

NET WORTH STATEMENT AND INCOME STATEMENT

Two types of financial statements of a complete set of farm records are a balance sheet or net worth statement and an income statement (Table 5.24). These two statements serve different purposes. A balance sheet shows the financial position of the business at a point in time, while an income statement shows the income and expenses over a given period of time. A balance sheet can be made during any time of the year; but the usual time is at the end of year. This allows a statement both for the end of the year and for the beginning of the year. The primary purpose of a balance sheet is to measure the financial strength and the position of a business. The comparison of the net worth

Table 5.24. Balance Sheet for a farmer in Faisalabad District (as of December 31, 1995).

Assets		Liabilities. (Rs.)	
Current		Current	
a) Cash in hand	Rs. 5000	a) Short term loans	Rs. 5000
b) Saving Accounts	Rs. 10000	b) Fertilizers	Rs. 4000
c) Wheat (1000 Kg)	Rs. 5000	c) Pesticides	Rs. 6000
d) Cotton (600 Kg)	Rs. 12000		
e) Fertilizer	Rs. 1000		
f) Youngstock	Rs. 15000		
g) Sub-total(a to f)	Rs. 48000	d) Sub-total(a to c)	Rs.15000
Intermediate		Intermediate	
h) Machinery	Rs. 3,00,000	e) Machinery loans.	Rs. 2,50,000
i) Livestock	Rs. 40,000	f) Dairy animal loans.	Rs.1,00,000
j)(Buffaloes, Cows)			
k) Sub-total:	Rs. 3,40,000	g)Sub-total:	Rs. 3,50,000
(h to j)		(e to f)	
Fixed		Long-term	
l) Land	Rs. 12,00,000	-	-
m) Building	Rs. 2,00,000	-	-
n) Sub-total	Rs. 14,00,000		
(l + m)			
o) Total Assets.	Rs. 17,88,000	Total Liabilities.	Rs.3,65,000
(g + k + n)		(d + g)	
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Net worth	=	Total Assets -	Total Liabilities
Rs. 14,23,000	=	17,88,000 -	3,65,000

of one year with that of another is an effective way to determine the progress over time.

The simplest way to describe a net worth statement is to list all the things owned in business in one column and to list all the things owed in another column. The difference between these two columns is called the net worth. If the net worth is a negative figure, it means the business has more liabilities than assets. An important point about the balance sheet is that total assets must exactly be equal to the total liabilities plus net worth, i.e., bottom line values on both side of the balance sheet should be equal.

A. Assets

Assets and liabilities can be divided into three groups:
a) Current assets; b) intermediate assets; and c) fixed assets.

a) *Current Assets*

These are the most liquid assets which can be used or sold in the next year. Their sale does not disrupt the future production activities. Cash in hand, seeds, fertilizers, livestock etc are the most liquid assets.

b) *Intermediate Assets*

Intermediate assets are less liquid as compared to current assets. Their life ranges from one to ten years. The examples of intermediate assets are farm machinery, equipment, breeding livestock etc.

c) *Fixed Assets*

Fixed assets are the least liquid of all the assets. They have a useful life of more than 10 years. Their sale would seriously affect the ongoing nature of a business. The examples of fixed assets are land, building etc.

B. Liabilities

Liabilities can be divided into three groups: a) current; b) intermediate; and c) long term liabilities.

a) *Current liabilities*

These are the financial obligations which must be met within one year from the date of balance sheet and include the payment of short term loans and the payment for farm supplies like fertilizers feeds, pesticides, etc.

b) *Intermediate Liabilities*

These liabilities can be deferred for the present year and their payment can be made between one to ten years. Most important intermediate liabilities include the medium term loans obtained for the purchase of farm machinery, dairy animals, etc.

c) *Long-term Liabilities*

These are payable beyond ten years. Example is the long term loan.

ANALYSIS OF FARM BUSINESS RECORDS AND INTERPRETATION OF RESULTS

A. Analysis of Net Worth Statement

The computed net worth shows only the absolute amount. It may not indicate the true picture of the soundness of the farm business. Therefore, these data are further analysed by using various ratios to know the effective measures of the financial position and the strength of the business. These ratios provide a standard unit of measurement that helps in comparing the business firms at a point of time as well as their overtime performance. There are four ratios which are commonly used to establish the soundness of the farm business. These are: (a) net capital ratio; (b) debt/equity ratio; (c) current ratio; and (d) working capital ratio.

a) Net Capital Ratio

This ratio is a measure of overall financial strength and solvency of the business. It can be computed using the following formula:

$$\text{Net capital ratio} = \frac{\text{Total assets}}{\text{Total liabilities}}$$

The term solvency is used to express the ability of a business to meet its debt. For the balance sheet presented, net capital ratio is 4.90 = $\left(\frac{17,88,000}{3,65,000} \right)$

A net capital ratio of one indicates that total liabilities are equal to total assets that shows zero net worth. If the net capital

ratio is less than one, then insolvency exists. This implies that if the business is liquidated, then the cash generated would not be sufficient to pay all the liabilities. As a general rule, this ratio should ideally be two. However, one to one ratio is acceptable if the majority of the assets are other than real estate.

A net capital ratio which has been increasing over time, indicates the business is making financial progress.

b) Debt/Equity Ratio

This ratio shows the relationship of owned capital to borrowed capital. It is computed as:

$$\text{Debt/equity ratio} = \frac{\text{Total liabilities}}{\text{Net worth}} = \frac{3,65,000}{14,23,000} = 0.26$$

The smaller this ratio, the larger is the net worth relative to total liabilities indicating a stronger financial position.

c) Current Ratio

It is a ratio between current assets and current liabilities. It is a ratio which measures liquidity of the business. It can be computed as

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}} = \frac{48,000}{15,000} = 3.2$$

The importance of this ratio lies in the ability of the business to meet quick needs for money.

A current ratio equal to one implies current liabilities are just equal to current assets. A ratio less than one shows a potential liquidity problem. Ideally this ratio should be eight

assets to one liability, however, this will depend upon when the balance sheet is completed.

d) Working Capital Ratio (WCR)

This is an intermediate measure of both liquidity and solvency. It can be computed as:

$$WCR = \frac{\text{Current assest} + \text{intermediate assests}}{\text{Current liabilities} + \text{intermediate liabilities}} = \frac{3,88,000}{3,65,000} = 1.6$$

This ratio indicates whether the total value of current and intermediate assets exceeds the total value of current and intermediate liabilities. Therefore, it measures the liquidity over several years. Ideally this ratio should be six assets to one liability.

B. INCOME STATEMENT

The income statement, also called an operating statement or profit and loss statement, is a summary of income and expenses over a given time period. An income statement is a list of all farm expenses and all receipts in a convenient form. All expenses are deducted from receipts to determine the net income for a particular year. Its primary purpose is to calculate profit for a given time period.

A typical statement is given in Table 5.25. Many entries could be further divided into various items, if necessary.

Table: 5.25 Income Statement for a Farm in Faisalabad District

Cash farm income	(in rupees)
A) Crop sales	
Cotton.....	15000
Sugarcane.....	12000
Wheat.....	1000
Maize.....	500
Kharif fodder.....	-
Rabi fodder.....	-
B) Livestock sales	
Milk.....	5000
Milk products.....	-
Animals:	
Buffalo.....	-
Cow.....	-
Youngstock.....	5000
Sheep.....	-
Goat.....	1000
Poultry.....	-
Eggs.....	-
C) Custom work.....	
D) Machinery.....	
E) Other cash income.....	
Total cash income.....	Rs. 40500
 Cash farm expenses	
Farm yard manure.....	-
Ploughing/Planking.....	1000
Fertilizer.....	8000
Insecticide/Pesticide.....	3000
Casual labor hired.....	10000
Seeds.....	1000
Plants.....	-
Water.....	1000
Electricity.....	-
Fuel and oil.....	-
Feed purchased.....	5000
Repair and maintenance of machinery.....	-

Livestock purchased.....	-
Miscellaneous.....	2000

Fixed cash expenses

Interest paid.....	1000
Insurance.....	-
Permanent labor.....	6000
Land revenue, water value etc.....	2000

Total cash expenses.....Rs. 40,000

Net cash farm income..... Rs. 5000

Non cash adjustments to Income Depreciation

Machinery and equipment.....	500
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Building.....	3000
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Total:..... Rs.3500

Inventory changes:

Crops.....	5000
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Livestock.....	3000
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Farm inputs.....	1000
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Net inventory change..... **Rs.9000**

Net farm income (Net farm
income-Depreciation +

Inventory changes **Rs.6000**
