

Balance Sheet

Most important farm
financial management tool



The balance sheet should be completed in the farm office where other records are at hand. Nancy and Kenneth Heath, East Prairie, Missouri, in their well organized farm office.

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Your Balance Sheet

Most Important Financial Tool

Your financial tool kit

Managing money is an important part of operating a farm. As this management becomes more important to you your financial tools become more valuable.

The three most common financial tools include—

1. The balance sheet
2. Cash flow sheet
3. Profit and loss statement

This circular shows you how to prepare a balance sheet and how to use it in making financial decisions. A balance sheet is the single most important document you use in financing your farm.

The balance sheet is an essential document when borrowing money, but more importantly, it can help you determine how much progress you are making on the farm. The balance sheet also can tell you ahead of time when financial problems are likely to occur.

Balance sheet; your most important financial tool

A balance sheet can tell you more about the financial progress of your farm than any other document. It simply balances assets against liabilities to show your net worth.

If a *balance sheet* is new to you, it's probably because you've heard it called by other names. You may have heard it called *financial* or *net worth* statements. All are essentially the same.

A business picture

A balance sheet is a picture of your business at one point in time. It is like a family picture—taken on January 1 each year. By comparing these pictures, over time, you can see how your family has grown or changed. Similarly, balance sheets (compared over time) will show you how your business has changed and grown.

A financial tool

A properly-prepared balance sheet is your most valuable management tool. Preparing your own balance sheet and doing it at the beginning of your farm business year has the following advantages.

- You will learn more about your business and this will help you improve your management.
- Accurate balance sheets are necessary before you can calculate a true profit and loss statement for your farm business.
- A properly-prepared balance sheet can make it easier for you to borrow more money. It can help you convince your lender that you not only understand your farm business but that you have made financial progress.
- Today many others want information about your business. If you want to lease equipment or get an interest-free machinery loan, financial information is required.

Prepare balance sheet at home

This circular is designed to help you prepare your own balance sheet. In the past, many lenders filled out the financial statement as the farmer sat at the loan officer's desk and recalled the details from memory. The day of this approach will soon be past. More and more lenders are asking farmers to bring a completed balance sheet—just as they ask other businessmen to do.

Your home or office is a better place to prepare a balance sheet than in your lender's office where you have to rely on memory to gather facts about your business. Work at it at home where you have your business records and other files.

You will discover that there is no right way to prepare a balance sheet but simply better ways of doing it. The first time may be difficult and frustrating, but you'll find it gets easier. You know more about your business than anyone else.

Organization of the balance sheet

A balance sheet is a listing of business assets, balanced against liabilities or debts. *Net worth* is obtained by subtracting the liabilities from the assets. Net worth shows the amount of money you have invested in the business, while the liability figure shows what your lenders have invested in your business. It tells you where your business is *today!*

Assets - What your business is worth

Liabilities - What you owe your lender

Net worth - What you own

Balance sheets of most businesses on Main Street generally have two types of assets and liabilities—current and long-term. Farm balance sheets should have three types of assets and liabilities—current, intermediate, and long-term. Farms have much more land—which does not depreciate—than do other businesses. Land and buildings are usually grouped separately on the farm balance sheet.

Understanding the differences between the three types of assets and liabilities helps greatly both in preparing the balance sheet and in analyzing what it means to you. Understanding the meaning of the figures will help you analyze the financial structure of your business and give you clues as to when the business should be refinanced and when financial problems are about to occur.

Assets

Current Assets

Current assets are those that can be sold without affecting the productivity of the farm business. In general, current assets will either be sold or used up within a one-year period.

Current assets include:

- Cash & savings
- Accounts receivable
- Marketable securities
- Stored crops—corn, beans, milo, hay
- Investment in growing crops
- Supplies—feed, seed, fuel, fertilizer
- Market livestock

Current assets are liquid and can be turned into cash on short notice. Some—such as market livestock—are held because they may not be ready for market. Others such as crops may be stored and held for sale at a particular time during the year when prices are more favorable, or are to be used as feed.

Intermediate Assets

Intermediate assets are the working assets on the farm. They are the ones used to carry on production activities. They will wear out and must be replaced over a two- to ten-year period.

Intermediate assets are not as liquid as are current assets. If you sell certain of these assets—machinery or breeding livestock—your ability to produce is reduced. Included are:

- Breeding livestock
- Autos & trucks
- Machinery
- Retirement accounts
- Securities:
 - PCA stock
 - cash value life insurance
 - equity in cooperatives

Long term Assets

Land and buildings are the main assets with long life. Land is almost unique to a farm business. It often appreciates in value and seldom depreciates.

- Land
- Buildings
- Dwelling
- Long-term contracts
- Stocks - Federal Land Bank

Liabilities

Current Liabilities

Current liabilities are those debts that are due within one year. The collateral behind these debts should be the current assets.

Obligations that you have incurred as of the date on the balance sheet and must be paid within 12 months are current liabilities.

- Accounts payable—feed, seed, fuel, fertilizer bills, etc.
- Cash rents
- Lease payments
- Taxes: due & accrued
 - Income, Social Security, real estate and property
- Notes—operating loans
- Principal payments (due in 12 months)
 - intermediate and long-term loans
- Accrued interest—current, intermediate, long-term

Intermediate Liabilities

Intermediate liabilities are debts against intermediate assets. Loans on those assets usually are for a two- to ten-year period.

- Bank, PCA, or FmHA term loans
- Machinery loans
- Life insurance loans

That portion of the principal due within the next 12 months is considered a current liability.

Long-term Liabilities

Long-term liabilities are loans against long-term assets. Those loans usually run more than ten years.

- Federal Land Bank loans.
- Insurance company loans

- Individual land contracts
- Savings & Loan mortgage on dwelling
- FmHA real estate loans

That portion of the principal payment due within one year is considered a current liability.

When to prepare a balance sheet

Loan renewal

Traditionally, lenders have prepared the balance sheet for you—usually at loan renewal time. Some lenders prefer to have balance sheets at the time of loan renewal. Their reasoning is that this gives them a better picture of their current collateral position than if the balance sheet was taken at another time of the year.

There are a number of disadvantages in preparing a balance sheet at loan renewal time. First, the balance sheet no longer coincides with the start of your farm record year. Consequently, the balance sheet cannot be used in calculating a profit and loss statement. The second drawback is that seldom are loans renewed exactly at the same time each year.

Beginning of the year

The best time to prepare a balance sheet is at the beginning (or end) of your farm business year. If your business is on a calendar year basis—that is, you start your records on January 1—then the balance sheet should also be prepared as of January 1. If your business year (for accounting purposes) begins March 1, then your balance sheet should be taken as of March 1.

Many lenders, today, are anxious to get your balance sheet as of your accounting year.

- They know that if it is well-prepared, it represents an accurate picture of your business, more so than one taken at loan renewal time by interviewing you in the office.
- They know with just a little more work it is possible to prepare a profit and loss statement.
- By having a balance sheet prepared ahead of time you'll be able to spend more time at loan renewal on your plans and loan request.
- You can provide all persons with whom you deal the same balance sheet.

How to prepare the balance sheet

The first time you prepare your own balance sheet you may find the experience frustrating, though not unusual for anything you do the first time. The second year it will be much easier and become even easier the following year. Following are a few suggestions for preparing your balance sheet.

Use last year's balance sheet

One of the best ways to complete a balance sheet is to start with a copy of last year's balance sheet. This gives you a place to start and acts as a checklist so you don't forget something.

Go and count

You will need to physically go out and estimate the number of bushels on hand or count the number of head of livestock.

Use your records

Some information such as cost or depreciation on machines, buildings and land should be available from your records.

Contact lenders

Organizing information on your debts the first time may be more difficult than you think. You may need to contact your lender to get loan balances. Figures on debts are firm in the sense that they are agreed-upon obligations but it's sometimes difficult to get current balances. Look for ways to keep an accurate record on your debts.

Example Balance Sheet

John and Mary Farmer

To analyze the financial position of their farm business, John and Mary Farmer assembled the following information about their farm business.

What Did They Own?

Current Assets (normally sold or converted to cash during the year)

1. First, they balanced their checkbook as of January 1. The cash balance was \$1,251.
2. John and Mary also remembered that they had \$1,350 in a passbook savings account.
3. Next, John inventoried the market livestock on the farm:
 - 176 head of hogs (averaging 70 lbs.) @ \$50/head
 - 170 head of hogs (averaging 150 lbs.) @ \$85/head
4. Then, John checked his grain supplies:
 - 14,000 bu. corn @ \$2.60/bu. (4,000 bu. under loan at \$2.40)
 - 2,467 bu. beans @ \$6.40/bu.
 - 6 tons SBOM @ \$200/ton
 - \$400 worth of pig grower on hand
 - \$515 in diesel fuel on hand
 - \$2,600 in supplies for buildings and fencing
5. John also remembered that some purchased supplies were in his growing wheat crop. He estimated about \$55 per acre expense in 100 acres.
6. Checking their records, John and Mary discovered that a neighbor still owes them \$800 for some custom work.

I.T. Assets (productive assets not normally sold during the year)

7. John's inventory of breeding livestock on the farm January 1:
 - 42 sows @ \$150/sow
 - 8 gilts @ \$100/gilt
 - 2 boars @ \$200/boar
8. The cash value of John's life insurance has increased to \$2,800.

9. An inventory of machinery and equipment was developed separately as follows:

Item	Date acquired	Basis cost	Remaining book value	Current market value
Ford car	1979	\$ 8,900	\$ 3,900	\$ 4,500
GMC truck	1975	12,000	2,344	5,500
JD 4430	1977	14,900	7,900	14,300
JD combine	1978	30,200	14,200	20,100
IH 1086	1981	31,500	25,830	32,500
Other machinery & equipment		48,600	27,513	30,000
		\$146,100	\$81,687	\$106,900

Depreciation on machinery and equipment for the past year—\$18,206

L.T. Assets (real estate and improvements)

10. John and Mary estimated the total value of their farm land, buildings, and improvements as follow:

	Original cost	Improvements	Current market
160 acres (1962)	\$ 60,000	\$80,000	\$180,000
160 acres (1969)	90,000	15,000	155,000
80 acres (1981)	\$108,000		108,000
Remaining book value of buildings—\$80,000			
Depreciation on buildings for the past year—\$4,000			
11. In reviewing their records, John and Mary also noted they had \$2,250 in FLB stock.

What Did They Owe?

Current Liabilities (debts you are obligated to pay within one year)

12. During the past year, they continued to utilize an operating line of credit with the First Bank. \$45,000 is still outstanding and will have to be renewed. Accrued interest (if they had to pay off the loan today) is \$4,600.
13. Farm Co-op sent John a reminder that he has a feed bill of \$1,800 and a fuel bill of \$600 which are still unpaid from last year. No interest was charged.

14. John also remembered that he still owed a neighbor \$200 for renting a field for hog pasture.
15. They also have 4,000 bushels of corn under a CCC loan at \$2.40 per bushel. Interest has been prepaid.
16. Real estate taxes levied in the past year and payable after January 1 are \$3,800. Personal property tax bill will be \$405. John estimates his federal income and social security tax to be \$4,560 (to be paid by March 1).
17. John and Mary skip the principal portion of I.T. and L.T. liabilities (due in 12 months) until the sections below on I.T. and L.T. liabilities are worked out. They will also need to work out these sections before calculating the accrued interest on I.T. and L.T. liabilities in the current obligations section.

I.T. Liabilities (debts due in 2 to 10 years)

18. Sorting out their I.T. loans is a chore, but they finally get them organized.
 - a) JD combine loan at First Bank. Balance is \$18,000 with principal payment of \$6,000 due March 1. Interest at 12%.
 - b) JD 4430 loan at First Bank. Balance is \$4,300 with principal payment of \$4,300 due March 1. Interest at 12%.
 - c) IH 1086 tractor loan at First Bank. Balance is \$20,000 with principal payment of \$5,000 due April 1. Interest at 14%.
 - d) Hog feeders loan at Co-op. Balance is \$10,200 with annual principal payment of \$5,100 due August 1. Interest at 15%.
19. Calculate the principal portion of I.T. liabilities due in 12 months and enter in the current liabilities section above.

20. John and Mary also calculated the accrued interest due on the I.T. loans and entered in the current liabilities section above:

JD combine loan	\$1,800*
JD 4430 loan	430
IH 1086 loan	2,100
Hog feeders	638
	\$4,968

*Calculation: \$18,000 balance x .12 = \$2,160
 \$2,160 ÷ 12 months = \$180 interest/month
 \$180 x 10 months (3/1 to 1/1) = \$1,800

L.T. Liabilities (debts due in 10 years or more)

21. Long-term loans on land and buildings were as follow:
 - a) 160-acre farm with FLB. Balance is \$38,000 with principal payment of \$2,100 due March 1. Interest at 10½%.
 - b) 160-acre farm with Tom Jones. Balance is \$6,400 with principal payment of \$3,200 due July 1. Interest at 6%.
 - c) 80-acre farm with Sam Smith. Balance is \$90,000 with principal payment of \$9,000 due November 1. Interest rate is 10%.
22. Calculate the principal portion of the L.T. liabilities due in 12 months and enter in the current liabilities section above.
23. The accrued interest due on the L.T. loans is calculated and entered in the current liabilities section above:

FLB	\$3,325
Tom Jones.....	192
Sam Smith	1,500
	\$5,017

BALANCE SHEET

NAME JOHN & MARY FARMER ADDRESS COLUMBIA, MISSOURI DATE JAN. 1, 198

CURRENT ASSETS		Assets normally sold or converted to cash during year		CURRENT VALUE
Cash	1,251	Savings	1,350	2,601
Accts. Receivable				800
Marketable Securities				
Hedging Account Equity				
Commodities for Sale & Feed		Unit value	if under contract	
Kind	No. units			
CORN	14,000	2.60		36,400
CORN	(4,000)		CCC	
BEANS	2,467	6.40		15,789
Investment in Growing Crops	100 AS. OF WHEAT @ \$55			5,500
Feed	1,600	Seed		1,600
Fert.		Chem.		
Fuel	515	Other Supplies	2,600	3,115
Livestock Held for Sale	No.	Weight	Unit value	
MKT. HOGS	176	70#	50	8,800
MKT. HOGS	170	150#	85	14,450
Non-farm				
Amounts from Schedule 1				
1. CURRENT ASSETS	SUBTOTAL			89,055
I. T. ASSETS	Assets not normally sold during the year			
Breeding Livestock	No.	Weight	Unit value	
SOWS	42		150	6,300
GILTS	8		100	800
BOARS	2		200	400
Auto(s) (yr., make, model)	1979 FORD			4,500
Truck(s)	1975 GMC			5,500
Machinery Book value:	81,687			96,900
Book value:				
Retirement accts.	Notes rec'bl			
Securities	Cash value			
	life ins.	2,800		2,800
Non-farm				
Amounts from Schedule 2				
2. INTERMEDIATE TERM ASSETS	SUBTOTAL			117,200
LONG-TERM ASSETS	Real estate & improvements			
Acres	Year purchased	Orig. cost	Improvement cost since purchase	
160	1962	60,000	80,000	190,000
160	1969	90,000	15,000	155,000
80	1981	108,000		108,000
Contract(s) notes rec'bl.	FLB STOCK	2,250		2,250
Non-farm				
Amounts from Schedule 3				
3. LONG-TERM ASSETS	SUBTOTAL			445,250*
TOTAL ASSETS (1 + 2 + 3)				657,505

Rev. 10/78 *\$80,000 BOOK VALUE IN BUILDINGS.

CURRENT LIABILITIES		Amounts due in 1 year		AMOUNT(S) OWED
		Creditor(s) name		
Feed	FARM CO-OP			1,800
Seed				
Fertilizer				
Chemicals				
Fuel	FARM CO-OP			600
Repairs				
Other Accounts				
Rent(s)/Lease(s)				200
Estimated & Accrued: Income Tax	Soc. Sec.			4,560
R. E. Taxes				3,800
Property Taxes				405
NOTES TO:		Date due		
FIRST BANK				45,000
CCC CORN (4,000 Bbl. @ \$2.40)				9,600
Principal Portion I.T. Liab. due in 12 mo. (from and less than 10 years below)				20,400
Principal Portion L.T. Liab. due in 12 mo. (below)				14,300
Accrued int. - notes				4,600
Accrued int. I.T. \$	4,968	L.T. \$	5,017	9,985
Non-farm				
Amounts from Schedule 4				
4. CURRENT LIABILITIES	SUBTOTAL			115,350
I. T. LIABILITIES	Debts due in more than 1 and less than 10 years (less current amounts)			
PAYABLE TO:	Pymt. date	Princ. balance (-)	Princ. due in 12 mo. =	
FIRST BANK	3/1	18,000	6,000	12,000
"	"	3/1	4,300	0
"	"	4/1	20,000	15,000
FARM CO-OP	8/1	10,200	5,100	5,100
Non-farm				
SHOW TOTAL IN CURRENT ABOVE				20,400
Life ins. loans				
Amounts from Schedule 5				
5. INTERMEDIATE TERM LIABILITIES	SUBTOTAL			32,100
LONG-TERM LIABILITIES	Debts due in more than 10 yrs. (less current amounts)			
CREDITOR(S) NAME:	Pymt. date	Princ. balance (-)	Princ. due in 12 mo. =	
FLB	3/1	38,000	2,100	35,900
TRM JONES	7/1	6,400	3,200	3,200
SAM SMITH	11/1	90,000	9,000	81,000
Non-farm				
SHOW TOTAL IN CURRENT ABOVE				14,300
Amounts from Schedule 6				
6. LONG-TERM LIABILITIES	SUBTOTAL			120,100
TOTAL LIABILITIES (4 + 5 + 6)				267,450
NET WORTH (PRIOR YEAR \$)				384,055

BALANCE SHEET

NAME _____ ADDRESS _____ DATE _____

CURRENT ASSETS	Assets normally sold or converted to cash during year	CURRENT VALUE
Cash	Savings	
Accts. Receivable		
Marketable Securities		
Hedging Account Equity		
Commodities for Sale & Feed		
Kind	No. units Unit value	✓if under contract
Investment in Growing Crops		
Feed	Seed	
Fert.	Chem.	
Fuel	Other Supplies	
Livestock Held for Sale		
	No. Weight	Unit value
Non-farm		
Amounts from Schedule 1		
1. CURRENT ASSETS		SUBTOTAL
I, T. ASSETS Assets not normally sold during the year		
Breeding Livestock		
	No. Weight	Unit value
Auto(s) (yr., make, model)		
Truck(s)		
Machinery Book value:		
Book value:		
Retirement accts.	Notes rec'bl	
Securities	Cash value	
	life ins.	
Non-farm		
Amounts from Schedule 2		
2. INTERMEDIATE TERM ASSETS		SUBTOTAL
LONG-TERM ASSETS Real estate & improvements		
Acres	Year purchased	Orig. cost Improvement cost since purchase
Contract(s) notes rec'bl.		
Non-farm		
Amounts from Schedule 3		
3. LONG-TERM ASSETS		SUBTOTAL
TOTAL ASSETS (1 + 2 + 3)		

CURRENT LIABILITIES	Amounts due in 1 year	AMOUNT(S) OWED
Feed	Creditor(s) name	
Seed		
Fertilizer		
Chemicals		
Fuel		
Repairs		
Other Accounts		
Rent(s)/Lease(s)		
Estimated & Accrued:		
Income Tax	Soc. Sec.	
R. E. Taxes		
Property Taxes		
NOTES TO:		
	Date due	
Principal Portion I.T. Liab. due in 12 mo. (from below)		
Principal Portion L.T. Liab. due in 12 mo.		
Accrued int. - notes		
Accrued int. I.T. \$	L.T. \$	
Non-farm		
Amounts from Schedule 4		
4. CURRENT LIABILITIES		SUBTOTAL
I, T. LIABILITIES Debts due in more than 1 and less than 10 years (less current amounts)		
PAYABLE TO:	Pymt. date	Princ. balance (-) Princ. due in 12 mo. =
Non-farm		
SHOW TOTAL IN CURRENT ABOVE		
Life ins. loans		
Amounts from Schedule 5		
5. INTERMEDIATE TERM LIABILITIES		SUBTOTAL
LONG-TERM LIABILITIES Debts due in more than 10 yrs. (less current amounts)		
CREDITOR(S) NAME:	Pymt. date	Princ. balance (-) Princ. due in 12 mo. =
Non-farm		
SHOW TOTAL IN CURRENT ABOVE		
Amounts from Schedule 6		
6. LONG-TERM LIABILITIES		SUBTOTAL
TOTAL LIABILITIES (4 + 5 + 6)		
NET WORTH (PRIOR YEAR \$)		

Preparing a balance sheet

This is a step-by-step procedure for completing the balance sheet. One of the more critical aspects—particularly with assets—will be establishing values.

Current Assets

Cash

CURRENT ASSETS	Assets normally sold or converted to cash during year	CURRENT VALUE
Cash	Savings	
Accts. Receivable		
Marketable Securities		
Hedging Account Equity		
Commodities for Sale & Feed		
Kind	No. units Unit value ✓if under contract	
Investment in Growing Crops		
Feed	Seed	
Fertil.	Chem.	
Fuel	Other Supplies	
Livestock Held for Sale	No. Weight Unit value	
Non-farm		
	Amounts from Schedule 1	
1 CURRENT ASSETS	SUBTOTAL	

There are several ways to obtain a cash balance—but only ONE best way.

Actual checkbook balance (the best way)

The most accurate cash figure is the checkbook balance as of January 1, or the date of your balance sheet. Be sure to include all monies deposited and all checks written before the date of the balance sheet.

Bank statement balance

The bank statement balance is another possible source of obtaining the cash balance. However, seldom is this an actual cash balance as of balance sheet date because not all checks written prior to that date will have been returned.

Same cash balance figure each year (least preferred way)

Traditionally, many balance sheets prepared in co-operation with a lender, use the same cash balance figure each year—such as \$500. Over a long period of years, such as 5 or 10 years, this method may not cause problems. However, when the farmer makes end-of-the year purchases or sales, for tax purposes the cash balance can vary greatly from year-to-year. Most farmers manage their cash in such a way that the checkbook balance is fairly uniform throughout the year. However, because of the selling and buying activities that occur at the end of the year, this balance may actually vary a great deal.

Savings

Savings include the balance in farm savings accounts and certificates of deposit as of the balance sheet date.

Accounts receivable

Accounts receivable are sales you have not received payment for or have not deposited the check as of the date of the balance sheet. For example, if you sell hogs on December 30 but you will not receive payment until January—include the amount with accounts receivable. If you have performed custom services for a neighbor but have not received payment this is also an account receivable.

Marketable securities

Marketable securities include stocks or bonds that can easily be sold. Publicly-held or publicly-listed securities are considered easily sold. Equity in cooperatives or stock in privately-held firms that *cannot easily be sold are not* a current asset. They should be listed under either intermediate or long-range assets.

Hedging account equity

If you are using the futures market to hedge grain or livestock and have a margin account with a broker, give the balance in the margin account on the date of the balance sheet.

Preparing a balance sheet

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Current Assets

Cash

CURRENT ASSETS	Assets normally sold or converted to cash during year	CURRENT VALUE
Cash	Savings	
Accts. Receivable		
Marketable Securities		
Hedging Account Equity		
Commodities for Sale & Feed		
Kind	No. units	Unit value
		✓ if under contract
Investment in Growing Crops		
Feed	Seed	
Fert.	Crain	
Fuel	Other Supplies	
Livestock Held for Sale	No.	Weight Unit value
Non-farm		
	Amounts from Schedule J	
1. CURRENT ASSETS	SUBTOTAL	

There are several ways to obtain a cash balance—but only ONE best way.

Actual checkbook balance (the best way)

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Bank statement balance

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Same cash balance figure each year (least preferred way)

Traditionally, many balance sheets prepared in co-operation with a lender, use the same cash balance figure each year—such as \$500. Over a long period of years, such as 5 or 10 years, this method may not cause problems. However, when the farmer makes end-of-the year purchases or sales, for tax purposes the cash balance can vary greatly from year-to-year. Most farmers manage their cash in such a way that the checkbook balance is fairly uniform throughout the year. However, because of the selling and buying activities that occur at the end of the year, this balance may actually vary a great deal.

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Marketable securities include stocks or bonds that can easily be sold. Publicly-held or publicly-listed securities are considered easily sold. Equity in cooperatives or stock in privately-held firms that *cannot* easily be sold are *not* a current asset. They should be listed under either intermediate or long-range assets.

Hedging account equity

If you are using the futures market to hedge grain or livestock and have a margin account with a broker, give the balance in the margin account on the date of the balance sheet.

Commodities for sale and feed

List all grain and hay on hand as of the balance sheet date. Under “kind” list the name of the item, such as corn or alfalfa hay. “Number of Units” can be number of tons, cwt., or bushels, and the kind of unit. Give the price in the same unit as you report quantity—such as dollars per bushel.

Since current assets are readily marketable you can price them at their current market value less marketing and transportation costs. For example, if the market price of corn is \$3.25/bu., but it costs you 10 cents to get it to market, the balance sheet price should be \$3.15. If you have sold the commodity on a contract, use the contract price less any cost of getting it to market. Likewise, if you have locked in the price of a commodity through a hedging contract, indicate the price at which the commodity has been locked in. If you have contracted, or hedged, any of the crops indicate this by checking in the appropriate space. If crops are under CCC loan you might indicate this by writing in CCC rather than using a check mark.

Investment in growing crops

Lenders vary in their attitudes toward putting a value on a growing crop. However, in most cases, it is permissible to report the expenditure made for seed, fertilizer, and chemicals applied to the growing crops that have not been harvested. The most common example in Missouri is winter wheat. It is advisable to record the number of acres planted and cost per acre in addition to the total investment in the growing crop.

Seed, feed, fertilizer, chemicals, fuel & other supplies

Include supplies that you have bought for later use. Feed is generally considered to be protein supplement and minerals. Grain is usually entered in crops inventory rather than listed as feed. You will also want to list supplies you have bought and paid for that have not been delivered. Give the total value of these items that you have on hand.

You may also list those items that you have ordered and are obligated to pay for but have not paid for. For example, if you are listing items such as seed corn you have ordered and are obligated to pay for as an asset, then you must also list the amount due as a liability under accounts payable.

Livestock held for sale

Include steers, barrows, and other livestock being held for sale as slaughter animals. Give the kind of animal, the number of head, approximate weight per head, and the value per head. If you give the value in cwt., rather than head, then also give the quantity as cwt. Be sure to indicate the kind of units you are using so that a person reading the balance sheet can tell whether it's head or cwt.

If you have hogs of different weights, list them in separate groups. Group those that are about 40 lbs. on one line and include those that may be closer to 120 pounds on another line. This gives a better picture of the animals that you have on hand. You can price the animals at their current market price less trucking or sales charges.

Non-farm

If you have non-farm current assets that you want to include on your farm balance sheet, list the amounts. Include a brief description.

Amounts from schedule 1

If you need more space to record current assets, use Schedule 1 on the reverse side. Be sure to provide appropriate breakdown for items recorded. Enter the total of items in Schedule 1 on the front side on the appropriate line.

Intermediate-term assets

Intermediate assets are the productive assets of the farm operation. They are sometimes known as the working assets, the ones that do the work and earn the income.

Breeding livestock

Separate breeding livestock as much as possible by class—such as cows, heifers, and bulls. Record the number, approximate weight per head, and value per head.

There is a disagreement on how breeding livestock should be valued. In any case, realistic values must be used.

1. One method is to use the current market value. This approach, however, can create great fluctuation in the balance sheet from year to year.

2. A second method, preferred by many lenders and farm management advisers, is to use the same conservative market value each year. For example, a beef cow may be valued at \$400 each year. This approach will slightly over-value animals during the low periods of the price cycle and under-value the livestock during the high part of the cycle. It will, however, maintain more stability on the balance sheet.

1. T. ASSETS <small>Assets not normally sold during the year</small>			
Breeding livestock	No.	Weight	Unit value
Autos(s) (yr., make, model)			
Truck(s)			
Machinery Book value			
Book value			
Retirement accts	Notes rec'd		
Securities	Cash value		
	Life ins.		
Non-farm			
			Amounts from Schedule 2
2. INTERMEDIATE TERM ASSETS			SUBTOTAL

Autos

Include the year, make, model and value. Trucks could be listed here or could be included in the machinery section.

Machinery

From a true accounting standpoint, machinery and equipment should be carried on the balance sheet at book value. Book value is used by accountants keeping books for most non-farm businesses. The book value is an important figure to have if you want to calculate a true profit and loss on your operation.

A balance sheet should provide as much information about the farm business as possible. Therefore, we suggest that you record the purchase cost and the depreciation taken to date as well as the current market value. Purchase cost and depreciation information can be obtained from your tax schedule.

The preferred value to record on the balance sheet is, of course, the book value. However, farmers usually carry the machinery at an estimated current value. If you prefer to use a current market value, note the book value on your balance sheet. On the other hand, if you use the book value, one suggestion is to record the current machinery value in the left margin.

Very likely your lender will want a more detailed listing of the machinery on hand. You may want to visit with him concerning the acceptability of your tax depreciation schedule or make other arrangements. These kinds of arrangements will vary with each lender.

Retirement accounts

If you have an established account, record the current value of that account.

Notes receivable

If you have lent money to other people, give the value of loans outstanding.

Securities

Securities include investments in small corporations or businesses that may not be trading on the stock exchange—PCA stocks and equities in co-operatives.

Non-farm

If you have non-farm assets that you want to include on the farm balance sheet, record them. Be sure to note the nature of these assets.

Amounts from schedule 2.

If you need additional space for recording intermediate-term assets, use schedule 2 on the reverse side of the balance sheet, and bring the total to the appropriate line on the front side.

Long-term assets

Land and buildings

LONG-TERM ASSETS		Real estate & improvements	
Acres	Year purchased	Orig. cost	Improvement cost since purchase
Contract(s) notes rec'd			
Non-farm			
		Amounts from Schedule 3	
3 LONG-TERM ASSETS		SUBTOTAL	
TOTAL ASSETS (1 + 2 + 3)			

The major long-term assets are land, buildings and improvements. Improvements could include terraces, land clearing, lakes, water supply, etc. List each parcel of land—include the number of acres, year purchased, the amount you paid for the land including improvements. If you have made additional improvements, additions to buildings, terraces, waterways, etc.—include the cost of these improvements. Show the amount of depreciation on the buildings or taken to date. This information should be available from your tax records. Subtracting depreciation from total cost gives you the book value of your property.

What value should be used on land and buildings?

1. One method is to use the book value just discussed. This is the preferred method from a pure accounting standpoint.
2. However, convention has it that current value shall be reported. How you wish to handle it depends on your lender. One way is to record the book value in the value column and the current market value in the left-hand margin. Or you can do it the other way around. However, it is important that it be clear on the balance sheet how you arrived at values.
3. Another approach is to use a conservative market value and update this value periodically, such as every four or five years. In this way, it is possible to analyze the business without bringing inflation into the analysis.

If you have owned land for a considerable period of time, the book value may be difficult to establish. However, it is to your benefit (or to the benefit of your heirs) to establish the book value and record it. There will be a time when you or your heirs will need this information. Documenting this information could save you taxes in later years in addition to providing you with valuable information for your balance sheet.

Contract(s)/note(s) receivable

A number of items can be recorded. Be sure to include your stock from Federal Land Bank loans if you have such. Also, record any long-term loans that you made to others.

Non-farm

You have the opportunity, if you desire, to record long-term non-farm assets. This could be the value of the residence if not included in the farm value. It could also be a house or a business in town. (Provide a brief description of the type of assets to be included). If you record the total value of non-farm assets, be sure to include the liabilities on these assets in the non-farm liability section.

Amounts from schedule 3

If the amount of space to record long-term assets is insufficient use schedule 3 on the reverse side of the balance sheet. Bring the total to the front side.

Total assets

Now, total the value of assets in each section. Then add the *current*, *intermediate*, and *long-term* totals to get total assets. This is the value of assets you own.

Current liabilities

Debts you are obligated to pay within one year are current liabilities. A number of items will take some thought to clarify in your mind; but, ask yourself this question: "If I were to quit farming today and sell out, what debts must I pay today and in what amount?"

Feed, seed, fertilizer chemicals, fuel, repairs, and other accounts

Bills for supplies you have purchased but have not paid are accounts payable. In some cases the supplies may still be on hand but in other cases you may already have used them. Anything you have recorded as an asset or have already used but not paid for should be listed under amounts owed.

CURRENT LIABILITIES	Amounts due in 1 year Creditor(s) name	AMOUNT(S) OWED
Feed		
Seed		
Fertilizer		
Chemicals		
Fuel		
Repairs		
Other Accounts		
Rent(s)/Lease(s)		
Estimated & Accrued:		
Income Tax	Soc. Sec.	
R. E. Taxes		
Property Taxes		
NOTES TO:	Date due	
Principal Portion I.T. Liab. due in 12 mo. (from below)		
Principal Portion L.T. Liab. due in 12 mo.		
Accrued int. - notes		
Accrued int. I.T. \$	L.T. \$	
Non-farm		
	Amounts from Schedule 4	
4. CURRENT LIABILITIES	SUBTOTAL	

Rent(s)/lease(s)

Include lease payments you are obligated to make during the coming year. This is particularly true for things such as irrigation or tractor leases. Record under current liabilities only the amount of these payments due the coming year.

Land rents are usually not recorded as a liability unless they are past due. If rent payments are due in March and October, it may, however, be well to record the March payments. Probably an important issue in recording land rent is to take into account the nature of the lease obligation and to be consistent from year-to-year.

Estimated and accrued income tax

Include the amount of income tax and social security due on the past year's income. The accurate amount will likely not be known at the time the balance sheet is prepared; use a reasonable estimate.

Real estate taxes

Record property taxes that are due and payable. On balance sheets being prepared at the first of the year no taxes are due—if the taxes have been paid on them (in December). However, if the taxes have not been paid, record the amount due. Also, if the balance sheet is prepared at some other time of the year, consider the proportion of taxes that ought to be due at that time.

Notes

Record loans due within the next year. This should include operating loans from banks, PCA, and FmHA. Also include loans from individuals and relatives that are of a short-term nature. Record the amount of principal owed.

What the balance sheet shows

Net worth

$$\begin{aligned} & \text{Assets} \\ - & \text{Liabilities} \\ = & \text{Net Worth} \end{aligned}$$

Your net worth is the investment or equity you have in your business. An important question to ask, however, is "If I were to sell out would I really end up with this amount of money?" The answer depends on how you have valued your assets and the actual sale price. But for the moment let's assume you sold the assets at value listed on the balance sheet. If you were to sell your current assets, all income would be taxed as regular income.

What about the intermediate-term assets? All sales of farm-raised breeding livestock would be taxed as capital gains. If you have recorded the book value on machinery, no tax would be due. Any sales value above the book value, however, would require regular income tax be paid on the gain. The same is true of long-term assets sold.

Your net worth figure is not as firm a figure as you might expect. It is very likely the government owns a part of your net worth and will collect at the time you sell the assets.

Working capital

$$\begin{aligned} & \text{Current Assets} \\ - & \text{Current Liabilities} \\ = & \text{Working Capital} \end{aligned}$$

One of the more useful figures that you can compute is Working Capital. Current liabilities are due within 12 months. One way to pay them off would be to sell all the current assets. The amount of working capital is the difference between the current assets and the current liabilities. Those operations with a good working capital position—current assets are considerably higher than current liabilities—have a great deal of cushion to weather adversity. They have a greater ability to handle drought or a serious turn of events. A good working capital position puts you in a better position to make investments. Working capital makes it easier to borrow money and puts you in a more liquid position.

To properly interpret this working capital position, however, be sure that short-term notes are actually against short-term assets and not against intermediate-term or long-term assets. Frequently farmers, and lenders too, will finance machinery on short-term notes. These notes may be rolled over from year-to-year but in doing so does not give a good picture for the balance sheet.

How do you get more working capital?

One way to increase working capital is to reduce current liabilities. A traditional way has been to refinance long-term assets—borrow money on land to pay off short-term debt. This is one of the easiest and one of the most practical ways, but it can also raise interest rates if the long-term loans are fixed at low rates. The important point is to recognize that farm businesses in good working-capital positions find it must easier to borrow money than those in poor working-capital positions.

Percent equity in the business

Another very useful figure is the percent equity you have in the farm business. To obtain this figure, divide net worth by the total assets and multiply by 100. This tells you the percent of the assets that you own. This percentage figure depends, to a large extent, on how you have valued your intermediate and long-term assets.

$$\text{Net Worth} \div \text{Assets} \times 100 = \text{Percent Equity}$$

Guidelines and standards are established for many commercial businesses to assign book values to assets. A standard by which a certain percent equity in a farm business is judged good or bad is difficult to develop.

The variability among farms in the value placed on intermediate and long-term assets is too great. Therefore, greater skill is required to analyze a farm business compared with many non-farm businesses.

Leverage ratio

A figure similar to percent equity is the leverage ratio. Divide the liabilities by net worth to obtain leverage ratio.

$$\text{Leverage Ratio} = \frac{\text{Liabilities}}{\text{Net Worth}}$$

Leverage ratio tells you how many dollars your lenders have “invested” for each dollar you have invested.

Using the balance sheet in making decisions

Balance sheets can be a valuable tool in making investment and financial decisions. They can tell you ahead of time the kinds of problems that can result from some of these decisions.

The key to using a balance sheet in analyzing new investments is to look at the balance sheet before and after an investment is made.

First, let’s consider ways that assets and liabilities can change on a balance sheet.

Assets increase

- Inflation (increase in value or price)
- Gifts (an inheritance of cash or land)
- Growth (raised livestock, stored crops)
- Purchases* (land, machinery, supplies)

*Total assets increase only if money is borrowed to buy the asset—such as a tractor. If cash in the bank is used, then assets have been converted from cash to machinery.

Assets decrease

- Deflation (stored crops decrease in price)
- Depreciation (machinery wears out)
- Sales* (land, machinery)

*Sales decrease assets only if money is used to pay off debt. If put in cash, then only the form is changed.

Liabilities increase

There is only one way to increase liabilities—borrow or buy on credit.

Liabilities decrease

There is only one way to reduce debts—use cash to pay off the debt.

Net worth

Two basic ways to increase net worth are:

1. **Growth.** (increase assets, crops, livestock, cash, etc., from earnings)
NOTE: You have to be an active farmer to get this kind of net worth increase.
2. **Inflation.** In recent years inflation in land and machinery has increased the net worth of farmers.
NOTE: You don’t have to farm to get this type of net worth growth.

Leverage ratio

Let’s take a simple example to see how to use the balance sheet leverage ratio in decision making. Example: Assume that John Farmer has the following financial statement:

Assets	\$200,000
Liabilities	100,000
Net worth	\$100,000

He is considering buying two pieces of land, each priced at \$100,000. For simplicity, let's say he borrows the entire amount— or refinances current land to pay for the added purchase. What is the effect on his balance sheet?

	Present	Purchases	
		\$100,000	\$200,000
Assets	\$200,000	\$300,000	\$400,000
Liabilities	100,000	200,000	300,000
Net worth	\$100,000	\$100,000	\$100,000
Liabilities	\$100,000	\$200,000	\$300,000
Net worth	\$100,000	\$100,000	\$100,000
leverage ratio	1:1	2:1	3:1

Now let's consider:

Net Worth. Regardless of the amount purchased, John's net worth did not change. As he bought land—he added to both assets and liabilities.

Leverage Ratio. His starting ratio wasn't outstanding. He and his lender each owned half of the business. As he added land his lenders increased their share in the business. There is little question that as this ratio increases his lenders become more concerned—not only because they "own" a greater portion, but also about John's ability to pay off the debt.

Working capital

Working capital can be important to watch. It affects the feasibility of an investment.

Let's say John Farmer is required to make a 20 percent down payment on the land and he can't refinance the existing land to make the down payment. John decides he has some stored crops on hand that he can sell to get cash.

Buy		\$100,000	\$200,000
Borrow		80,000	160,000
Sell Current Assets		20,000	40,000
Assets: Current	\$ 50,000	\$ 30,000	\$ 10,000
I.T.	50,000	50,000	50,000
L.T.	100,000	200,000	300,000
Total	\$200,000	\$280,000	\$360,000
Liabilities:			
Current	\$ 30,000	\$ 30,000	\$ 30,000
I.T.	30,000	30,000	30,000
L.T.	40,000	120,000	200,000
	\$100,000	\$180,000	\$260,000
Net worth	\$100,000	\$100,000	\$100,000
Working capital	10,000	0	- 20,000
Leverage	100,000	180,000	260,000
	\$100,000	\$100,000	\$100,000
Ratio	1:1	1.8:1	2.6:1

The above example shows why a good working capital position is important. John might be able to swing the purchase of one parcel—if he has a very generous banker. But with no working capital he's in trouble if anything goes wrong.

With purchase of two parcels he's in trouble. Looks like he may have sold mortgaged property. His current assets aren't able to cover short-term debt. Even with his intermediate and current assets he can barely cover short-term and intermediate debt.

Any way you look at it, he's headed for trouble.

Profitability

A balance sheet doesn't show if an operation is profitable or if making an additional investment is profitable. Comparing several balance sheets over time can, however, show growth in assets. Growth is not possible without making a profit.

However, it is possible to tell from a balance sheet the kind of earnings that are necessary to make payments on the debt. Making projections based on purchases can give some idea regarding the feasibility of repaying new debt.

Let's again take our previous example to show how this can be done. Business assets should be productive and generate income. The earning rate of assets is usually stated as a certain percent of all assets. However, if there is debt against the assets we need to pay annual interest on the debt.

	Present	Purchases	
		\$100,000	\$200,000
Assets	\$200,000	\$300,000	\$400,000
Liabilities	100,000	200,000	300,000
Net worth	\$100,000	\$100,000	\$100,000
Case I			
Earnings 10%	\$ 20,000	\$ 30,000	\$ 40,000
Interest 15%	15,000	30,000	45,000
	\$ + 5,000	\$ 0	\$ - 5,000
Case II			
Earnings 10%	\$ 20,000	\$ 30,000	\$ 40,000
Interest 8%	8,000	16,000	24,000
	\$ 12,000	\$ 14,000	\$ 16,000

Leverage pays when the earning rate on assets is higher than the interest rate. This is shown clearly in Case II. We saw this situation in certain parts of the 1970s. In this situation the more assets one owns the more profitable the operation, regardless of the leverage ratio or amount of debt.

When farm profitability turns to the relationship shown in Case I, then high leverage can cause serious financial problems—not only profitability problems but more important repayment problems. Debt must be paid from profits.

Deciding how much debt to carry is a very important question and the answer is not the same for everyone. Becoming a good producer and manager can be more important than becoming big. Some producers will find earnings increase faster by becoming a more efficient producer rather than increasing in size of operation. This is especially true when the earning and interest ratios are as shown in Case I. When interests are lower than earnings that's the time to expand the size of an operation.

Summary

Your balance sheet can be a valuable financial tool. It tells you how your farm business looks today—just like a photograph. Balance sheets can tell you how your business has changed over time. A balance sheet can also be a valuable tool in examining how a large investment such as land purchase can affect the financial health of the business.

