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Farm Liquidity – Your Current Ratio

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The measures of financial liquidity quantify the ability of your farm to meet the financial obligations as they come due as well as to generate cash to pay family living expenses, income taxes, and make debt payments on time. The typical measures of liquidity under review by your FBFM field staff or lender are: 1) the current ratio, 2) working capital, and 3) the working capital/gross revenue ratio. This post will review the current ratio. The current ratio measures the extent to which current assets, if liquidated, would pay off all current liabilities. The higher the ratio, the greater the liquidity and as we learned in [last month's post](#), cash is king.

Current assets are a balance sheet item that represents the value of all assets that are reasonably expected to be converted into cash within one year in the normal course of your farm business. Current assets include cash, accounts receivable, inventory, marketable securities, prepaid expenses and other liquid assets that can be readily be converted into cash. Current assets are important to a business because they are the assets that are used to fund day-to-day operations and pay ongoing expenses. Cash and bank account balances, grain and market livestock in end-of-year inventory, and prepaid expenses are examples of some of the more significant current assets to an operating farm. Assuming that per bushel prices for corn and soybeans remain high, we will have a high value assigned to the bushels that were produced in 2012. If you expect to receive an indemnity payment on crop insurance and if you have not received that payment prior to the end of the year, make sure that you contact your crop insurance agent and get an estimate of that 'accounts receivable' to include in your current assets on your end-of-year balance sheet.

Current liabilities are a farms debts or financial obligations that are due within one year. Current liabilities are a balance sheet item and include operating debt, accounts payable, accrued liabilities. Essentially, these are bills that are due to creditors and suppliers within a short period of time. Normally, a farm operation uses cash and other current assets in order to pay their current liabilities. The current portion of deferred income taxes should be included as a current liability. If omitted, one may overstate their current ratio.

The current ratio is a very simple measure to determine if one has the ability to pay off their current liabilities. A current ratio of 1:1 would show that current assets could retire the current assets with no value of current assets left over. A current ratio that is greater than 1:1 indicates there would be current assets 'left over' that can fund ongoing operations after the current liabilities are paid. A current ratio of

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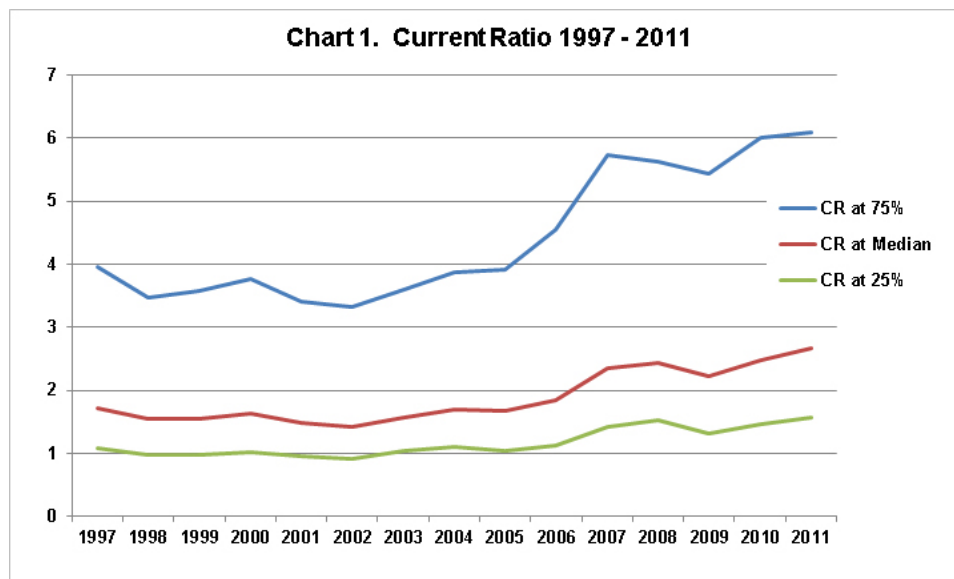
less than 1:1 indicates that there are insufficient current assets to pay the current liabilities.

It is important to measure the current ratio at the same point in the production cycle. Typically, a balance sheet is prepared on December 31st of a calendar year. The current ratio can vary greatly if not measured at the same point in the production cycle and this would present difficulties in comparing current ratios.

The current ratio is influenced by the type of farming enterprise. Overtime, grain farms have shown higher current ratios than hog, dairy, or beef cattle farms. In 2011, the median current ratio for grain farms in Illinois was 2.73. Hogs farms trailed the grain farms slightly with a 2.59 current ratio. Beef and dairy farms had current ratios of 1.92 and 1.91.

The current ratio increases as age of the operator increases. In 2011, the median current ratio for the 30-39 age group is 2.05. The median current ratio for the 40-49, 50-59, and 60+ age groups are 2.33, 2.47, and 3.60.

See Chart 1 for a 15 year history of the current ratio at the 25th, median, and 75th percentiles. It would appear that a shift occurred and that current ratios have increased especially at the median and the 75th percentiles.



Click [here](#) to find other financial benchmarks for your farm.

The author would like to acknowledge that data used in this study comes from the local Farm Business Farm Management (FBFM) Associations across the State of Illinois. Without their cooperation, information as comprehensive and accurate as this would not be available for educational purposes. FBFM, which consists of 5,500 plus farmers and 60 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.