Balance Sheet
or
Net Worth Statement

Assets = Liabilities + Owner Equity

Owner Equity = Assets - Liabilities

<table>
<tr><th colspan="2">Balance Sheet</th></tr>
<tr><td rowspan="2">Assets</td><td>Liabilities</td></tr>
<tr><td>Owner Equity</td></tr>
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- Assets
  - Everything owned that has value including claims against others
- Liabilities
  - Any obligation owed to others at the given moment in time
  - A claim by others against the assets

A picture of the business at a point in time.

Uses of the Balance Sheet

- Acquiring Debt
- Considering Farm Business Risks
- Measuring Financial Progress
- Calculating Profitability

Uses of the Balance Sheet

- Can answer such questions as:
  - If you quit farming today and put everything up for sale, how much money would you have left over after all debts have been paid?
  - What are your financial commitments for the next 12 months?
  - How much more financial risk can your business stand?

What Entity?

- Business vs. Personal
- Consolidated Balance Sheet

Cost vs. Market

- Cost
  - Cost minus use or depreciation
  - Typically more useful when measuring the financial progress of a business from year to year
- Market
  - Fair market value less selling costs
  - Used to evaluate financial position for credit analysis and estimating owner equity

Reasons for including both Cost and Market values on your Balance Sheet

- To determine if Net Worth changes are due to:
  - Inflation (deflation) and/or
  - Retained earnings
- Estimate deferred taxes (hidden liability)
- Market values needed to determine current financial position.
- Selected cost values needed to prepare accrual-adjusted income statement.

Categories of Assets

Current and Non-Current

Categories of Assets

- Current Assets
  - Most liquid
  - Can be converted to cash without disrupting the ongoing business
  - Will be used up or converted to cash during the year

Categories of Assets

- Non-Current
  - Yield services to the business over a period of time on an ongoing basis
  - Their sale would disrupt the business
    - Machinery
    - Equipment
    - Breeding livestock
    - Real estate
    - Investments in cooperatives

Liabilities

- An obligation that exists at the date of the Balance Sheet.
- When the obligation is due is the basis for categorizing the liability.

Current Liabilities

- Accrued interest and Accrued taxes
  - If you were to sell out and convert all assets to cash, the balance sheet would need to reflect all claims that existed against those assets
- Deferred taxes on current liabilities
  - Recognize the tax liability arising from the difference between the values of certain assets and liabilities and their tax basis

Non-Current Liabilities

- Liabilities associated with real estate or with an original maturity beyond one year, excluding the principal portion due within the next 12 months.
- Deferred tax on non-current liabilities
  - Would be triggered by conversion of non-current assets to cash
  - Only a market value liability concept (not in cost column)

Current Assets

- Cash on hand or in checking
  - Cash payment of an expenditure should be considered to be at the moment the check is written, not when the check clears.
- Savings and money market accounts
  - Add amount of interest accrued
- Marketable bonds and securities
  - Cost or basis includes purchase price plus any interest or dividends re-invested
  - Estimate current market value of securities from their published trading values

Current Assets

- Futures and options accounts
  - Value if you were to close the account
  - Account equity = total deposits + accrued profits – accrued losses – commissions

Current Assets

- Accounts receivable
  - Results from sale of products and services that are part of farm income
    - Sale of grain or feeder livestock, custom work
    - Government payments (e.g., deficiency payments)
    - Do not include sale of capital assets (breeding livestock, equipment—s.t. capital gains)

Current Assets

- Feeder livestock and poultry
  - Requires physical inventory
  - What livestock/poultry should be included?
  - Livestock you will be selling as culls during the year?

Current Assets

- Feeder livestock and poultry
  - Value on Cost vs Market columns?

    Weight × current market price - marketing costs

Current Assets

- Crops and feed
  - Requires physical inventory
  - Estimate of net market value
    - Exception is purchased feed and supplements (use cost)
  - Don't include accounts receivable items

Current Assets

- Crops and feed
  - Commodity Credit Corporation loan
    - List at the higher of market or loan rate
    - The CCC loan is listed in the note section of current liabilities
    - Can show cash and crop (off-setting liability)

Current Assets

- Prepaid expenses
  - Not yet delivered or listed as part of physical inventory
  - Payment has been made so must show a corresponding equity position
- Supplies
  - Use actual cost for cost and market

Current Assets

Investment in growing crops

Current Assets

- Investment in growing crops
  - Prepaid expenses concept
  - Preferred method
    - Accumulate all direct (fertilizer, seed, fuel) and indirect (depreciation) costs and report at the lower of cost or market.
  - Alternative method
    - Include only the direct cash cost incurred to date

Current Assets

- Other current assets
  - Example would be income tax refund not yet received or has been credited to next year's tax liability

Valuing Assets

- Basis
- Depreciation
- Adjusted Basis or Remaining Book Value
- Capital Account

Valuing Assets

- Cost-minus-Depreciation or Full Cost Approach
  - Asset (livestock) is fully capitalized.
  - Capitalize: direct and indirect costs of raising the animal (or group of animals) have been accumulated, removed from farm expenses, and transferred to a capital asset account.
  - The cost amount reported on the Balance Sheet is the remaining book value (accumulate costs minus depreciation)
  - Many record systems are inadequate to support this.

Valuing Assets

- Base Value Approach
  - Represents the cost of raising an animal to its current condition.

  e.g. Bred Heifer
  e.g. Cow

  - As each animal is transferred from one inventory to another and finally into the capital account, it is given a base or modified cost value.

Valuing Assets

- Base Value Approach
  - This value takes into consideration:
    - Market value of the animal at the time of transfer
    - Estimated costs of bringing animals into the herd
    - Conventional practices for valuation followed by the operation.
    - Some 'safe harbor' values provided by the IRS
  - The value is the same for all animals of like kind and remains constant from year-to-year.
  - Once the animal reaches maturity, the value remains constant until it is sold or dies.

Valuing Assets

- Base Value Approach
  - Special Issues
    - What about expenses?
    - How many transfer points?
    - Changes in value over time?
    - Purchased animals?

Valuing Assets

- Purchased breeding stock
  - Should be listed separately.
  - Depreciate.

Valuing Assets

- Machinery, equipment, trucks
  - Cost Amount?
  - Trade-in?
  - Old assets that are fully depreciated?

Valuing Assets

Capital Lease Asset

- Characteristics:
  - Transfers ownership at end of lease
  - Option to purchase
  - Used up
- What to do?
  - Cost basis (present value of all future lease payments) and depreciate
  - List buy-out amount each year

Valuing Assets

- Investments in cooperatives.
  - Why not a current asset?
  - Value as cost plus allocated equities.

Personal Assets

- Often included when there is no distinct financial or legal separation of the farm business from family or personal affairs.
- The purpose of including personal assets is to complement the picture of the current financial position.
- Only assets that are at all times distinctly separate from and unavailable for business use.

Current Liabilities

An obligation must exist at the date of the statement and be due within the following 12 months

Current Liabilities

- Accounts Payable
  - Exits immediately after a product or service is received
  - $100 cropland lease expense
  - $50 March 1 and $50 October 1
  - Balance sheet March 1?

Current Liabilities

- Notes Payable
  - Commodity Credit Corporation (CCC) loan
  - Harvest crop worth $10,000
  - Get CCC loan for $15,000
  - Balance sheet?

Current Liabilities

- Notes Payable
  - Operating Credit
  - Accrued Interest – amount due if paid off today
  - Principal due within 12 months on non-current liabilities

Current Liabilities

- Accrued tax liabilities
  - Personal property taxes
  - Real estate taxes
  - Employer payroll withholdings

Current Liabilities

- Deferred tax on current assets
  - Exists because of the ability to report taxable income by the cash method.
  - If current assets were liquidated, what would the tax obligation be?
  - Only an estimate.

Current Liabilities

- Income taxes
  - Progressive tax
- Capital Gains tax
- Self-employment tax
  - 15.3%
    - 12.4% for social security (max income limit)
    - 2.9% for medicare

Current Liabilities

$258,373 Taxable Current Assets
($24,465) Current Liabilities
= $233,908 Deferred income subject to tax

- Assume Federal + State = 38%
- $233,908 x 0.38 = $88,885 estimated tax

Non-Current Liabilities

- Capital Lease—constitutes a financial obligation.
  - "buyout amount"
  - Present value of all future payments

Deferred Tax on Non-Current Assets

- Arises from the potential capital gains on capital assets.
- Capital assets:
  - Not taxed at their full sale price
  - Only the capital gain is taxed.
  - Capital gains tax is often lower than on other income

Deferred Tax on Non-Current Assets

- Capital assets:
  - Market value – adjusted basis
  - Exception: raised breeding stock that have not been capitalized nor depreciated have an adjusted basis (for tax purposes) of 0. Thus, their entire market value would be taxable.

Owner Equity

Owner Equity = Assets – Liabilities

- Components on a cost value basis:
  - Retained earnings
  - Capital contributed
- Components on a market value basis:
  - Retained earnings
  - Capital contributed
  - Valuation equity
  - Personal net worth

Owner Equity

- Valuation Equity
  - Market value – cost basis of all assets
  - MINUS deferred tax on non-current assets