |

* High-performing businesses should aim for net profit above 15% of output – see p12

 **Note:** These benchmarks are general guidelines. For farms operating under contract farming or share farming arrangements, reported output or fixed costs may not reflect the full activity of the business. In such cases, benchmarking should be interpreted with care or adapted to suit the specific arrangement. For example, in a share farming agreement income and expenditure will only be a percentage of the normal total while for a contract farming agreement contract costs will replace both labour and power.



Additional space for workings/notes on p28-29.



Regularly reviewing your fixed costs relative to output can help you:

- Spot opportunities to streamline operations
- Assess whether current scale matches overhead commitments
- Improve resilience by reducing exposure to low-margin years
- Aid decision-making when making investments

NET PROFIT

Net profit is the amount left over after all costs have been deducted from your income (including both variable and fixed costs). It shows whether the farm is making money overall.

NET PROFIT = NET OUTPUT – (VARIABLE COSTS + FIXED COSTS)

But remember:

- It does not account for capital purchases (e.g. new tractor)
- It does not show personal drawings or family living expenses
- It may include non-cash figures, such as depreciation
- It does not include finance repayments (hire purchase, bank loans, etc.), only the interest associated with them

Net profit is a good indicator of long-term sustainability, but should not be looked at alone. Cashflow (when in the year payments are received or paid) and balance sheet strength (understanding how your net worth changes year-to-year) are all key metrics important in understanding your business.

High-performing businesses should aim for net profit above 15% of output.

UNDERSTANDING YOUR PROFIT & LOSS ACCOUNT

Understanding your profit and loss account means looking beyond the numbers to see what they are telling you about your business – where costs are rising, which enterprises are performing and how profit is really being made.

THE PROCESS IS:

- Look at your output first, compare with benchmarks and ensure you are maximising output
- Look at your gross margin percentage to ensure variable cost expenditure is on track
- Review your other income including subsidy to understand how reliant you are on this income and whether the farming business is performing in its own right
- Look at your fixed costs to ensure they are in line with the gross margin being generated
- Circle back and look at the business as a whole and see if any new areas to look at stand out

TURNING NUMBERS INTO DECISIONS

It's not enough to record the numbers – the value lies in asking questions and acting on what they reveal.



Be critical, honest and open-minded throughout this process, try not to fall into the trap of justifying the status quo but look for areas where real change can be made. The exercise is about making your business more profitable for you and your family, the more you embrace the process the bigger the impact you will have.

Key questions to ask:

- Which enterprise makes the largest contribution to fixed costs?
- Are variable costs rising faster than output?
- Is machinery or labour under-utilised?
- Are your profits resilient to price or cost fluctuations?
- How reliant is the business on support schemes?
- Are fixed costs in balance with the gross margin being generated?
- Could the business benefit from developing alternative income streams?
- Is the business generating enough profit to comfortably meet family living expenses, repay any capital portion of loans and provide for future investment?

These questions help highlight where the business is genuinely profitable, where it may be carrying excess overheads and where relatively small adjustments could make a big difference.

CHECKLIST FOR ACTION

USING YOUR P&L TO IMPROVE YOUR BUSINESS

ANNUAL TASKS

- ☐ Review profit and loss accounts for the past year
- ☐ Compare against the previous two to three years to identify trends
- ☐ Break down figures by enterprise (e.g. sheep, beef, cereals)
- ☐ Calculate gross margins and net margins for each enterprise
- ☐ Compare against industry benchmarks (FAS, QMS or Farm Management Handbook [SAC])

QUARTERLY/IN-YEAR

- ☐ Track income and major costs as the year progresses
- ☐ Monitor variable cost changes (e.g. fertiliser, feed, fuel)
- ☐ Watch for cashflow pinch points, especially pre-sale or pre-subsidy
- ☐ Reforecast if needed to manage expectations and cash availability

BEST PRACTICES

- ☐ Use coding to break income and costs into enterprises
- ☐ Keep P&L reporting simple but consistent
- ☐ Involve a consultant or adviser if you want an external perspective
- ☐ Regularly share financial progress with your business partners or family

ISSUES, ISSUES, ISSUES...

All businesses have issues, be it profits are too low, too much borrowing, succession or even what to do with the profit generated. The key is to work out what are the critical issues for your business. Typically, there are one or two areas which are impacting the business that overshadow everything else. Identifying what these are is the starting point for finding a solution.

USEFUL TOOLS

1. GROSS MARGIN ANALYSIS

Gross margin analysis measures how much money each enterprise makes after variable costs (feed, fertiliser, vet, etc.), but before fixed costs, such as labour and machinery.

This isolates the performance of each enterprise. It can:

- Help to justify whether to add, remove, expand or decrease an enterprise
- Identify the real return from sheep, beef or arable enterprises
- Compare systems (e.g. indoor lambing vs. outdoor lambing)

2. SENSITIVITY ANALYSIS

Sensitivity analysis is a way of testing how changes in key factors – such as prices, costs or yields – would affect your farm's margins and overall profitability.

Try 'what if' scenarios that are relevant to your farming system:

- What if beef or lamb prices fall by 10%?
- What if diesel costs increase by 20%?
- What if grain prices fall by 10%?

This helps you plan for volatility and stress-test your business model.

3. BENCHMARKING

Benchmarking is comparing your farm's costs and performance against other farms or industry standards to identify strengths and areas for improvement.

Use published figures to compare from the following sources:

- Quality Meat Scotland, Farm Management Handbook [SAC] or Agricultural Budgeting and Costings Book
- FAS Whole Farm Benchmarking Tool

Even comparing your own last three years' accounts is powerful benchmarking as it helps you to understand which areas of the business performed well and which did not in a formal rather than intuitive way.

4. SCENARIO PLANNING

Scenario planning is looking ahead at different 'what if' situations – such as price changes, expansion or diversification – to see how they would affect your business before making decisions.

Look ahead:

- What does a good year look like?
- What would allow me to invest in the next step?
- Should I scale back or diversify?

Partial budgeting is a simple way to test ideas before committing time and money. It looks at the effect of adding, expanding, reducing or removing an enterprise – showing the gross margin gained or lost, the capital required or released and the likely return on capital including interest costs.

The key to better farm management isn't more data – it's better use of the data you already have.

Management accounting doesn't need to be complex. Start small:

- Break down one enterprise
- Track one key cost
- Set one margin goal

Use that knowledge to build confidence, improve decisions and strengthen your farm's resilience. Don't aim for perfection. Aim for progress. Small, regular reviews make the biggest difference.

This guide is your starting point – use it to take control of your figures and shape the future of your farm business.

RESOURCES FOR FURTHER SUPPORT

- Accounts analysis template (found on the Monitor Farm Scotland website)
- If you're unsure where to start, speak to your consultant, accountant or Monitor Farm Scotland Regional Adviser
- Monitor Farm Scotland website (www.monitorfarms.co.uk)



CASE STUDIES

APPLYING ACCOUNTS ANALYSIS IN THE REAL WORLD

The following farm case studies based on real farm situations demonstrate how these principles work in practice – highlighting where using P&L accounts can improve decision-making, cost control or enterprise planning.

UNDERSTAND THE METHODOLOGY

The key here is not to focus on the issues that affect the businesses in the examples, it is to understand the methodology so you can apply it to your own business. So, if your business has a low net profit, the aim is to be able to identify if there is an output or variable cost issue as with Farmer A, or an issue with overheads as with Farmer B, then drill down to identify practices within your control that you can change to bring the benchmarks back into line.

Remember that the benchmarks are not absolutes, they are a starting point and a guide to starting the process. Another way to approach the task would be to ask ‘what do I need to do to achieve 15% net profit from a base of 10%?’ A strategy might be improving gross margin.




IT'S THE PROCESS THAT MATTERS – NOT JUST THE FIGURES

Breaking accounts down to a per head or per hectare basis makes the numbers easier to compare, but the real value lies in the process of doing it. Working through the figures helps you understand how the business performs, where costs sit and what drives profitability. The numbers themselves will change from year-to-year, but the habit of analysing and questioning them is what builds clarity, confidence and better decision-making.

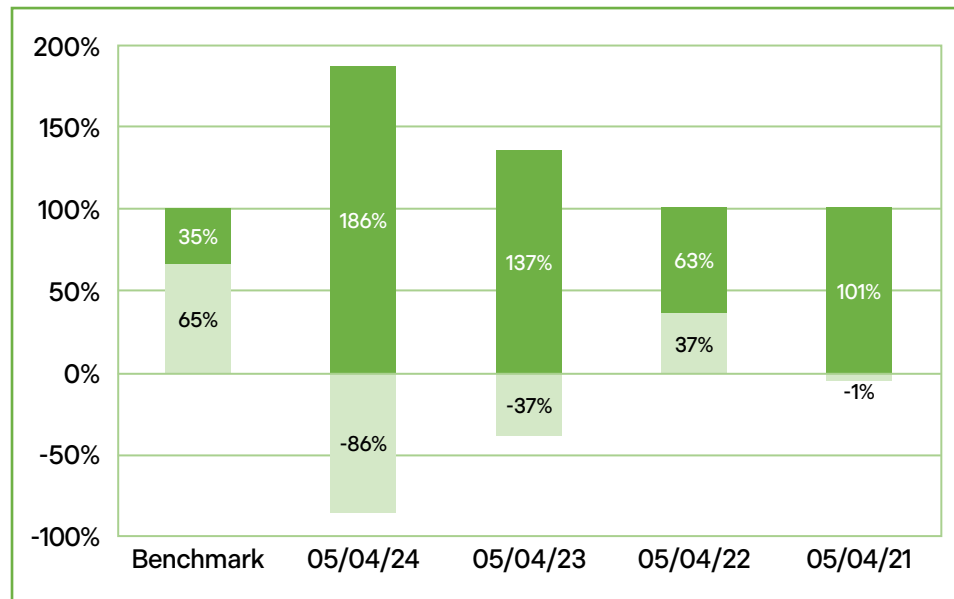
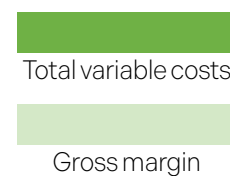


FARMER A INCONSISTENT OUTPUT, HIGH VARIABLE COSTS, LOW GROSS MARGIN

| INCOME | 05/04/24 (£) | 05/04/23 (£) | 05/04/22 (£) | 05/04/21 (£) | MAX. (£) | MIN. (£) | RANGE (£) | % CHANGE | |
|--|-----------------|-----------------|-----------------|-----------------|--|-------------|--------------|-------------|--------|
| Sheep sales | 16,900 | 5,100 | 21,200 | 7,400 | 21,200 | 5,100 | 16,100 | 316% | |
| Wool | 65 | 152 | 61 | 84 | 152 | 61 | 91 | 149% | |
| Total income | 16,965 | 5,252 | 21,261 | 7,484 | 21,261 | 5,252 | 16,009 | 305% | |
| COST OF SALES | | | | | | | | | |
| Opening valuation | 21,300 | 14,500 | 17,500 | 13,700 | 21,300 | 13,700 | 7,600 | 55% | |
| Purchases | 1,800 | 1,800 | 0 | 1,040 | 1,800 | 0 | 1,800 | | |
| Closing valuation | 15,500 | 21,200 | 14,300 | 17,600 | 21,200 | 14,300 | 6,900 | 48% | |
| Cost of sales | (7,600) | 4,900 | (3,200) | 2,860 | 4,900 | (7,600) | 12,500 | 164% | |
| Net output | 9,365 | 10,152 | 18,061 | 10,344 | 18,061 | 9,365 | 8,696 | 93% | |
| VARIABLE COSTS ALLOCATED IN ACCOUNTS | | | | | | | | | |
| Purchased feed | 11,000 | 8,500 | 5,400 | 3,700 | 11,000 | 3,700 | 7,300 | 197% | |
| Vet & med | 4,600 | 3,900 | 4,600 | 4,800 | 4,800 | 3,900 | 900 | 23% | |
| Livestock sundry direct items | 1,400 | 40 | 200 | 700 | 1,400 | 40 | 1,360 | 3,400% | |
| Seed | 150 | 1,200 | 1,100 | 830 | 1,200 | 150 | 1,050 | 700% | |
| Grazing | 260 | 300 | | 430 | 430 | 260 | 170 | 65% | |
| Total variable cost as allocated in accounts | 17,410 | 13,940 | 11,300 | 10,460 | 17,410 | 10,460 | 6,950 | 66% | |
| Gross margin | (8,045) | (3,788) | 6,761 | (116) | 6,761 | (8,045) | 14,806 | 184% | |
| | | | | | | | | | |
| | 05/04/24 (£) | 05/04/23 (£) | 05/04/22 (£) | 05/04/21 (£) | BENCHMARK | | | | |
| Net output | 9,365 | 10,152 | 18,061 | 10,344 | | | | | |
| Variable costs | 17,410 | 13,940 | 11,300 | 10,460 | | | | | |
| Variable costs as a % of net output | 186% | 137% | 63% | 101% | | | | | 30-35% |
| Gross margin | (8,045) | (3,788) | 6,761 | (116%) | | | | | |
| Gross margin as a % of net output | -86% | -37% | 37% | -1% | | | | | 65-70% |
| | | | | | | | | | |
| Number of animals | 160 | 160 | 160 | 160 | <div> Note: Farmer A runs a flock of 160 ewes on in-bye and common grazings; the above table shows the analysis of the sheep enterprise.</div> | | | | |
| Net output (£/head) | 59 | 63 | 113 | 65 | | | | | |
| Variable costs (£/head) | 109 | 87 | 71 | 65 | | | | | |
| Gross margin (£/head) | (50) | (24) | 42 | (1) | | | | | |

 **Note:** Farmer A runs a flock of 160 ewes on in-bye and common grazings; the above table shows the analysis of the sheep enterprise.

FARMER A SHEEP GROSS MARGIN AND VARIABLE COSTS AS A % OF SHEEP NET OUTPUT COMPARED TO BENCHMARKS



The chart shows that variable costs have exceeded the benchmark in all years analysed, resulting in consistently weak or negative gross margin performance.

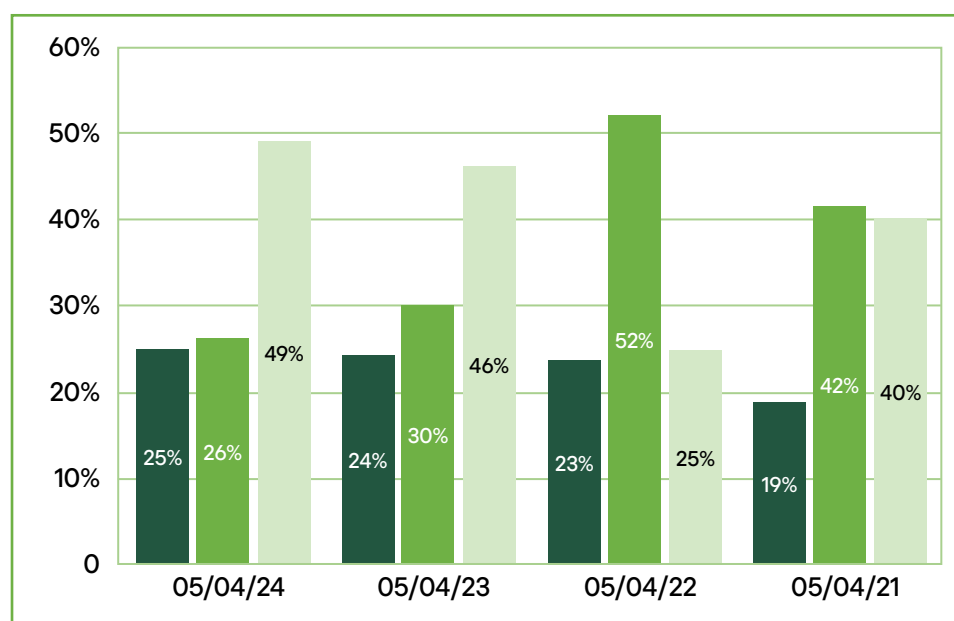
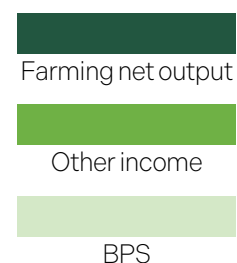
There are three main issues to focus on:

INCONSISTENT OUTPUT: Sheep sales varied between £5,000 and £21,000 with two years of lower sales (£30 to £45 per ewe and two years of higher sales £106 to £132 per ewe). The Farm Management Handbook [SAC] for 23/24 suggests income of £40-£50 per ewe for a moderate hill.

Looking at net output, adjusting for stock changes and purchases smooths the output figures to circa £10,000 per annum or £60 per ewe, apart from the 2022 year which has a very high net output of £113 per ewe.

The graph below shows how farming net output varied over time as a percentage of total net output (i.e. including all other income). The graph also shows the relative importance of farming income, subsidy income and other income.

FARMER A FARMING NET OUTPUT, BPS, OTHER INCOME AND NET PROFIT/LOSS AS A % OF TOTAL NET OUTPUT



HIGH VARIABLE COSTS AND LOW GROSS MARGIN: Variable costs ranged from £10,460 to £17,410, equivalent to £65 to £109 per ewe, which meant that a positive gross margin was achieved in only one of the four years.

Gross margin performance varied between a negative £50 per ewe in 2024 and a positive £42 per ewe in 2022. In comparison, SAC benchmarks (2023/24) suggest variable costs of around £27 per ewe and a gross margin of £9-£19 per ewe.

Farmer A's costs averaged around £6 per ewe for each of feed, away wintering, vet and medicine and sundries, but in practice feed costs varied widely between £23 and £68 per ewe, while vet and medicine costs ranged from £24 to £30 per ewe, both significantly above benchmark levels. These results highlight that feed and vet costs are the main drivers of weak margins and provide the clearest opportunities for improvement.

Although output is high compared with the benchmarks, the extra income is outweighed by the high costs needed to achieve it, leaving gross margins below target. A review of sheep flock management, with realistic targets for both sale price and variable costs, would help ensure output translates into stronger margins.

KEY RECOMMENDATIONS FOR FARMER A

1. UNDERTAKE A FULL ANNUAL BENCHMARKING REVIEW

Use the Farm Management Handbook [SAC] or QMS Sheep Enterprise benchmarks to assess:

- Output per ewe
- Cost per ewe (especially feed and vet)
- Margin per ewe

2. SHEEP ENTERPRISE REVIEW

Given variable output and high costs, this enterprise requires a system-wide review:

- Improve lamb survival and marketing weights
- Investigate health issues or poor thrift leading to high vet bills
- Re-evaluate feed regime (cost vs. benefit)
- Consider breed suitability for upland system



FARMER B

OVERHEAD COSTS NOT IN BALANCE WITH TOTAL GROSS MARGIN

Farmer B runs a 500-cow suckler herd alongside a 900-acre arable enterprise within a 2,500-acre mixed farming business.

Their accounts show a gross margin of between £540,000 and £772,000 per year. However, overhead costs ranged from £551,000 to £755,000, meaning the business only made a profit in two of the three years reviewed.

In those profitable years, net returns were modest at just 2-4% of net output. The detailed overhead analysis is presented in the following section. Gross margin performance met or exceeded benchmark targets in all years analysed.

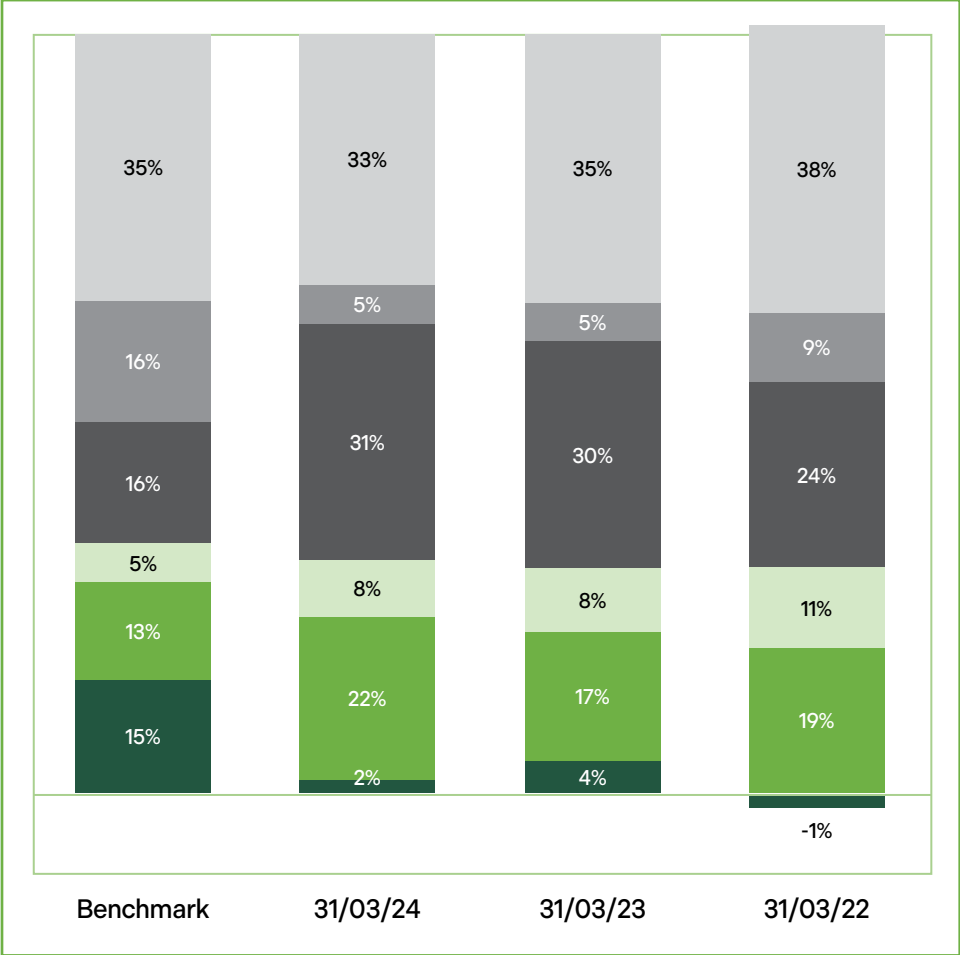
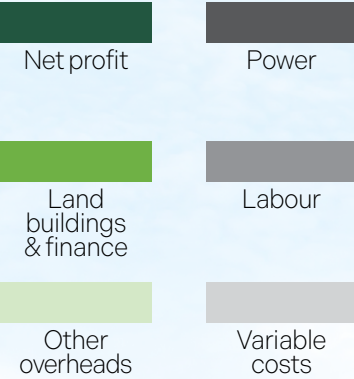


FARMER B OVERHEAD COSTS NOT IN BALANCE WITH TOTAL GROSS MARGIN

| | 31/03/24 (£) | 31/03/23 (£) | 31/03/22 (£) | MAX. (£) | MIN. (£) | RANGE (£) | % CHANGE |
|---------------------------------------|-----------------|-----------------|-----------------|-------------|-------------|--------------|-------------|
| Total gross margin after other income | 775,000 | 635,000 | 540,000 | | | | |
| LABOUR | | | | | | | |
| Staff salaries | 60,000 | 50,000 | 80,000 | 80,000 | 50,000 | 30,000 | 60% |
| Labour total | 60,000 | 50,000 | 80,000 | 80,000 | 50,000 | 30,000 | 60% |
| POWER | | | | | | | |
| Contract work | 95,000 | 92,000 | 63,000 | 95,000 | 63,000 | 32,000 | 51% |
| Depreciation – plant & machinery | 93,000 | 104,000 | 96,000 | 104,000 | 93,000 | 11,000 | 12% |
| Depreciation of motor vehicles | 52,000 | 0 | 0 | 52,000 | 0 | 52,000 | |
| Fuel & oil | 103,000 | 60,000 | 42,000 | 103,000 | 42,000 | 61,000 | 145% |
| Machinery repairs | 47,000 | 68,000 | 56,000 | 68,000 | 47,000 | 21,000 | 45% |
| Profit on sale of machinery | (10,000) | (30,000) | (45,000) | (10,000) | (45,000) | 35,000 | 78% |
| Profit on sale of motor vehicles | (20,000) | 0 | 0 | 0 | (20,000) | 20,000 | 100% |
| Power total | 360,000 | 294,000 | 212,000 | 360,000 | 212,000 | 148,000 | 70% |
| OTHER | | | | | | | |
| Sundry expenses | 0 | 10,000 | 9,000 | 10,000 | 0 | 10,000 | |
| Accountancy | 6,000 | 5,000 | 5,000 | 6,000 | 5,000 | 1,000 | 20% |
| Fencing & drainage | 0 | 15,000 | 32,000 | 32,000 | 0 | 32,000 | |
| Heat & light | 14,000 | 7,800 | 6,000 | 14,000 | 6,000 | 8,000 | 133% |
| Hotels, travel & subsistence | 500 | 1,500 | 100 | 1,500 | 100 | 1,400 | 1,400% |
| Insurance | 28,000 | 26,000 | 24,000 | 28,000 | 24,000 | 4,000 | 17% |
| Legal & professional | 4,000 | 0 | 0 | 4,000 | 0 | 4,000 | |
| Motor running costs | 9,000 | 0 | 0 | 9,000 | 0 | 9,000 | |
| Printing stationery & advertising | 1,500 | 0 | 0 | 1,500 | 0 | 1,500 | |
| Subscriptions | 3,000 | 0 | 0 | 3,000 | 0 | 3,000 | |
| Telephone | 4,700 | 3,800 | 3,300 | 4,700 | 3,300 | 1,400 | 42% |
| Water rates & council tax | 16,000 | 14,000 | 13,000 | 16,000 | 13,000 | 3,000 | 23% |
| Other total | 86,700 | 83,100 | 92,400 | 92,400 | 83,100 | 9,300 | 11% |
| LAND BUILDINGS & FINANCE | | | | | | | |
| Bank interest & charges | 80,000 | 56,000 | 72,000 | 80,000 | 56,000 | 24,000 | 43% |
| Bank term loan interest | 31,000 | 26,000 | 7,400 | 31,000 | 7,400 | 23,600 | 319% |
| Grazing rent | 47,000 | 47,000 | 53,000 | 53,000 | 47,000 | 6,000 | 13% |
| HP interest | 6,500 | 4,500 | 2,500 | 6,500 | 2,500 | 4,000 | 160% |
| Land rent | 20,500 | 19,500 | 18,000 | 20,500 | 18,000 | 2,500 | 14% |
| Property repairs | 55,000 | 14,000 | 14,000 | 55,000 | 14,000 | 41,000 | 293% |
| Rent | 9,000 | 0 | 0 | 9,000 | 0 | 9,000 | |
| Land buildings & finance total | 249,000 | 167,000 | 166,900 | 249,000 | 166,900 | 82,100 | 49% |
| TOTAL OVERHEADS | 755,700 | 594,100 | 551,300 | 755,700 | 551,300 | 204,400 | 37% |
| NET PROFIT | 19,300 | 40,900 | (11,300) | 40,900 | (11,300) | 52,200 | 462% |

The graph below summarises the overhead costs when compared to the benchmark position.

FARMER B
COSTS & NET PROFIT
AS A % OF TOTAL NET
OUTPUT COMPARED
TO BENCHMARKS



FARMER B NET OUTPUT ANALYSIS AND COMPARISON TO BENCHMARKS

| | 31/03/24 (£) | 31/03/23 (£) | 31/03/22 (£) | BENCHMARK |
|---|--------------|--------------|--------------|-----------|
| Net output | 1,150,000 | 980,000 | 870,000 | |
| Labour costs | 60,000 | 50,000 | 80,000 | |
| Labour costs as a % of net output | 5% | 5% | 9% | 15-17.5% |
| Power costs | 360,000 | 294,000 | 212,000 | |
| Power costs as a % of net output | 31% | 30% | 24% | 15-17.5% |
| Other overhead costs | 86,700 | 83,100 | 92,400 | |
| Other overhead costs as a % of net output | 8% | 8% | 11% | 5% |
| Land buildings & finance costs | 249,000 | 167,000 | 166,900 | |
| Land buildings & finance costs as a % of net output | 22% | 17% | 19% | 10-15% |
| Total overheads | 755,700 | 594,100 | 551,300 | |
| Total overheads as a % of net output | 66% | 61% | 63% | 45-55% |
| NET PROFIT (£) | 19,300 | 40,900 | (11,300) | |
| NET PROFIT (%) | 2% | 4% | -1% | 15-20% |

KEY RECOMMENDATIONS
FOR FARMER B

1. CONFIRM OUTPUT LEVELS

- Review output by enterprise and compare with benchmarks to ensure that low net profit is not the result of weak output.
- Check whether higher 'other income' is masking any output issues within the core farming enterprises.

2. ADDRESS RISING OVERHEADS

- Overheads have risen by 37% in two years – complete a line-by-line review to confirm which costs are driving the increase.
- Put in place a simple, annual overhead review to monitor costs against benchmarks and highlight early warning signs.

3. MACHINERY & POWER COSTS

- Carry out a 10-year machinery plan to map purchases and manage future depreciation charges.
- Consider machinery sharing, contract farming agreements or selling under-utilised kit to reduce capital and running costs.
- Review fuel use in litres to separate out price inflation from usage increases. Investigate more efficient field operations, transport between units and material handling to reduce double handling.

4. OTHER OVERHEADS

- Test insurance, accountancy and utility costs in the market to confirm competitiveness.
- Undertake an energy audit to identify savings from efficiency upgrades or assess the viability of renewables investment.

5. LAND, BUILDINGS & FINANCE

- Review grazing strategy, as heavy reliance on seasonal lets may be driving costs. Improving grass output on owned or tenanted ground could reduce this dependence over time.
- Assess whether the current enterprise mix (suckler vs. arable balance) is the best fit for the fixed cost structure.
- Use partial budgeting to test different system scenarios, particularly where grazing or livestock scale could be adjusted.

6. FINANCIAL STRUCTURE & RESILIENCE

- Rising interest costs highlight the need to review borrowing structure. Explore refinancing options or stretching repayments to reduce annual pressure.
- Consider a full business appraisal to clarify family objectives, balance enterprise scale with fixed cost structure and identify sustainable strategies for the long term.

THERE ARE TWO KEY ISSUES FOR FARMER B TO FOCUS ON

IS NET OUTPUT HIGH ENOUGH?

While gross margin percentages are meeting the benchmarks, this does not necessarily mean that there is not an output issue. While unlikely, working through each enterprise and checking output against the relevant benchmarks as in the previous case study will be beneficial in ensuring the low net profit is not related to output and is a consequence of high overheads as suspected. A possible issue might be that low farm output may be being masked by higher levels of other income.

HIGH OVERHEAD COSTS

Assuming that the output analysis confirms farming output is reasonable, then we can see the overheads are higher than expected.

- Overheads have increased from £551,000 to £756,000 between 2022 and 2024. This means that overheads have risen by 37%. Looking at the current year's accounting records will confirm if this is in fact the case and also whether the trend for increasing costs has been maintained.
- Looking more closely at the analysis of each overhead type as a percentage of output, we see that labour costs have decreased from 9% of output down to 5%. This is positive in that labour costs have been addressed, but because they are between half and one-third of the benchmark, it means that the other categories of overhead are even further away from their relative benchmarks.
- Power costs have seen the biggest increase from £212,000 to £360,000, an increase of 70% on 2022 costs, increasing from 24% of net output to 31% of net output, double the benchmark. Within this, contract charges, depreciation and fuel have significantly increased. Understanding why the increases have occurred and whether any strategies to reduce costs can be employed, such as further use of contractors, selling redundant equipment, using machinery sharing agreements or contract farming agreements may be helpful.

- A machinery plan should be undertaken where the anticipated machinery complement for the next 10 years is mapped out and expensive purchases spaced out so that the future annual depreciation charge is known, understood and managed.
- Fuel spend has increased significantly. Looking at annual usage in litres would be helpful in understanding how much of the fuel increase is use related and how much is price-related. Review operations, especially if significant travelling is incurred between farming units takes place to see whether different vehicles or ways of working can reduce costs. A review of materials handling might also help to see if there is any double handling that can be managed out of the system.
- Other costs show a variation of 11% between lowest and highest costs with other overheads varying between 8% and 11% of net output. A review of the main costs has identified that insurance costs, heat and light and accountancy costs have seen significant increases. Testing these costs in the market might be beneficial. An energy audit would also be beneficial to see if there is potential to benefit from more energy-efficient infrastructure or whether investment in renewables is a viable strategy.
- Land, buildings and finance costs show a difference of 49% between lowest and highest across the three years, increasing from 19% of net output to 22% of net output, against a benchmark of 10-15%. Finance charges accounted for just under half of this category in the 2024 year, alongside significant expenditure on grazings and property repairs. A significant proportion of this additional cost flows from increased interest rates over the period.
- The business shows heavy reliance on seasonal grazings and a review of grassland production and grazing systems could be beneficial if, over time, the output from swards on the home farm can be increased. The enterprise mix should also be revisited to see if changing the balance between the scale of the livestock enterprise, the scale of the arable enterprise, the fixed cost structure and the need for seasonal grazings might deliver a more profitable system. Testing scenarios with partial budgets would be helpful.
- In some circumstances, this level of overhead costs may not be sustainable in the longer term, and a full business appraisal could be helpful in clarifying the objectives of the family and possible ways to address the borrowing.



FAQs

Q THIS SEEMS LIKE A LOT TO DO AND QUITE DAUNTING – WHERE DO I START?

A Your profit and loss (P&L) account has the answers to a lot of the initial questions. It's a straightforward way of showing your income, variable costs and fixed costs, and you'll be able to pull out a lot of information to fill in the tables in this guide. Understanding each part is the first step to using it as a decision-making tool. Start small, so break down one enterprise, track one key cost or set one margin goal.

Use that knowledge to build confidence, improve decisions and strengthen your farm's resilience. Don't aim for perfection. Aim for progress and understanding. This guide is your starting point, and it's best to tackle it in short bursts. Don't expect to do it all in one sitting. Once you've worked through it, you should be able to come back to it time and time again to revisit your figures and make decisions more easily and quickly.



Q I'M STUCK WITH SOME OF THIS – WHERE CAN I GET HELP?

A If you're unsure where to start, speak to your accountant, consultant or Monitor Farm Scotland Regional Adviser.

Q I'VE DONE SOME OF THIS, THE FIGURES DON'T LOOK GOOD; CAN I JUST STOP ANALYSING?

A The questions in this guide help highlight where the business is genuinely profitable, where it may be carrying excess overheads and where relatively small adjustments could make a big difference. All businesses have issues, be it profits are too low, too much borrowing, succession or even what to do with the profit generated. The key is to work out what the critical issues are for your business. Typically, there are one or two areas which are impacting the business that overshadow everything else. Identifying these is the starting point for finding a solution.

Q HOW OFTEN SHOULD I DO THIS?

A It's a good idea to look at this regularly. So, each quarter or so, track income and major costs as the year progresses, monitor variable cost changes (e.g. fertiliser, feed, fuel), watch for cashflow pinch points – especially pre-sale or pre-subsidy, and reforecast if needs be to manage expectations and cash availability. The clearer your understanding, the quicker you can act – and the less likely you are to be caught out by rising costs or falling prices.

Q WHAT ABOUT USING THE INFORMATION FOR THE GENERAL DIRECTION OF MY BUSINESS?

A Each year, review your profit and loss accounts for the past year and compare against the previous two to three years to identify trends. Break down figures by enterprise (e.g. sheep, beef, cereals), calculate gross margins and net margins for each enterprise and compare them against industry benchmarks (Farm Advisory Service, Quality Meat Scotland or Farm Management Handbook [SAC]). As the years go by, you will be able to see progress made and be clearer on your future priorities and realistic achievements.

Q ANY MORE TIPS?

A There are some best practices which will help make the most of this. Think about using standardised coding to break income and costs into enterprises. Keep your P&L reporting simple but consistent. Involve an accountant, consultant or adviser if you want an external perspective, and regularly share financial progress with your business partners or family.

Q I'M NOT SURE I LIKE WHAT I'VE DISCOVERED...

A Be critical, honest and open minded throughout this process. Try not to fall into the trap of justifying the status quo, but look for areas where real change can be made. The exercise is about making your business more profitable for you and your family, the more you embrace the process, the bigger the impact you will have.

Q WHAT ELSE CAN I DO WITH THIS INFORMATION NOW?

A There are lots of things you can do. Gross margin analysis will isolate the performance of each enterprise so you can make decisions about developing or changing them. Sensitivity analysis will test how changes in key factors – such as prices, costs or yields – would affect your farm's margins and overall profitability so you can plan for volatility. Benchmarking your farm's costs and performance against other farms or industry standards will identify strengths and areas for improvement, while scenario planning will help you look ahead at different 'what if' situations – such as price changes, expansion or diversification – to see how they would affect your business before making decisions confidently.

SPACE FOR WORKINGS/NOTES



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