Heart of the Farm

Financial Management Factsheet Series

Understanding the Farm Business Balance Sheet, Part I

The first primary financial management report often created for the farm business is the Balance Sheet. It provides insight of farm liquidity and solvency . What is the Concept and Structure of the Balance Sheet?

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The balance sheet is a report of the farm business' financial position (strength) at a point in time. It is referred to as a "balance" sheet because it adheres to the accounting formula:

Assets = Liabilities + Net worth

The balance sheet is also known as a *net worth statement* because of the importance of net worth with respect to representing financial position.

How is the Balance Sheet Created?

The farm business is comprised of "assets" – such things as cash, savings, cattle, machinery, buildings, and land. The assets have claims upon them by lenders, cooperatives, dealers, etc., referred to as "liabilities." The assets are also claimed by the owner, referred to as "net worth" (or owner equity).

The value of the assets "balance," or equal the sum of the liabilities and net worth, creating the conceptual structure to the balance sheet.

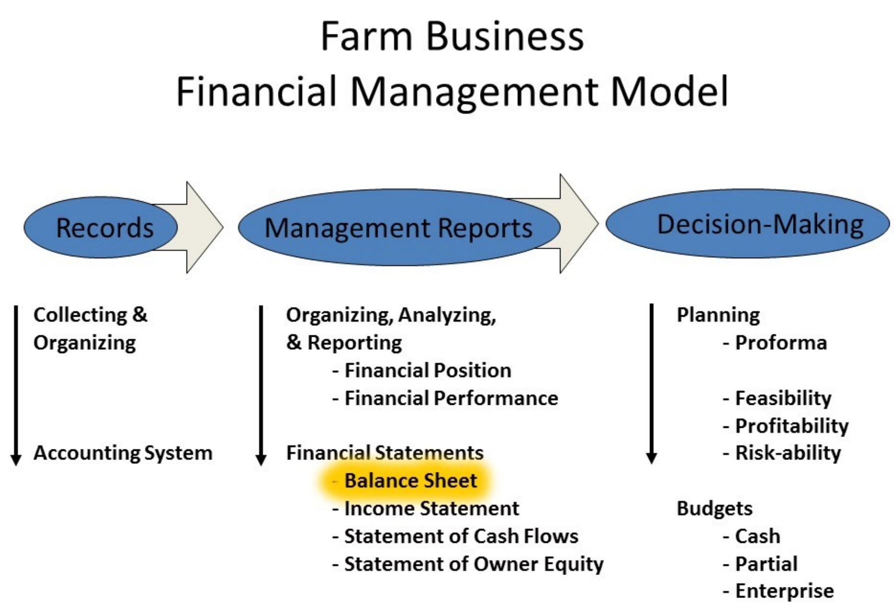
Assets (identifying and valuing)

The balance sheet is specifically structured by how the assets are classified, either as "current" or "non-current" assets. All assets are identified; those assets generally used or sold within the next year are classified as current assets, and assets having a longer life are classified as non-current assets.

It is common in production agriculture to further classify non-current assets as "intermediate" and "long-term" assets. Intermediate assets include such things as breeding livestock, and machinery and equipment. Long-term assets include such things as buildings and land.

It is important to identify and have an accurate physical count (i.e., number of head, bushels, etc.) of all assets. It is also important to appropriately value all assets, being consistent in the valuation approach over time.

The valuation method(s) used will affect how the balance sheet represents the financial position of the farm business. An application of representative market values to



The **Financial Model** illustrates the management-to-decision-making process, and the tools used to make decisions. Beginning with collecting and organizing financial information (records) through an accounting system, the information is then transformed into financial statements for analysis and interpretation of the farm's financial position and performance. Through the budgeting process, analysis for feasibility, profitability and risk-ability, allow for making the best decisions for the farm business.

current assets, and some trend of market values to non-current assets, is somewhat common in creating a "market-value" balance sheet.

Applying a cost-less-depreciation approach to non-current assets is common in creating a "cost-basis" balance sheet. Market value and cost-basis balance sheets provide different insights to financial position and serve different purposes.

Furthermore, what is included in "all" assets will determine if the balance sheet represents the farm business or is a combined balance sheet, representing business and personal assets.

Liabilities

Liabilities are commonly classified as current or non-current (intermediate and long-term), similar to how the assets are classified. Current liabilities are due within the next year, intermediate liabilities will generally be paid within 1 to 10 years, and long-term liabilities are due beyond 10 years. A particular claim (i.e., mortgage) may have portions classified as current or non-current, depending how the claim is structured to be paid.

"Contingent" liabilities may or may not be included on the balance sheet. They are often associated with the market value balance sheet, representing a liability triggered by an event, such as capital gains tax triggered by the sale of land. Balance sheets for "ongoing" farm businesses sometimes omit contingent liabilities.

Net Worth (Owner Equity)

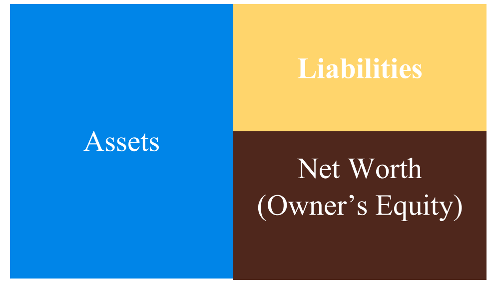
Net worth represents the claim upon the assets of the farm business by the owner. It is calculated by subtracting the value of the liabilities from the value of the assets.

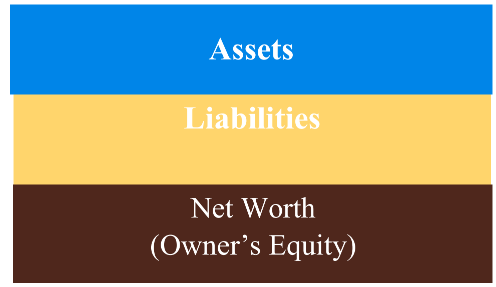
Balance Sheet Design

While the balance sheet may have varied designs or appearances, it adheres structurally to the balance concept of the accounting formula:

Assets = Liabilities + Net Worth

There are two common preferences in designing the balance sheet as show in the following diagrams:





Summary

This factsheet discusses the concept of the balance sheet and how it is structured to represent the financial position of the farm business. Interpretation and Analysis of financial position (i.e., liquidity, solvency, etc.) are addressed in Part II of this series.

Next up….

Part II: Interpretation and Analysis of the Farm Business Balance Sheet

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The Heart of the Farm – Women in Agriculture program addresses the needs of farm women and men by providing education on pertinent topics, connecting them with agricultural resources, and creating support networks. http://fyi.uwex.edu/heartofthefarm

For other farm financial information and resources contact: Center for Dairy Profitability: http:://cdp.wisc.edu