THE BALANCE SHEET - AN INTRODUCTION

A balance sheet is a financial statement that gives a snapshot of the business' assets, liabilities and net worth on a particular date, providing the farm owners with an idea of what they own and owe.

THE BALANCE SHEET

The most basic farm financial statement is the balance sheet. Simply put, the balance sheet is a snapshot of the farm's financial position, showing everything that is owned, everything that is owed, and what would be left should the farm be sold, at a particular point in time.

More specifically, the balance sheet is a listing of all the farm's assets - the tools, machinery, land, buildings, supplies and other items of value such as money in cash, checking or savings accounts that belong to the farm, and all the farm's liabilities - money that the farm owes to others such as farm bills to be paid, and loan notes on land, machinery, implements and other infrastructure to banks, dealers, government, family, or other lending services and investors.

WHAT THE BALANCE SHEET TELLS US

When the total value of liabilities are subtracted from the total value of assets, the difference is considered the "net worth," which is the owner's equity in the farm (what is owned free and clear). If the equity is positive, then the operator owns more of the business than its creditors. If the farm (and all its assets) were to sell, positive equity means the farm is "solvent." All liabilities can be paid in full, while also producing a positive value for the operator to retain. If the equity is negative, the creditors own more of the business than the operator. The farm is considered "insolvent." Should the farm (and all its assets) need to sell, there are not enough assets to cover the liabilities.

The hope for any farm operator is that their net worth is increasing over time. For many a farmer, their net worth, in the form of assets owned free and clear, is usually a component of their retirement plan - the higher the net worth, the more secure their future is, with more options available for considering a farm or other transition. In addition, assets owned free and clear, can be used as "collateral," something pledged as security, for farm loans that can aid strategic growth towards business viability and stability. By having a balance sheet, it serves as a trust factor when approaching a lender. It is a true statement of your farms financials. If done accurately, it hides nothing of your financial situation, while also telling an accurate picture of where the farm has been and where it is going. This is useful to a farm lender.

Balance sheets can also serve as a significant communication tool for partners, which can reduce stress. It is common for one partner, and sometimes both partners, to feel that the farm is taking more than it is giving. The annual completion of a balance sheet can relieve anxiety about money, by providing information about the "liquidity" of the farm - what resources you have available should the need arise for immediate cash by selling assets, the solvency of the farm (should the venture fail or otherwise, not meet family or other goals), and it clarifies value/worth through a different lens other than enterprise profitability. For beginning farmers in particular, when investments and debt are usually high as the farm is being capitalized, and consequently, the returns feel limited, annual balance sheet completion, providing a snapshot of increasing net worth, can provide motivation to show the operator how far they've come. Conversely, the snapshot can, and should, provide pause and deliberate consideration, if one's net worth is decreasing in a significant way and/or for a sustained period of time.

WHAT DOES A BALANCE SHEET LOOK LIKE AND CONTAIN

The balance sheet is usually a single page (single-sided) document comprised of two main sections, one section for assets, the other for liabilities (often structured as two columns or rows, assets on the left or top, liabilities on the right or bottom). For each asset and liability section, the balance sheet is further divided into three sections - current, intermediate, and long-term - assets and liabilities.

This resource has focused on the balance sheet as a farm financial statement. In doing a balance sheet for the farm, only assets and liabilities of the farm business are included. A balance sheet can also be done for the household. If you are an aspiring farmer without farm business assets or liabilities yet, it would be excellent practice and useful information, to still complete an annual household balance sheet, using personal assets and liabilities only. Alternatively, a balance sheet can be consolidated between household and business, to include both personal and farm business assets and liabilities. In a consolidated balance sheet, even though it contains both, be sure to keep personal and farm business assets and liabilities separate, with the exception of the net worth tally (assets - liabilities = net worth), which for a consolidated balance sheet, is a combination of the household and the farm.

The definitions of current, intermediate, and long-term assets and liabilities below, include details for both the household and farm (*definitions are taken or adapted from Fearless Farm Finances, published by Midwest Organic and Sustainable Education Services or MOSES, and Finpack Balance Sheet Instructions*):

- **Current Assets**: Represents the value of assets that can reasonably be converted into cash within one year in the normal course of business. Current assets include cash, money in checking and savings accounts, accounts receivable (income owed to you), inventory (crops or feed that are either sellable or usable products for your operation, or other on-hand inventory that will reduce costs by not purchasing the product in the current year), prepaid expenses (such as fertilizer bought the previous year for the current year production or a pre-paid service that has yet to be received, but will be received in the near future), market livestock (livestock you intend to market within the current year), and other liquid assets that can be readily converted to cash.

- **Intermediate Assets**: Represents the value of assets with a useful life of more than one year, but less than ten years. This includes machinery, equipment, perennial plants, breeding livestock that you intend to own for more than a year, titled vehicles such as pick-up trucks, cars, boats or trailers, household goods, and can also include items that are not easily converted to cash, such as stock in a cooperative, or the cash value of a life insurance policy.

- **Long-Term Assets**: Represents the value of assets that have a more permanent nature, with generally, a useful life of more than ten years, to include farm land and other real estate, buildings, land and building improvements, co-op shares (valued as of the date of the statement that coincides with the balance sheet date), and retirement accounts.

- **Current Liabilities**: Represents all debts owed as of the statement date and payable within one business year. These include bills (unpaid accounts) that are due to creditors and suppliers, operating loans and other short-term notes, such as a line of credit, credit card balances, property and income taxes, and any other payables due within a year, such as a bill you owe to a person or businesses for a service. In addition, any principle due within the year on longer-term debts (two or more year loan terms), must be posted as a current liability. This tends to be one of the more difficult pieces of information to gather, as some lenders list the principle due within the year, but many do not (you may need to call lenders to get these numbers).

- **Intermediate Liabilities**: Represents loans with an original term of more than one and up to ten years, to include loans for machinery, equipment, breeding livestock, student loans, auto loans, and other similar debts. Be sure to subtract the current year principle amounts on intermediate loans that are already listed in current liabilities (you don't want to count those principle balances twice).

- **Long-Term Liabilities**: Represents loans with an original term of ten years or more, usually associated with real estate. Be sure to subtract the current year principle amounts on long-term loans that are already listed in current liabilities (you don't want to count those principle balances twice).

The balance sheet, on the same single page, also contains a name - either the name of the farm business, the household name, or both if consolidated, a date - which is used as a reoccurring date for the annual completion of the balance sheet, and the final net worth calculation (total assets - total liabilities = net worth). The name and date is found at the top of the page, the net worth is found at the bottom. In between is the asset and liability table.

HOW TO VALUE ASSETS

There are two ways to value assets. One can choose to use a "current market value" basis - what somebody would pay for the asset if sold today. For example, you own a tractor - regardless of what you purchased it for, if you can sell it for $5,000, it appears on the balance sheet with a value of $5,000.

Alternatively, one can use a "cost" basis - assets are listed at their original cost minus the amount the asset has depreciated during the time the business has owned it (depreciation means - the gradual reduction of an asset's value, which takes into account the increasing age, rust, rot, mechanical ware, or other 'aging' factors). There are different ways to account for depreciation, one way is using the tax depreciation schedule filed for farm taxes. For example, if you own a tractor that was purchased for $5,000 and it depreciated $500 per year since the purchase, with 8 years having passed (or $4,000 worth of depreciation), it appears on the balance sheet with a value of $1,000, the amount remaining of the original purchase price. Using a cost basis will eventually eliminate the value of assets, as they depreciate out, on your balance sheet. While this doesn't sound positive, the benefit gained is that it doesn't hide the farms financial performance from year to year. As machinery and buildings ware, rust, or rot (and need replacement), a cost basis that accounts for this depreciation doesn't hide poor financial performance behind a screen of high market value for land or machinery.

The distinction typically employed for deciding which basis to choose is - current market value is used for farm planning and loan applications, whereas cost basis is used for business analysis. It is recommended that whichever method is used, it is important to be consistent so that apple-to-apple comparisons can be made with past and future balance sheets. While this recommendation makes strong sense, as a beginning farmer, it is also important that you choose a value basis you feel confident and comfortable completing, can logically understand, and will help you move the farm forward. If that means shifting the value basis later should the need or desire arise, so be it.

To put the decision in context, in agriculture, it is more common to see balance sheet assets valued at the current market value. It is a simpler balance sheet to develop, as it doesn't require you to keep track of depreciation over the years, and it often feels like a more grounded balance sheet (i.e. if you need cash and sold the tractor today, or if you want to make an implement investment by selling an asset you no longer need, you could make $4,000 on the market today for the tractor you no longer use). Further, a lender will request a balance sheet using a current market value, as a way to run credit analysis. The lender needs to know what the farm assets are worth today (not the purchase or depreciated value) as collateral for a loan. Beginning farmers in particular are ripe for farm operating, capital and ownership loans, therefore, it is generally encouraged to use current market value for your asset basis.

OTHER BALANCE SHEET TIPS FOR BEGINNING FARMERS

- In the balance sheet chapter of *Fearless Farm Finances*, it is suggested (and wisely so!), "Don't let the perfect get in the way of the pretty good." What is important, is that you pick a style of balance sheet, and a value basis, that you are comfortable working with, and do the work it takes to complete it annually. There are many free balance sheet templates found online, through the Farm Service Agency, and through various other resources. They all work. Some can also be a little confusing. If it's a balance sheet template with a heavy influence on livestock or crops, the pre-populated language and cells may not fit your needs as a vegetable or maple syrup producer, leaving you confused with where to input your asset and liability information. The balance sheet needn't be complicated, and if pre-populated categories don't fit your needs, delete them (or find a different template). In fact, it was refreshing to hear a farm loan specialist from the Farm Service Agency say that a balance sheet need be no more complicated than a piece of notebook paper, folded in half along the height, then folded twice more, to create 2 columns and 3 rows once unfolded to serve as a template for listing (in simple pencil) current, intermediate, and long-term assets and liabilities in each box left by the folds. Over time, it may be easier to maintain a slightly more sophisticated template, but ultimately, a good tip is - keep it simple!

- It is important to complete your balance sheet on the same date each year. Income and expenses are often very disparate for farms as the season progresses. By using the same date, the comparison from year to year is more true to actual financial performance. Further, if you complete your balance sheet on January 1st of every year, it provides a beginning and end balance sheet for each year, which further aids in accurate assessment of financial progress. Using this date is recommended, though note - if you apply for a loan, they may need a balance sheet completed within a certain month period from the loan application. Simply do another balance sheet for the purpose of the loan, but continue to use your annual date for ongoing purposes.

- If you do not have farm assets or liabilities yet, it is encouraged to complete a household balance sheet. Your household net worth may provide insights towards your future farm and enterprise planning. For example, if you have a high household debt-to-asset ratio, consider low-cost farm entry options that allow you to pay off debt and save money for farm investments before committing to a higher cost and thus higher risk farm purchase. Or, if your household net worth is limited or negative, it may drive some farm enterprise choices which have varying levels of capitalization needs and varying return rates on your investment (some enterprises produce income immediately, other enterprises such as an orchard or dairy operation, may take years to see a return based on yield time for crop production or herd growth).

- It is useful to see one's net worth in the form of a consolidated balance sheet, and as a farm only balance sheet. The consolidated balance sheet provides a better holistic view of the financial situation of the individual or family. But it is also good to see how the farm is performing on its own, as a stand-alone business. It is encouraged that you do a consolidated balance sheet, then simply eliminate the personal information in a second copy to see the net worth of the farm only.

- While the balance sheet itself is generally a single page, it references a set of "schedules" - worksheets behind the balance sheet which provide richer detail of the asset and liability categories. Examples of schedules might include:

  - Schedule A - Farm assets divided into sections for tractors, implements, vehicles, infrastructure, and other. For current market value basis, include purchase date, purchase price, market value, and in case the item sells, a space for the sold date and sold price.

  - Schedule B - Land assets divided into descriptions for the different real estate you own (if more than one property), including a description of the property, purchase value, balance owed, net value, and any important ownership details (if ownership is not straightforward).

  - Schedule C - Supply and inventory assets divided into supplies in stock (such as seeds, egg cartons, feed) and product inventory (farm product on hand that can be sold). Include the amount of inventory and the value.

  - Schedule D - Non-farm assets that are not land, divided into sections for vehicles, household, and other categories that represent personal assets. Include the purchase date, purchase price, market value, and in case the item sells, a space for the sold date and sold price.

  - Schedule E - Debt schedule to include the creditor, the purpose of the loan, the monthly payment, the balance, the interest rate, and any clarifying notes.

  For motivated financial record-keepers, you can create a balance sheet that allows you to track both market value and a cost basis, side by side, in the same schedule. This added level of detail could be helpful in the future. The reality however, is that it's often hard enough for farmers to make the time to do the minimum. As a beginning farmer, it's good to set strong financial management goals for yourself. It is also really important to be realistic and successful. Keep this in mind as you complete your first balance sheet!