# Farm and Ranch Economic Dictionary

Guide Z-103

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This publication is scheduled to be updated and reissued 9/14.

Communication with lenders is one of the main problems faced by farmers and ranchers, especially as agriculture moves away from its past as a self-contained, labor- and land-intensive industry and becomes a business-oriented, capital-intensive industry. As agriculture moves in this direction, farmers and ranchers must become fluent in the language used by bankers and other businessmen. As with any other profession, businessmen use jargon, words relevant to their business with exact definitions. These words minimize the amount of verbiage needed to explain what is meant and minimize misunderstanding.

Farmers and ranchers have their own jargon, for example such words as *heifer* and *anhydrous*. This language is well known to individuals familiar with agriculture but not necessarily understood by others. In the same way, lenders and businessmen use their own language which may not be immediately interpretable to farmers and ranchers. Following are some of the most common business terms and definitions applicable to the farm and ranch.

**Accrual Accounting**: A system of accounting which recognizes income and expenses when they are effectively earned or incurred, rather than when cash changes hands. Under accrual accounting, grain produced during the year is counted as income in that year, regardless of whether it was sold or stored. Farmers and ranchers may choose to maintain their records and file taxes using accrual accounting methods, but publicly-owned corporations are required to use this system.

**Accrued Liability**: A liability which has been incurred but not yet paid. For example, if mortgage interest is to be paid annually on February 1, eleven months of interest would have accrued by January 1 although the cash payment is not yet due.

**Amortized Loan**: A loan in which the amount borrowed is repaid in installments over the term of the loan.

**Annual Percentage Rate**: Often referred to as APR, it reflects the interest and noninterest costs associated with a loan expressed on an annual percentage. APR may differ substantially from the contractual interest rate stated on the note.

**Annuity**: A series of payments of a fixed amount covering a specified number of years.

**Appreciation**: The long-term increase in value of an asset due to inflation, other economic conditions or an increase in demand for that asset. If, for example, land or corporate stock is valued above what was paid for it, the asset is said to have appreciated.

**Asset**: Any item which is owned. Full value of land or of stored grain is classified as an asset, regardless of whether there is a mortgage or lien on that property.

**Audit**: A check of business record books or tax returns for accuracy and completeness.

**Average Costs**: Average cost is a concept related to the production function and related cost curves, and represents average cost per unit of output. Average cost is defined as total costs divided by output, which is total variable costs plus total fixed costs divided by output.

**Average Physical Product**: Average physical product is a concept related to the production function and represents the average amount of output produced by a given amount of variable input, i.e., output divided by input.

**Balance Sheet**: A statement of all items of value owned (assets); the claims against those assets, including debts owed (liabilities); and the owner's net worth or equity at a specific point in time. The balance sheet is also called a net worth or financial statement.

**Basis**: A term used in income tax preparation and valuation of assets. The basis of an item generally refers to the value of cash and other assets paid for the item when originally purchased. Adjusted basis or depreciated book value or cost basis are all terms which refer to the value of an asset calculated by subtracting depreciation taken from the purchase price.

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**Book Value**: The cost of an item less its accumulated depreciation allowances.

**Bookkeeping**: Keeping track of income and expenses for income tax, credit application or management analysis purposes. Records provide the necessary basis for all forms of business analysis.

**Budget**: A written estimate of future income and expenses covering a definite time period. Budgets can take several different forms, such as a partial budget, a cash flow budget, a whole farm budget or others, depending upon the need or decision to be made. Regardless of form, each budget is a projection into the future which should be used as a plan or a guideline.

**Capital**: As used in capital assets, capital investments, capital improvements; to describe money (owned or borrowed) invested in anticipation of a return.

**Cash Flow**: Actual cash coming into or going out of the business.

**Cash Flow Budget**: A written estimate of projected cash income and outgo for a definite period. It is usually prepared on an annual period, by months, showing cash receipts, expenditures and cash needed or surplus for each period. Most lending agencies require a cash-flow budget to help them plan their own cash flow needs.

**Consolidated Financial Statements:** Financial statements (Balance Sheets, Income Statements, Cash Flow Statements) which combine business and personal items, including assets, income and sources of funds.

**Constructive Receipt**: A tax term that describes proceeds from sales that may not yet be converted to cash or deposited in a bank account, but nonetheless are available. A common example is a check received for sale of a commodity in late December, but not cashed until January. Those proceeds are included in December receipts and are taxable in that year, regardless of when the check was cashed or deposited.

**Contingent Liability**: A liability or debt incurred only if some specific event should occur, such as the sale of an asset or business.

**Credit**: Money borrowed with the understanding that it will be repaid. Alternatively, credit may be referred to as the amount of money that can be borrowed, i.e., a credit reserve.

**Credit Rating**: A judgment of an individual's ability to handle credit based on past performance, assets owned, repayment capacity, character and other factors.

**Credit Risk**: The risk assumed by the lender that the borrower will not repay a loan.

**Credit Worthiness**: The proven ability of a borrower to use and repay borrowed funds.

**Current Asset**: An asset which is or may be converted to cash easily (a liquid asset such as stocks and bonds), one which will be sold within 1 year (such as grain in storage, feeder livestock or a cull cow), or one with a useful life of less than 1 year (such as a prepaid expense or supplies and feed).

**Current Liability**: A liability which will be paid off within 1 year, such as an operating loan, interest accrued on a long-term loan and due within 1 year, principal due within 1 year or an accrued income tax liability.

**Debt**: An obligation owed to another. Alternatively, debt refers to the total sum of money owed to others.

**Depreciation Expense**: Annual accounting charge for the deterioration, obsolescence or wear of an asset whose productive life is more than 1 year. Although depreciation is not paid in cash, it is an expense to the business because the entire purchase price of a long-lived asset cannot be deducted in any 1 year. According to Internal Revenue Service definitions, depreciation was replaced by the Accelerated Cost Recovery System for all assets purchased after December 31, 1980.

**Disposable Income**: The amount of net income left after taxes.

**Enterprise Analysis:** An analysis of costs and returns specific to each crop and livestock commodity produced on the farm or ranch.

**Enterprise Budget**: A detailed listing of projected prices, yields and costs associated with a specific crop or livestock commodity.

**Equity:** The part of an asset or an entire business owned outright by the operator. For example, equity in a business is the value of the business less the amount owed. Sometimes expressed as percent of ownership.

**Expenditures**: All items of cash outflow. Most expenditures are also business expenses, but others (such as the purchase of a machine or principal payments on a loan) are not.

**Expenses**: Annual costs incurred in doing business, whether paid in cash or not. Many expenses are also expenditures, but others (such as depreciation) are not.

**Financial Statement**: Usually refers to a Balance Sheet, although it may include all financial statements such as the Income Statement and Cash Flow Budget.

**Fixed Costs**: Expenses that do not vary with level of production, such as depreciation and personal property taxes. For example, personal property taxes are the same on a tractor, regardless of whether that tractor is used on 1 acre or 300 acres, or is not used at all.

**Gross Margins**: A concept used in developing the Whole Farm Plan. Gross margins are income over variable costs, i.e., Gross Receipts minus Variable Costs.

**Gross Returns:** Total cash receipts from an enterprise, i.e., total yield times price or weight of cattle times price.

**Income:** Money or increased value of inventory earned. An accrual accounting concept, income reflects money earned from commodities produced or services rendered, regardless of whether that commodity was actually sold on the market or payment was received.

**Income Statement**: (Also called operating statement or profit and loss statement.) An accounting of income and expenses for a period of time (usually 1 year) for the purpose of calculating net farm or ranch income, or net loss for the period.

**Inflation**: A continuous increase in the general price level, thus a decline in the purchasing power of money.

**Interest:** A calculated rent paid for the use of someone else's money, or an opportunity cost on the use of owned capital.

**Interest on Operating Capital and Equipment Investment**: A calculated cost, or opportunity cost, on the use of capital in the business. For some farmers and ranchers, the interest cost might be a cash outlay while for others it might be an imputed cost.

**Intermediate Assets**: Assets which are less liquid than current assets or which have a useful life of more than 1 year but less than 10 or 15 years. Examples include trucks, breeding or dairy livestock and machinery.

**Intermediate Liabilities**: Notes or mortgages held on intermediate assets.

**Leases**: A contractual (verbal or written) obligation to use some asset belonging to another individual for a specified time period and for a specified fee. Only a fine distinction exists between a rental agreement and a lease. Lease agreements often contain clauses for eventual purchase, and the leasee (the one who uses the asset) will usually pay for repairs and maintenance.

**Leverage**: Use of borrowed funds as supplemental equity capital. The leverage ratio measures the degree to which borrowed capital exceeds net worth.

**Liability**: A debt or obligation expressed in terms of money.

**Line of Credit**: An agreed-upon amount which may be borrowed in the course of normal operation. Interest is usually charged only on the amount actually used, and only over the period in which it is actually used.

**Liquidity**: The ease and speed with which assets could be turned into cash. Liquid assets are those that can be quickly converted to cash.

**Long-Term Assets:** Assets with a useful life of more than 10 years. Examples include land and buildings.

**Long-Term Liabilities**: Notes or mortgages held on long-term assets.

**Marginal Costs**: Marginal cost is a concept related to the production function and related cost curves, and represents the additional cost of one additional unit of output. Marginal cost is defined as a change in total cost divided by a related change in output.

**Marginal Physical Product**: Marginal physical product is a concept related to the production function and represents the increase in output generated by the last unit of variable input applied, i.e., change in output produced divided by change in input used.

**Marginal Revenue**: Marginal revenue is a concept related to the production function. It is defined as the additional revenue generated by an additional unit of output, i.e., change in total revenue divided by change in output. In most agricultural commodities, an individual farmer or rancher cannot affect price; therefore, marginal revenue is the unit price of the output.

**Net Farm or Ranch Income:** Returns to labor, management, capital, land and risk, i.e., gross returns minus purchased inputs and fixed costs.

**Net Operating Profit**: Gross returns minus total operating expenses.

**Operating Capital**: Operating expenses minus fixed costs. The amount of cash required for all purchased inputs (including labor, fuel, oil and repairs) to produce a crop or livestock commodity, but excluding machinery, equipment and land investments.

**Operating Expenses**: The total of all costs attributable to the production of a crop or livestock commodity, except interest.

**Opportunity Cost**: Cost of using a resource in one enterprise when it could be used in alternative enterprises or investment opportunities. This is measured in terms of the return that would be obtained from using the resource in the alternative investment. For example, if cash used to buy inputs for production of a crop could also be invested at a 10% rate of interest, the opportunity cost of cash to the crop would be 10%.

**Overhead Costs:** Fixed costs not directly associated with production, such as insurance, employee benefits, land taxes and utilities. These costs, once agreed to, occur without regard to level of production, or whether production exists at all.

**Partial Budgeting**: A management technique or planning procedure that lists only items of receipts and expenses affected by a particular change in procedure or organization.

**Prepaid Expenses**: Expenditures paid before the good or service has been used or consumed.

**Present Value**: An estimate of today's value of money that will be received or spent at some future date. For example, if $1 is to be received in 2 years, and the inflation rate is 10%, the net present value of the $1 is only 83. (Can also be used to figure net present value of a series of payments to be made in the future.) Present value captures the concept called time value of money.

**Production Function**: The physical relationship between the amounts of variable inputs applied to a crop or livestock commodity and the response of resulting output (typically yield or gain). The first few units of input applied usually result in increasingly larger amounts of output. At some point, adding more input units results in smaller and smaller additions to output and eventually may cause a decline in total output.

**ProForma**: An accounting term usually used in conjunction with the Income Statement or Balance Sheet which means the statement is a projection into the future or a budget.

**Rate of Return on Investment**: Net operating profit divided by the total machinery, equipment and land investment. It measures profitability of assets in percentage terms.

**Ratios**: One of several types of measurements used to indicate the position of a business. Ratios are often used to make comparisons with other businesses. Some commonly used ratios are:
Current ratio = Current assets ÷ Current liabilities
Equity ratio = Net worth ÷ Total assets
Leverage ratio = Total liabilities ÷ Net worth
Net capital ratio = Total assets ÷ Total liabilities
Profit to net worth = Net income ÷ Net worth

**Receipt**: The term *receipt* can be used in two major ways: 1) a written record of a transaction, or 2) money received. In cash accounting terminology, a receipt is any item of cash inflow, such as proceeds from the sale of a good or service or borrowed money, whether or not that money can be classified as income.

**Rent**: A contractual (verbal or written) obligation to use some asset belonging to another individual for a specified time period and for a specified fee. Only a fine distinction exists between a rental agreement and a lease. Seldom will a rental agreement contain a clause for eventual purchase. Under most rental agreements, repair and maintenance costs are borne by the owner.

**Repayment Capacity**: Ability of a business to produce receipts above expenditures. In other words, ability of a business to repay money borrowed for that business.

**Return to Land and Risk:** Net operating profit minus the interest charge on the use of machinery, equipment and operating capital.

**Return to Risk**: Return to land and risk minus an additional charge for land investment. Because the only residual is the return to risk, this concept is usually called pure profit because payments have been made to all other factors of production.

**Rollover Loans:** Short-term loans obtained with the anticipation the loan will be renewed at its due date.

**Solvency**: A term used to describe the long-term financial position of the business. A business is called solvent if the value of assets exceeds liabilities, and insolvent (or technically bankrupt) if liabilities exceed assets.

**Time Value of Money**: A concept which reflects the fact that the present value of a given amount of money is greater if received now than if received in the future. The reduction of value is caused by inflation, risk, interest that could be earned or because of preference for money now rather than in the future. The sooner a dollar is to be received, the greater is its present value.

**Variable Costs**: Expenses which vary with the level of production, such as labor, fuel, oil and repairs, feed, fertilizer and seed.

**Variable Interest Rates**: Interest rates on borrowed money that vary from time to time, depending on the interest rates on major money markets or the prime interest rate.

**Whole Farm or Ranch Budget**: A ProForma (or Projected) Income Statement built from the enterprises selected in the Whole Farm or Ranch Plan.

**Whole Farm or Ranch Plan**: A forward plan of farm or ranch enterprise organization for the coming year. This plan is an attempt to determine the most profitable combination of enterprises, within the constraints of available fixed resources, rotations, conservation, and financial and climatic limitations.

**Working Capital**: The amount of capital or current assets available for use in operating the business. Commonly figured as the amount by which current assets exceed current liabilities.

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**Revised September 2009** **Las Cruces, NM**