Balance Sheet

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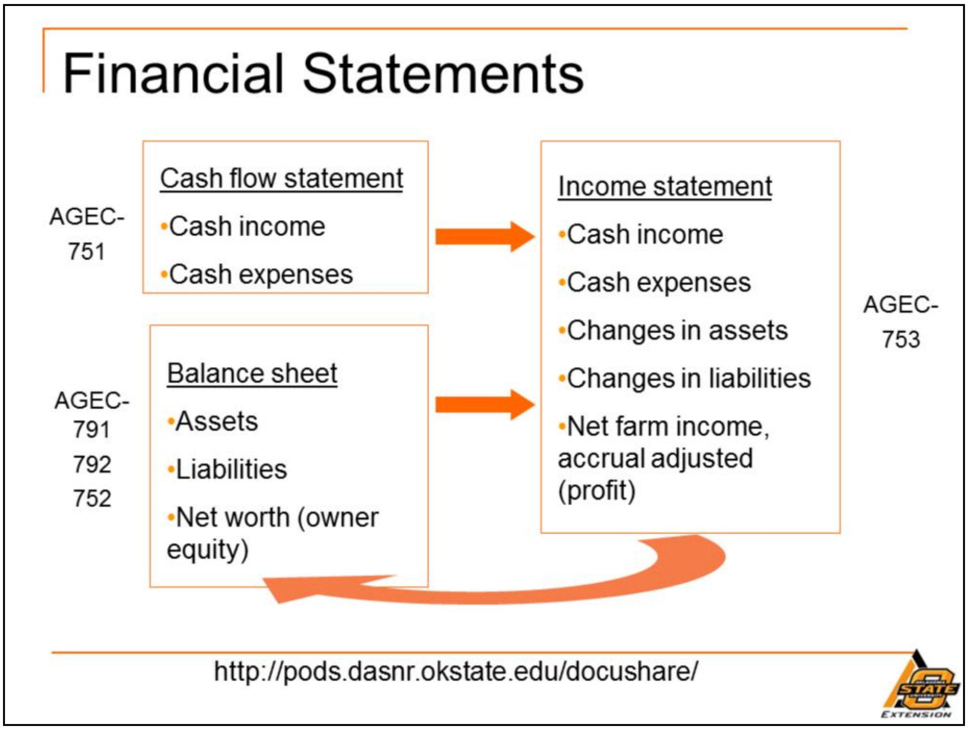
Welcome to a brief discussion of balance sheets. The balance sheet is a summary of the things owned and owed by a business. You may choose whether it focuses on the business only or is a combined personal and business financial statement. But, if the farm or ranch is intended to stand-alone as a business, it is important to develop and maintain a farm-only version to understand changes in the business financial position over time.



The balance sheet is one of three financial statements that we encourage all producers to develop annually and analyze for the insights provided. The balance sheet shows financial position **at a point in time**. In other words, how well off are you? A **series** of balance sheets will document the change in financial position **over** time, showing growth in wealth or losses in equity. Thus, we generally recommend updating information in the balance sheet annually. The beginning and ending balance sheets together with the cash flow statement for the year provide essential information for the income statement.

The numbers in this slide refer to OSU fact sheets that provide more detail along with detailed examples and step-by-step instructions for completing forms. AGEC-752 is the publication number for a fact sheet on the Balance Sheet while 791 and 792 refer to asset and liability schedules which support the balance sheet summary.

Balance Sheet Discussion Items

- Business versus personal
- Sources of information
- Balance sheet development
- Uses of the balance sheet
- Relationship to other financial statements

Statements or plans can either focus solely on the business or may include both business and personal assets. What you choose to include may depend on the expected uses. Is it for communication with lenders and, if so, are both farm and personal assets pledged for loan repayment? That would argue for including both farm and personal items. On the other hand, if the balance sheet is designed to document and analyze how the business is doing, then limit the information included to the farm or ranch.

In discussion to follow, we'll talk about where you find information for the balance sheet, how you summarize it, some of the insights it provides and will reiterate its relationship to other financial statements.

Balance Sheet

- Summary sheet of items owned and owed.
  - Assets
    - Current
    - Non-current
  - Liabilities
    - Current
    - Non-current
  - Net Worth = Assets - Liabilities
- Done at the beginning and end of each fiscal time period.

As an overview, the balance sheet has three sections: assets, liabilities and net worth (which is also referred to as owner equity).

Current assets includes cash plus items that are easily converted to cash or are expected to be used up in the course of the year. You may sometimes see the label short term assets to refer to these same things.

Non-current assets is the label that the Farm Financial Standards Council attached to what have historically been called intermediate and long-term assets. There are items that contribute to farm/ranch production over multiple years.

Current liabilities are the debts that you expect to repay this year as well as the portion of longer term debt that you repay this year.

Non-current liabilities are the portion of long term debt that will be repaid in future years. They also include deferred taxes.

We’ll talk more about each of these groups in a minute.

When the balance sheet is updated annually, the balance sheet for the end of this year serves as the beginning document for next year.

Which Method to Use?

- Market Value
  - Typically used by most lending institutions
  - Easiest to determine
  - Easiest to over or under estimate
  - Due to rapidly changing markets, could overstate or understate net worth.
- Cost Basis
  - Must have good records
  - Must know depreciation of assets
  - Gives a truer picture of the value of the business

The method that you use for valuing assets is important. Current market value is the amount which would be received if the asset was sold at the balance sheet date. The amount is usually determined by referencing sales of similar assets and is therefore subjective. Market value may be required by lenders when the asset will be used to secure a loan as they are interested in the value that they would receive in the event of a default. It is also used to estimate the amount of taxes that will be owed if the assets are sold and to estimate owner equity. You may want to deduct costs necessary to convert an asset to cash to record a net realizable value.

Another method of valuation is historical cost. It provides a more conservative approach to valuation than the market value approach, particularly during inflationary periods or when assets such as land are appreciating in value rapidly. These values should be available from estate and tax records. For depreciable assets such as machinery and equipment, the cost basis will be adjusted to reflect economic depreciation. This method is best for the manager interested in developing internal benchmarks as the reference values do not fluctuate due to circumstances outside the manager’s control.

Current Assets

Current assets are assets that will be used up or sold during the next twelve months.

Examples include:

- Cash, checking accounts, savings
- Investments
- Accounts receivable
- Prepaid expenses
- Cash investments in growing crops
- Inventories
  - Market livestock, stored crops, purchased feed, supplies

Current assets are expected to be converted to cash in the coming year, in other words, sold or used up. Examples beyond cash in checking or savings accounts include investments, money owed to you such as for hay that has not yet been received, prepaid expenses such as rents, the cash already spent on growing crops and inventories. Inventories that can be easily sold or are expected to be sold include market livestock, such as stockers or calves to be weaned, wheat in storage, purchased feed and other supplies.

Non-Current Assets

Non-current assets are assets that have a useful life of more than 1 year.

Examples include:

- Breeding livestock
- Machinery, equipment
- Vehicles
- Investments in capital leases
- Land
- Buildings and improvements

Non-current assets have a useful life of more than a year. And, they contribute to the productive capacity of the business. The cow herd isn't expected to be liquidated annually so it is an example of a non-current asset. Likewise, for the tractor, no-till drill, combine, pickup, farmland and barns.

Current Liabilities

- Accounts payable
- Notes payable
- Current portion of term debt
- Accrued interest
- Taxes payable
- Deferred taxes

Current liabilities are expected to be paid this year. As such, they include accounts and notes payable such as the outstanding bills at the feed store and co-op or money borrowed from Aunt Sue. Also included in current liabilities is the current portion of term debt. The principal payments due this year on a 30 year land note or 5 year machinery loan or 3 year cattle note are examples of this.

Accrued interest expense on all liabilities is another current liability along with taxes payable. Is calculated on all farm loans to the balance sheet date. The easiest and most accurate means of determining the interest accrued is by obtaining a statement from the lender. If the loan statement is not available, an approximate amount may be calculated.

Deferred Taxes arise when asset values increase beyond their tax basis. The change represents taxable income which is not recognized for tax purposes until the assets are actually sold. Most current assets will not have a tax basis since the cost of the assets are expensed. Two exceptions are marketable securities and livestock purchased for resale. Accrued expenses are subtracted from the excess of market value over tax basis to determine deferred taxable income for the current assets. This amount is then multiplied by an estimated average tax rate for federal and state income taxes.

Non-current Liabilities

- Notes payable, non-real estate
- Notes payable, real estate
- Deferred taxes

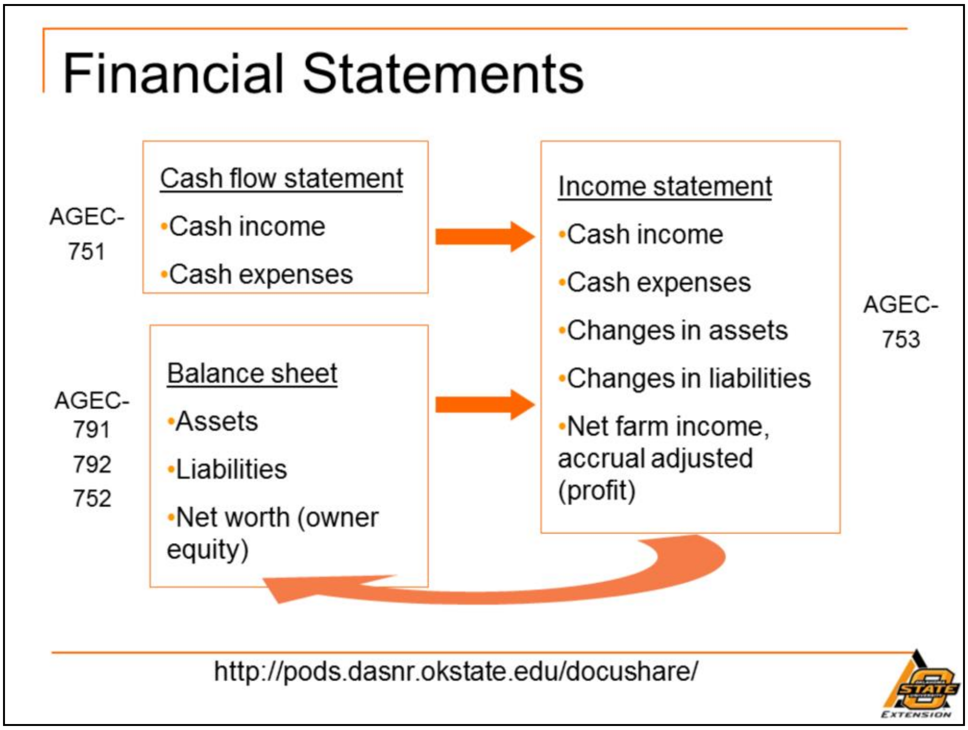
Non-current liabilities are those which are not due in the current operating year, but are due beyond this year. Let’s say you borrowed $100,000 for a used combine, have paid back $20,000 principal and are scheduled to make a $5,000 principal payment this year. The remaining $75,000 balance is a non-current liability. Noncurrent Deferred Taxes are calculated in the same manner as current deferred taxes. The procedure is slightly simpler since social security and medicare taxes do not apply to the noncurrent deferred income.

Net Worth

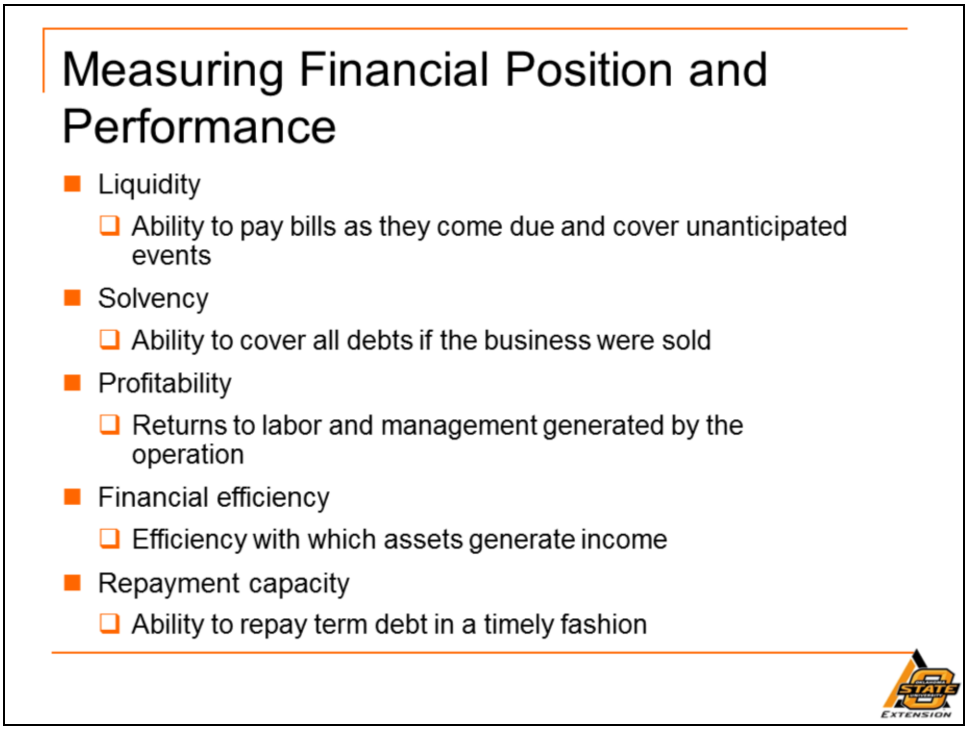
- Net worth of the business is the difference between the total value of the assets and the total value of the liabilities.

  (Current Assets + Non-current Assets)
– (Current Liabilities + Non-current Liabilities)
= Net Worth

Net worth, also referred to as owner equity, is a calculated residual after the claims of others (liabilities) are subtracted from the value of assets. Total equity is, therefore, easy to determine once the value for total assets and total liabilities have been calculated. Division of total equity into contributed capital, retained earnings, and valuation equity is very useful in analyzing the farm’s productivity and financial position.



The balance sheet is one of the most commonly used financial tools. Time invested in keeping records and preparing financial statements including the balance sheet yield positive returns. However, the balance sheet does not measure profitability except to the extent that profits increase retained earnings and total owner equity from one period to the next. It also does not measure the repayment capacity or the ability to meet financial obligations when they come due. Thus, for financial analysis and credit management purposes, the balance sheet should be supplemented with an income statement and a cash flow projection.



The balance sheet provides information that is essential in calculating a variety of financial ratios, especially those focused on financial position. One measure of liquidity, the ability to pay bills as the come due, is calculated from balance sheet values by subtracting current liabilities from current assets. Solvency ratios, which indicated the business ability to cover all debts if the business had to be liquidated, are also calculated from balance sheet data by comparing assets to liabilities. Changes in inventories are measured by changes in balance sheet values and factor into profitability measures. You will learn more ratios and their value to farm management in another segment.

References

At osufacts.okstate.edu:

- **Developing a Balance Sheet, AGEC-752**
- **Owner Equity Section, AGEC-938**
- **Schedule of Assets, AGEC-791**
- **Schedule of Liabilities, AGEC-792**
- **Valuation of Raised Breeding Livestock , AGEC-323**
- **Consolidated Financial Statements, AGEC-937**
- **Deferred Taxes, AGEC-939**

FINPACK, https://www.cffm.umn.edu/FINPACK/

We encourage to you to learn more about developing a balance sheet by reading the OSU fact sheet 752. It provides a farm example with detailed explanation as well as a blank form should you want to develop one for your operation. The other publications listed here provide references for related topics. You may also be interested in software tools that assist in financial statement development. FINPACK is one example of that kind of tool.

Please contact your local Extension office or area agricultural economics specialist if you would like more information or are interested in having a program on this topic in your area.