

# Training Manual: The Basics of Financing Agriculture

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Module 2.1 | Basics of the Balance Sheet

# Acknowledgement

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*The Agriculture Finance Training Manual is part of AgriFin's Agriculture Finance Training Tools. The Manual was developed by [IPC](#) - Internationale Projekt Consult GmbH as part of AgriFin's technical advisory project for Cameroon Cooperative Credit Union League ([CamCCUL](#)).*

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# Session Overview

<b>LEARNING OBJECTIVE</b>	<b>Balance sheets are one of the three financial statements used to analyze business performance. Agriculture financing professionals must have an understanding of the balance sheet and its relevance to assess a client's financial sustainability.</b>
<b>SCOPE</b>	<p>By the end of this session, the trainee will know the following basic principles:</p> <ul style="list-style-type: none"><li>• An understanding of the balance sheet and its use in analyzing financial performance</li><li>• An understanding of the balance sheet equation</li><li>• An overview of balance sheet terminology including current assets, fixed assets, current liabilities, long term liabilities, and equity</li><li>• Case studies and solutions to understand and practice learned concepts</li></ul>
<b>TARGET</b>	Agriculture loan officers, trainers, agriculture experts with limited financial analysis training, and other professionals interested in agriculture financing
<b>DURATION</b>	1 hour

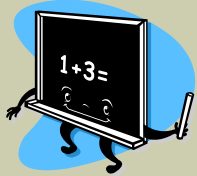
# Content

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1. Basics of Financial Analysis
2. The Balance Sheet
3. Current Assets
4. Fixed Assets
5. Current Liabilities
6. Long-Term Liabilities
7. Equity
8. Summary
9. Case Study 1
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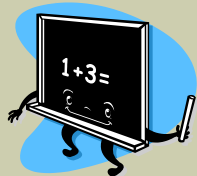
# 1. Basics of Financial Analysis

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What is Financial Analysis?

- An assessment of the creditworthiness of a potential borrower

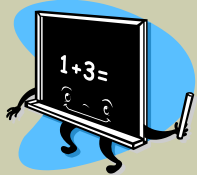


What is the primary purpose of Financial Analysis?

- To assess credit risk

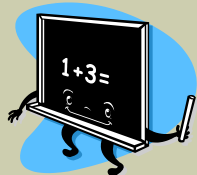
# 1a. Basics of Financial Analysis

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How is Financial Analysis achieved?

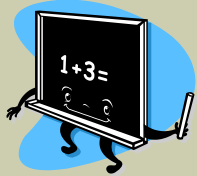
- By collecting and assessing relevant information



Why do we need Financial Analysis?

- The primary purpose is to assess the loan applicant's willingness and ability to repay a loan

# 1b. Basics of Financial Analysis



What basic criteria should you use to grant a loan to a client?

- To somebody who:
  - **wants** to pay back the loan (willingness)
  - **can** pay back the loan (capacity)



# 1c. Basics of Financial Analysis

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## Willingness to repay a loan

- Who is the client?
  - socio-psychological profile: age, family ties, values, background, business partners, reputation, future plans, etc.

## Capacity to repay a loan

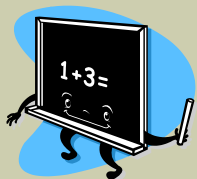
- Who is the client in business terms?
  - management, leadership, technical skills, organizational skills
- What is the client's business background?
  - history of the business, organization of the business, current situation in comparison to past and market, main suppliers, main customers, etc.
- Why does the client want a loan?
  - Loan purpose
- What are the client's other sources of income and expenses?



# 1d. Basics of Financial Analysis

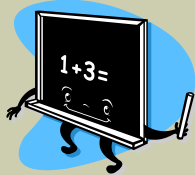
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- Determine the loan applicant's willingness and capacity to pay back the loan by analyzing their socio-economic status.
- The outcomes of the analysis can help us to determine:
  - What loan amount the client can bear?
  - For what loan term?
  - With what repayment schedule?
- The tools which can give us the answers are:
  - Balance sheet
  - Profit and loss statement
  - Cash flow statement



What tools of a financial statement are used to determine the financial situation of a client's business?

# 1e. Basics of Financial Analysis



Define Balance Sheet, Profit & Loss Statement, Cash Flow Statement

- **Balance Sheet** – captures the financial position of a business at the moment of analysis (static perspective)
- **Profit & Loss Statement** – shows the revenues generated and the costs incurred for a given period of time; it is a measure for the profitability of the business (dynamic perspective)
- **Cash Flow Statement** – shows the amount of cash generated and used by a company in operating, investing, and financing activities in a given period; it is a measure for the liquidity of a business (dynamic perspective)

# 2. The Balance Sheet

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What is the balance sheet?

- It is a snapshot of an enterprise; it is static data at one point in time
- Tells us the size of a business and its assets
- Tells us the sources of resources: own (equity) or borrowed (liabilities)
- Tells us how these resources are being used (working capital or fixed assets)

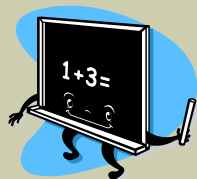
The balance sheet alone does not tell us anything about profit and profitability. It can only give us limited information on the availability of cash.

# 2b. The Balance Sheet

The three main parts of the balance sheet are:

- Assets
- Liabilities (the source of these assets)
- Equities

ASSETS	LIABILITIES
Size of resources and how these resources are used	External Financing
	EQUITY
	Own Financing



What formula is used to calculate Equity?

# 2c. The Balance Sheet

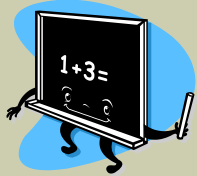
ASSETS	LIABILITIES
<p>From highly liquid assets</p> <p style="text-align: center;">↓ ↓ ↓ ↓ ↓</p> <p>To illiquid assets</p>	<p>From short-term liabilities</p> <p style="text-align: center;">↓ ↓ ↓</p> <p>To long-term liabilities</p>
	<b>EQUITY</b>
<b>Total assets</b>	<b>Total liabilities + equity</b>

## 2d. The Balance Sheet

The balance sheet lists assets and liabilities in order of their relative liquidity  
At a certain date:

ASSETS	LIABILITIES
<p><b>CURRENT</b> Current assets are expected to be converted to cash, sold or consumed within the normal operating cycle or within one year</p> <p><b>FIXED</b> Fixed assets are not held for sale, but rather are used to operate the business</p>	<p><b>CURRENT</b> Current liabilities are debts that are due to be paid within one year or within the entity's operating cycle</p> <p><b>LONG-TERM</b> Long-term liabilities are all liabilities that are not classified as current</p>
	<p><b>EQUITY</b> Is a hypothetical figure, the mathematical result of deducting liabilities from assets</p>

# 2e. The Balance Sheet



Make a Balance Sheet using the following terms and organize them into their appropriate categories!

- Accounts payable
- Accounts receivable
- Accrued short-term liabilities
- Business premises
- Cash and equivalents
- Equipment and furniture
- Inventories

- Land
- Long-term accounts payable
- Long-term loans
- Prepayments received
- Short-term loans
- Short-term loans to others
- Vehicles

# 2e. The Balance Sheet

ASSETS	LIABILITIES
<ul style="list-style-type: none"> <li>• Current assets               <ul style="list-style-type: none"> <li>• Cash and equivalents</li> <li>• Accounts receivable</li> <li>• Short-term loans to others</li> <li>• Inventories</li> </ul> </li> <li>• Fixed assets               <ul style="list-style-type: none"> <li>• Equipment and Furniture</li> <li>• Vehicles</li> <li>• Business premises</li> <li>• Land</li> </ul> </li> <li>• Other assets               <ul style="list-style-type: none"> <li>• Intangible assets</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Current liabilities               <ul style="list-style-type: none"> <li>• Accrued short-term liabilities</li> <li>• Accounts payable</li> <li>• Prepayments received</li> <li>• Short-term loans</li> </ul> </li> <li>• Long-term liabilities               <ul style="list-style-type: none"> <li>• Long-term accounts payable</li> <li>• Long-term loans</li> </ul> </li> <li>• Owners equity</li> </ul>
<b>TOTAL ASSETS</b>	<b>TOTAL LIABILITIES</b>





# 3. Current Assets

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Cash and cash equivalents in any medium of exchange accepted at face value.

- Cash on hand – the cash in the cash box, safe or with the member
- Bank accounts – the balance on the bank accounts as of the day of the analysis
- Savings – the balance on savings accounts as of the day of the analysis

Understand the relationship between the Balance Sheet and the important information it gives to the Agricultural Loan Officer

# 3a. Current Assets

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## ATTENTION!

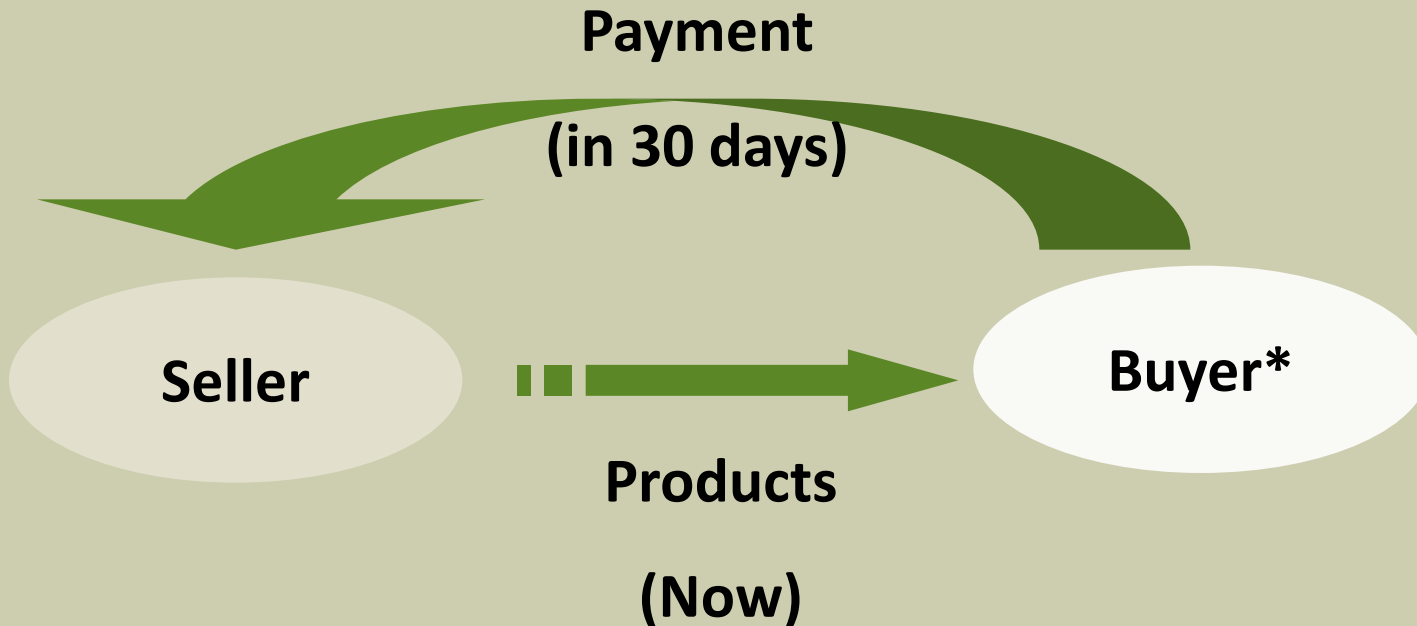
In case of higher amounts of cash being on hand, the LO must find out:

- Where did the cash come from?
- How long did it take to accumulate the cash/savings?
- What is the purpose of keeping that amount?

## 3b. Current Assets

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- Accounts receivable represent promises for future receipt of payment for products or services provided.



- \* There also receivables other than from sellers to buyers, such as from the state (taxes) or from lending money (loans given to others)

# 3c. Current Assets

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- Prepayments are expenses paid in advance
- Prepaid expenses
  - e.g. rent for a certain period
- Prepaid participation
  - e.g. down-payment on car not yet received

# 3d. Current Assets

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Inventories are recorded in the balance sheet at cost

- Raw materials
- Semi-finished products
- Finished goods
- Trading inventories
- Inventories in transport

Attention!

- Inventories must be seen and verified by the LO

# 4. Fixed Assets

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Fixed assets are not held for sale, they are used to operate the business. At the moment of the analysis, they are recorded at their current real market value

- Equipment and furniture
- Vehicles
- Business premises
- Land

Other assets are assets the business has, but they are not part of the actual business operation (e.g. valuable artifacts, premises and land that are not part of the business). At the moment of the analysis they are recorded at their current real market value



# 5. Current Liabilities

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- **Accounts Payable** – represent the promise to pay for goods or services received on credit
  - Amount – the exact amount of the payables and share of total purchases
  - Date of accrual – the date when the transaction occurred
  - Maturity – the original payment date and new payment date, if re-negotiated
  - General structure of suppliers – stable or new suppliers, frequency of purchases, general payment conditions, amounts of single purchases, outstanding amount for each supplier

Liabilities are obligations that a business has to its business partners (creditors, customers)

# 5a. Current Liabilities

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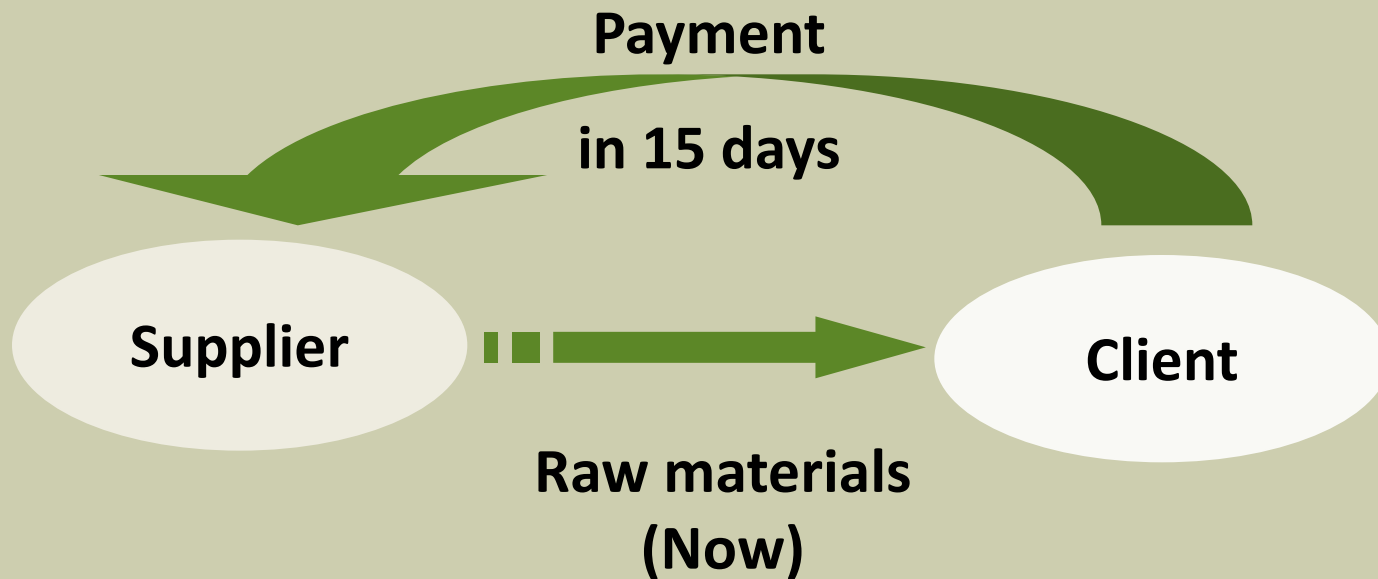
- **Prepayments received** – represent unearned revenues i.e. the payment was received before the goods or services were delivered
  - Clarify when the goods or services are going to be delivered
  - Clarify why the client is working with prepayments



# 5b. Current Liabilities

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- Current liabilities



- Accounts payable represent obligations for purchases made or services received with deferred payment, i.e. on credit

# 5c. Current Liabilities

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Attention!

To have accounts payable is not by definition something “bad”, it could also mean that:

- The client has a long-term relationship with his business partners and they trust him
- He is a good and regular payer

# 5d. Current Liabilities

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Short-term loans are loans with periods of maturity of up to 12 months

Short-term instalment loans

- Include the outstanding balance of the principal

Overdraft

- Include the current amount outstanding

# 6. Long-Term Liabilities

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Long-term liabilities have terms of more than 12 months

- Long-term accounts payable
- Long-term loans

NB:

- Get information on the amount, maturity, interest rate, other provisions, instalment and the collateral for each outstanding loan used by the client

# 7. Equity

**Equity** represents the assets owned by the business owners. It is the mathematical result of deducting total liabilities from total assets.

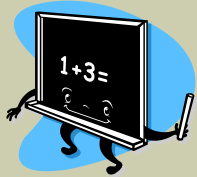
**Retained profit** is the part of the profit reinvested in the business.

Ideally equity corresponds to the starting investment + retained profit

ASSETS	LIABILITIES
Size of resources and how these resources are used	External Financing
	EQUITY
	Own Financing = Start-up capital + Retained profit

# 8. Summary

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- Define current assets and list examples
- Define fixed assets and list examples
- Define current and long-term liquidities with examples
- Define equity

# 8. Summary – Answers

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## I. ASSETS - Current Assets

- **Cash:** cash on hand and money in current accounts, including savings (unless blocked term deposits)
- **Accounts receivable:** third party obligations (e.g. goods sold on credit), which are expected to be met on time and in full
- **Inventories:** goods in stock, semi-finished goods, and raw materials

## II. ASSETS - Fixed Assets

- They are not held for sale and are used to operate the business  
e.g. equipment and furniture, vehicles, business premises, and land

# 8. Summary – Answers 2

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## III. LIABILITIES

- **Current liabilities:** debts due to be paid within one year or within the entity's own usual operating cycle.

e.g.: accrued liabilities, accounts payable, prepayments received, short-term loans

- **Long-term liabilities:** all liabilities with maturities exceeding 12 months.

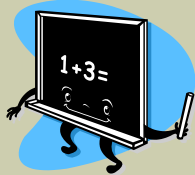
e.g.: long-term accounts payable, long-term loans

## IV. Equity

- Assets that are not financed with external (borrowed) resources



# 8a. Summary



What kind of information should you collect to understand Assets?

- **Cash** – Includes what you can see or logically prove (incl. money hidden under the mattress); do not include doubtful cash (e.g. money frozen on an account or cash that cannot be seen or traced)
- **Accounts receivable** – Collect information on all main accounts receivable (Who? How much? Date incurred? Due date? Conditions? History of co-operation?). List doubtful accounts receivable separately
- **Inventory** – Includes goods, semi-finished products, raw materials. Includes only what can be seen (logically traced). Value the inventory at PURCHASE price
- **Fixed Assets (buildings, equipment)** – Include what can be reasonably proven as client property that is used for business purposes. Value fixed assets at CURRENT market value

# 9. Case Study 1

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**Example:** A has XFA 1,000 in the till; XFA 1,000 in a bank account; an inventory of XFA 10,000 and no liabilities. While you are visiting the business, A receives a payment of 1,000 FCFA for goods delivered yesterday. He owns furniture valued at XFA 2,000 and a Toyota at a present market value of XFA 4,000.

**Compile the Balance Sheet (BS). How much equity does A have?**

# 9. Case Study 1 - Answers

... How much equity does A have?

Assets			Liabilities and equity	
<u>Current assets:</u>			<u>Current liabilities:</u>	
Cash	3,000		Accounts payable	0
Accounts receivable			<u>Short term liabilities (&lt; 12m):</u>	0
Stock	10,000		<u>Long term liabilities:</u>	
<u>Fixed assets:</u>			Loans > 12 m	0
Equipment and furniture	2,000		<u>Equity:</u> 19,000 - 0 = 19,000	
Real estate				
Other assets (car)	4,000			
<u>Other assets: (i.e.: investment)</u>				
<b>Total assets:</b>	<b>19,000</b>	=	<b>Total liabilities and equity:</b>	<b>19,000</b>



# 10. Case Study 1-2

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**Example:** Enterprise A now makes a delivery of goods to a client, who pays immediately. The purchase price of the goods was 3,000. A added a margin of 20%, so that the bill amounted to 3,600.

**Compile the balance sheet (BS). How much equity does A have now?**

# 10. Case Study 1-2 Answers

... How much equity does A have now?

Assets			Liabilities and equity	
<u>Current assets:</u>			<u>Current liabilities:</u>	
Cash	$3,000 + 3,600 = 6,600$		Accounts payable	0
Accounts receivable			<u>Short-term loans (&lt; 12m)</u>	0
Stock	$10,000 - 3,000 = 7,000$			
<u>Fixed assets:</u>			<u>Long-term liabilities:</u>	
Equipment and furniture	2,000		Loans > 12m	0
Real estate				
Car	4,000		<u>Equity:</u>	$19,600 - 0 = 19,600$
<u>Other assets: (i.e.: investment)</u>				
<b>Total assets:</b>	<b>19,600</b>	=	<b>Total liabilities and equity:</b>	<b>19,600</b>

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