



Financial Statements – The Balance Sheet¹

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There are four primary financial statements used in agriculture: (1) balance sheet or statement of net worth; (2) income statement; (3) statement of cash flows; and (4) statement of owner’s equity. Each financial statement has a specific purpose for managing a farm’s or ranch’s finances. This fact sheet explains the balance sheet. Other fact sheets and accompanying “ABM Decision Tools (Excel-based templates) are available at the ABM web site (<https://ABM.extension.colostate.edu>).

What is a Balance Sheet?

A balance sheet is a statement of the financial condition of a business at a specific time. It shows what is owned by a business, what is owed, and the owner’s equity (or net worth) of the business. The balance sheet is often called a net worth statement, since it shows the owner’s value of the business if all debt obligations were paid in full.

Traditionally, the balance sheet is arranged with assets listed on the left side and liabilities and owner's equity on the right side. The balance sheet must balance, hence the name balance sheet – total assets equal total liabilities plus net worth.

Business Name	Date
Current Assets	Current Liabilities
Non-Current Assets	Non-Current Liabilities
Total Assets	Total Liabilities
	Net Worth

Current assets include cash, items held for sale, and inventories of products that could be converted to cash in the normal business process within one year. The value of current assets will likely vary significantly over time. Crops may be harvested but held in inventory for on-farm use or sold at a later date. Similarly, feeder livestock may be purchased or sold at various times throughout the year.

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Non-current assets are those resources used mainly to support farm production and have a life expectancy of more than one year. These assets have a more permanent value and are needed to produce income. They include breeding livestock, machinery and equipment, buildings, and real estate.

Current liabilities include notes payable within one year, accounts payable, accrued interest and other accrued expenses, etc. Additionally, current liabilities include the portions of non-current liabilities that are due within 12 months. When they become due, current liabilities are paid with cash on hand, the sale of current assets, or the proceeds from another loan.

Non-current liabilities are those debts and other financial obligations that are payable in more than 12 months. Such liabilities are associated with non-current assets and are payable over a number of years.

Asset Valuation

There are two most common methods for valuing assets: current market value and cost. The National Farm Financial Standards Council recommends that the balance sheet be prepared on both a market and a cost basis. A lender will most likely prefer the market value methods because it more accurately shows the value of collateral used to secure a loan. A good financial manager will want to complete and analyze the farm or ranch business's financial condition, especially over time, using both methods.

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. The portion of total equity that has resulted from market value changes is the difference between the market value and cost basis owner equity.

Uses of the Balance Sheet

The balance sheet has many important uses. Firstly, it shows the business's financial condition at a specific point in time. A comparison of balance sheets over time will show how the business's assets, liabilities, and net worth are changing. It is important to note that such a comparison does not explain how or why those factors are changing.

Secondly, a balance sheet can be used by the business owner to support a request for borrowed funds. The balance sheet provides information on how best to meet liabilities. If liabilities are due in a short time, cash will be needed to pay them. If the sale of current assets will not raise sufficient funds and the loan cannot be renewed, then the owner may need to negotiate a long-term loan on the basis of non-current asset values.

Analyzing the Balance Sheet

A balance sheet can be evaluated by:

- Comparing the current balance sheet with previous balance sheets;

- Comparing the balance sheet with those for other, similar businesses; and
- Using ratios.

One of the most effective methods of evaluating the balance sheet is to compare one year with previous years for the same business. By comparing balance sheets over time, the growth or decline of assets, liabilities, and net worth can be determined. Further, a comparison of total current assets and total non-current assets determine whether too much or too little capital is tied up in permanent investments. A farm or ranch business, consisting primarily of non-current assets, has less flexibility than one that has sufficient current assets. Some flexibility in the business should be maintained. A balance sheet provides the information necessary for making these comparisons.

Comparing the balance sheet of one farm or ranch business to balance sheets for a group of similar (enterprises, gross sales, type, etc.) may give evidence of weak and strong points in the business. While some farm or ranch managers and owners may be reluctant to show their balance sheets to other farmers, management groups (i.e. farm management associations coordinated by land grant universities) commonly conduct such comparisons.

Ratios may be used to evaluate a single balance sheet. A ratio is a comparison of two numbers expressed as a numerical ratio of one number to the other. The Farm Financial Standards Council identifies several useful ratios. Some of the most commonly used ratios are:

- Current Ratio = total current farm assets divided by total current farm liabilities
- Debt to Asset Ratio = total farm liabilities divided by total farm assets
- Equity to Asset Ratio = total farm equity divided by total farm assets
- Debt to Equity Ratio = total farm liabilities divided by total farm equity
- Working Capital = total current farm assets less total current farm liabilities

Additional ratios may be calculated using information from the balance sheet and from other financial statements. For example, total farm equity and total farm assets (both values from the balance sheet) can be compared with net farm income and interest expenses (both values from the income statement). Two commonly computed ratios are:

- Return on Equity = net farm income divided by total farm equity
- Return on Assets = (net farm income plus interest expenses) divided by total farm assets

Resources

There are myriad resources available to help a farm or ranch owner manages the business's finances. Colorado State University Extension (and most other land grant universities) have fact sheets and spreadsheet templates for completing farm or ranch financial statements and analyzing the information from the statements. Such resources available from CSU can be found at <https://wr.colostate.edu/ABM/> and include:

- *Financial Statements – The Cash Flow Statement* (fact sheet and Excel spreadsheet)
 - *Financial Statements – The Income Statement* (fact sheet and Excel spreadsheet)
 - *Analyzing Financial Information using Ratio Analysis* (fact sheet and Excel spreadsheet)
 - *Getting on Track: Financial Statements* (on-line course)
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