farmdoc DAILY

Department of Agricultural and Consumer Economics, University of Illinois Urbana-Champaign

Minding Your Balance Sheet and Working Your Working Capital

Bradley Zwilling, Brandy Biros, and Dwight Raab

Illinois FBFM and Department of Agricultural and Consumer Economics
University of Illinois

January 18, 2019

***farmdoc daily* (9): 10**

Recommended citation format: Zwilling, B., B. Biros and D. Raab. "Minding Your Balance Sheet and Working Your Working Capital." *farmdoc daily* (9): 10 , Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, January 18, 2019.

Permalink: https://farmdocdaily.illinois.edu/2019/01/minding-your-balance-sheet-working-your-working-capital.html

If it isn't already on your New Years' Resolution list, improving your financial reporting and improving your understanding of your balance sheet should be on that list. Navigating the challenging financial and economic environment makes it very necessary that you understand the factors affecting your balance sheet. That knowledge and understanding are the keys to surviving and thriving in the current low price environment where margins are thin and cash is tight. Today's article discusses working capital but keep in mind that working capital is merely the short term or current part of your equity or net worth.

Understanding the causes of working capital changes gains insight on managing your farm business for 2019 and beyond. Measuring the difference between your current assets and current liabilities at the same stage of the accounting cycle or production year is how working capital is calculated and evaluated. In the Midwest, we typically prepare December 31st balance sheets. At that time, harvest is complete and either the 2018 crop has been sold and is represented as cash on your balance sheet assuming that cash remains unspent. Or, your 2018 crop is in end of the year inventory and is priced which creates a known dollar value that is a current asset. Or, your 2018 crop is in end of the year inventory and is unpriced creating the need to set a price so that the value of that unpriced crop is reported as a current asset. It is evident that commodity prices and the number of bushels represent two significant factors in current assets their change from year to year.

Improvements or additions to your working capital are typically the result of profits from your farm business but also include any other sources of net revenue from non-farm businesses or off-farm employment.

Things that draw upon your working capital. If profit driven improvements to your working capital are small then improving working capital become a matter of controlling expenses so that current liabilities are not increasing. And remember, not all drawn down of working capital is necessarily a sign of trouble. A planned build-up of working capital over a period of year followed by a planned draw down of working

We request all readers, electronic media and others follow our citation guidelines when re-posting articles from farmdoc daily. Guidelines are available here. The farmdoc daily website falls under University of Illinois copyright and intellectual property rights. For a detailed statement, please see the University of Illinois Copyright Information and Policies here.

capital could be the result of the planned acquisition of land or other assets. What might appear to be a drawdown of working capital could also be a difference in reporting dates of asset values. December 31st working capital can be vastly different from January 31st working capital if intermediate or long-term debt payments are due in January. In that case, working capital (short term net worth) is turned into intermediate or long term net worth and as such is turned into less liquid equity – reducing your working capital. This is why it's important to measure at the same stage of the accounting cycle or production year…need to make sure it is an 'apples to apples' comparison of working capital from one year to the next.

Know you working capital, in this period of declining prices you must be in the practice of preparing an accurate balance sheet and accrual income statement. You need to have the knowledge that you can take action and price grain if you see opportunities to sell. Don't leave grain in the bin and assume that tomorrow or next month or next year will be a better day.

Now is a great time to reinvest your working capital into your next crop. Now is not the time for unplanned uses of working capital. Paying federal and state income tax is OK…and is much better that spending working capital on depreciable capital asset purchases to solve a tax problem. There is no need to spend a dollar to save a dime. It's OK to leave your working capital as liquid cash. Have a supply of cash puts you in the position of being able to take advantage of opportunities that might materialize and lets you thrive in an economy that presents challenges – lower commodity prices, see sawing trade signals, changing government regulation, etc.

If a re-finance of intermediate term or long term assets is in your future – make sure you have considered the impacts carefully. Refinancing does provide cash to improve your working capital but does not change your net worth. Refinancing merely takes some of your intermediate term or long term net worth and turns it into current net worth. The obvious downside of refinancing term debt is that you are amortizing a short-term problem over a five, seven or even fifteen year payback period.

The authors would like to acknowledge that supporting data used in this article originates with the Illinois Farm Business Farm Management (FBFM) Association. Without Illinois FBFM, information as comprehensive and accurate as this would not be available for educational purposes. FBFM, which consists of 5,500+ farmers and 65 professional field staff, is a not-for-profit organization available to all farm operators in Illinois. FBFM field staff provide on-farm counsel along with recordkeeping, farm financial management, business entity planning and income tax management. For more information, please contact the State FBFM Office located at the University of Illinois Department of Agricultural and Consumer Economics at 217-333-5511 or visit the FBFM website at www.fbfm.org.