AgriLIFE EXTENSION
Texas A&M System

Balance Sheet – A Financial Management Tool

Overview

- A balance sheet is a statement of the financial condition of a business at a specific time.
- The balance sheet shows what is owned by a business, what is owed, and the owner's equity (or net worth) of the business.
- By comparing past balance sheets with the present balance sheet, the growth or decline of assets, liabilities and net worth can be determined.
- The balance sheet is often called a net worth statement. The net worth is the value that would be left if all of the business's debt obligation were paid in full.
- Assets may include cash on hand, bank accounts, accounts receivable, feed supplies, livestock, equipment, buildings, land and other items.
- Although each asset may not be completely paid for, its full value is listed. The unpaid accounts, notes and mortgages are listed as liabilities.
- In many farm businesses, there is no sharp distinction between business and family assets and liabilities.

Overview *cont.*

- The relationship of assets, liabilities and net worth is expressed as follows:
    - Assets – Liabilities = Net Worth (Equity)
    - Assets = Liabilities + Net Worth (Equity)
- A current asset is cash or other assets that can be quickly converted into cash in the normal business processes within 1 year.
- Noncurrent assets are those resources that are used mainly to support farm production. Unlike current assets, they are not expected to be sold in the normal operating cycle. These assets have a more permanent value. They include breeding livestock, machinery and equipment, buildings and real estate.
- Current liabilities include notes payable within a year, accounts payable, accrued interest and other accrued expenses, income taxes payable, and the current portion of deferred taxes. When they become due, they are usually paid from cash on hand, from the sale of current assets, or by creating another loan.
- Noncurrent liabilities include the noncurrent portion of notes payable, as well as land contracts and mortgages on land and buildings/improvements.

Uses of the Balance Sheet

- Lenders use the balance sheet to evaluate the financial position of most loan applicants.
- The balance sheet statement also can be extremely useful to the owner of the business because it indicates the business's net worth.
- Comparing balance sheets over time shows how much the business net worth is growing or decreasing.
- A balance sheet can be used by the owner of a business to support a request for borrowed funds.
- The balance sheet gives information on how best to meet liabilities.
- Comparing total current assets to total non-current helps determine whether too much or too little capital is tied up in permanent investments.
- A balance sheet provides the information for making these comparisons.

Asset Valuation

- One of the most important issues in completing and using the balance sheet is the method used to value assets.
- The two most common are current market value and cost.
- Market value is the estimated amount the asset would sell for on the date of the statement, less selling costs.
- Cost is the original cost or basis of the asset, less any accumulated depreciation.
- The method used to determine asset value affects financial ratios derived from the balance sheet and the amount of deferred taxes. Most importantly, it affects farm equity.
- The cost basis indicates the amount of earned and contributed owner equity.
- The market value also indicates the additional amount of equity that has resulted from the change in asset values due to inflation or deflation.

Evaluating the Balance Sheet

- Comparing it to balance sheets of the same business in previous years.
- Comparing it to balance sheets from other farms.
- Using ratios.
- Using a "common-size" statement.

Comparison to Previous Years

- One of the most effective methods of evaluating the balance sheet is comparing one year to previous years for the same business.
- Comparing balance sheets between years directs attention to changes that have occurred in the relationship between assets and liabilities and the resulting growth or decline in the net worth of the business.

Example: Balance Sheet (farm business only)

	Amount	Percent
ASSETS:		
Cash on hand	0	0.00
Cash on deposit in bank	31,140	3.97
Marketable securities	0	0.00
Market livestock	232,650	29.67
Crops held for sale and feed	17,980	2.29
Fertilizer and supplies on hand	7,625	0.97
Accounts receivable	10,000	1.28
Prepaid expenses	0	0.00
Cash investment in growing crops	9,000	1.15
Other current assets (list)	645	0.09
TOTAL CURRENT ASSETS	**$309,040**	**39.42**
Breeding livestock (market)	25,500	3.25
Auto-trucks (market)	13,520	1.72
Motorized equipment (market)	70,700	9.01
Machinery and equipment (market)	37,605	4.80
Investments in capital leases	0	0.00
Investments in other entities	6,000	0.76
Investments in cooperatives	18,000	2.30
Real estate (market)	198,750	25.35
Buildings-improvements (market)	104,950	13.39
Other assets (list)	0	0.00
TOTAL NONCURRENT ASSETS	**$475,025**	**60.58**
TOTAL ASSETS	**$784,065**	**100.00**

	Amount	Percent
LIABILITIES:		
Accounts Payable	0	0.00
Notes due within one year	118,975	15.18
Current portion of term debt due within 12 months	11,125	1.42
Accrued interest	8,500	1.08
Income taxes payable	3,200	0.41
Current portion deferred taxes	55,910	7.13
Other accrued expenses	4,000	0.51
Other current liabilities	0	0.00
TOTAL CURRENT LIABILITIES	**$201,710**	**25.73**
Noncurrent portion-notes payable	20,790	2.65
Noncurrent portion-real estate	83,025	10.59
Noncurrent portion-deferred taxes	71,275	9.09
Other noncurrent liabilities	0	0.00
TOTAL NONCURRENT LIABILITIES	**$175,090**	**22.33**
TOTAL LIABILITIES	**$376,800**	**48.06**
Retained earnings and contributed capital	280,160	35.73
Valuation equity	127,105	16.21
OWNER EQUITY	**$407,265**	**51.94**
TOTAL LIABILITIES AND OWNER EQUITY	**$784,065**	**100.00**

RATIOS:

Current ratio = Total current farm assets ÷ Total current farm liabilities = $309,040 ÷ $201,710 = 1.53
Debt/asset ratio = Total farm liabilities ÷ Total farm assets = $376,800 ÷ $784,065 = 0.48
Equity/asset ratio = Total farm equity ÷ Total farm assets = $407,265 ÷ $784,065 = 0.52
Debt/equity ratio = Total farm liabilities ÷ Total farm equity = $376,800 ÷ $407,265 = 0.93
Working capital = Total current farm assets – Total current farm liabilities = $309,040 - $201,710 = $107,330

Comparison to Other Farms

- Comparing the balance sheet of a farm business to the balance sheets of successful farms of a similar type may give evidence of weak or strong points in the business.

Use of Ratios

- A ratio is a comparison of two numbers expressed as a numerical ratio of one number to the other or as a percentage of one to the other.
- Examples of balance sheet ratios are:
  - Current ratio = Total current farm assets ÷ Total current farm liabilities
  - Debt/asset ratio = Total farm liabilities ÷ Total farm assets
  - Equity/asset ratio = Total farm equity ÷ Total farm assets
  - Debt/equity ratio = Total farm liabilities ÷ Total farm equity
  - Working capital = Total current farm assets – Total current farm liabilities

Common-Size Statement

- When different size operations are compared, using percentages rather than actual dollars has some advantages.
- This approach is called a common-size statement.
- Each farm is put on a “common-size” basis, that is, the various assets, liabilities and equity are expressed as percentages within the business.