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2017-2018 Student Project

Understanding a Balance Sheet

The balance sheet is a summary of the financial position of a business, individual or operation at a given point in time. This financial 'snapshot' can be used to compare to previous, similarly timed, balance sheets to identify earnings and other financial trends.

The basis for the balance sheet is the fundamental accounting equation:
Assets = Liabilities + Owner Equity
This equation shows the total assets of an operation belong partially to claimholders and partially to the owners.

The balance sheet consists of three main parts: Assets, Liabilities and Owner Equity.

<u>Assets</u>

Assets include anything owned by an individual or entity that has monetary value. Standard accounting practices value assets at either cost or market value. Valuation depends on what is preferred by the person preparing or requesting the balance sheet. Assets on the balance sheet are broken into the following classifications:

- ✓ **Current Assets** – Current assets can be converted to cash within a normal operating cycle (12 months). Examples of current assets include: cash, accounts receivable, crop and feed inventory, market livestock, prepaid expenses, growing crops and supplies on hand.
- ✓ **Intermediate Assets -** Intermediate assets are typically kept from 1 to 7 years. Examples of intermediate assets include: machinery, breeding livestock, vehicles, the cash value of life insurance, and personal property.
- ✓ **Long Term Assets –** Long term assets are kept for more than 7 years. Long term assets include: real estate, including land, buildings and improvements and equity in companies.

<u>Liabilities</u>

Liabilities include all claims against the business by creditors, vendors or any other person, business or institution to which a debt is owed. Similar to assets, liabilities are classified as current, intermediate, and long term.

- ✓ **Current Liabilities –** include all debts and obligations that will come due within the next 12 months. Examples of current liabilities include accounts payable, operating debt, accrued income and real estate taxes, accrued interest, and the principal portion of term loans due within the next year.
- ✓ **Intermediate Liabilities -** obligations owed to others due in 1 to 7 years. These include machinery and vehicle loans and breeding livestock loans.
- ✓ **Long Term Liabilities -** debts owed to others that are due more than 7 years in to the future. Long Term Liabilities include mortgage loans on farm real estate, house loans, and loans on buildings and improvements.

<u>Owner Equity</u>

Owner equity is liabilities subtracted from assets. It reflects the owner's claim on the business assets while liabilities reflect claims by creditors and suppliers. Owner Equity is generated by either the owner's investment of capital into the business or business profits accumulated over time and reinvested back into the business.

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