

Cash Flow

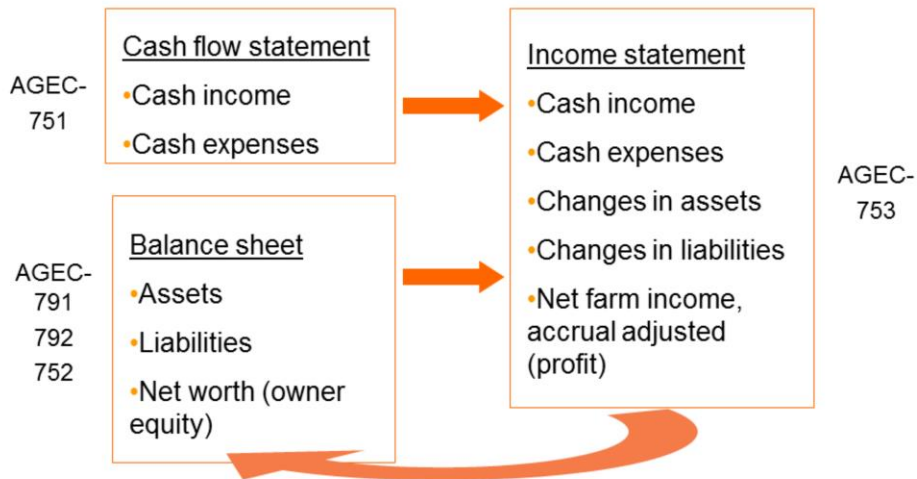


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Welcome to a brief discussion of cash flow. Cash flow refers to a summary or a plan of cash income and expenses. You can choose whether it focuses on the business only or is a combined personal and business statement or budget. But, if the farm or ranch is intended to stand-alone as a business, it is important to look at business cash flow regularly to understand seasonal patterns and recognize business strengths and weaknesses.

Financial Statements



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Cash flow can be summarized for historical purposes, which is usually referred to as a statement. The cash flow statement is one of three financial statements that we encourage all producers to develop annually and to analyze for the insights it provides for the farm business and family. The cash flow statement summarizes information for a period of time, typically a year. As depicted in this graph, the cash flow statement together with balance sheets for the beginning and ending of the time period provides essential information for the income statement.

The numbers in this slide refer to OSU fact sheets that provide more detail along with detailed examples and step-by-step instructions for completing forms. AGEC-751 is the publication number for a fact sheet on the Cash Flow Statement.

Cash Flow Discussion

- Statement versus plan, business versus personal
- Sources of information
- Cash flow statement development
- Uses of cash flow statement or plan
- Relationship to other financial statements



Cash flow can also be predicted or anticipated through a cash flow budget or plan. The cash flow statement provides a useful reference for future year to year comparisons while the plan provides a target for performance in coming months.

Statements or plans can either focus solely on the business or may include both business and personal income and expenses. What you choose to include may depend on the expected uses. Is it for communication with lenders and, if so, are both farm and personal incomes pledged for loan repayment? That would argue for including both farm and personal income and expenses. On the other hand, if the plan or statement is designed to highlight how the business is doing, then limit the information included to the farm or ranch.

In slides to follow, we'll talk about where you find information for the cash flow, how you summarize it, some of the insights it provides and will reiterate its relationship to other financial statements.

Sources of Information

- Records, records, records
 - Receipts, bills, invoices, etc.
 - Account statements
 - Transaction logs
 - Computer files



Ideally, you have a record-keeping system that lends itself to a cash flow summary. Cash transactions may be documented through a collection of receipts and invoices, plus bank, credit card, loan statements and notes, the same kinds of things that you save for tax purposes. The tax forms themselves would only be useful for an annual cash flow and still would need to be supplemented by other account statements as they wouldn't document loan payments for instance.

Software tools today make it easy to sort and summarize records in a variety of ways that can be useful in decision support. For instance, we've been teaching people how to use Quicken for farm and ranch financial records. Investing some time in learning to use a tool like Quicken gains you the ability to sort and summarize information quickly and easily. With a couple of clicks, you can generate an annual cash flow statement or monthly or quarterly reports. And, if you have records for multiple years in the file you can compare cash flow across years to better understand the variability due to changes in market prices, weather and so on.

Once you have a historical statement, it can be used as the basis for a forward looking plan.

Cash Flow Statement

Cash Inflows

- Operating receipts
 - Crop and livestock sales, government payments, other farm income
- Capital sales
- Contributed capital

Cash Outflows

- Operating expenses (feed, fertilizer, etc.)
- Capital purchases
- Family living and other withdrawals



The cash flow statement is organized into sections for cash inflows and cash outflows. Cash inflows include three types of items: operating receipts, capital sales, and contributed capital.

In the operating receipts section, the totals for crop sales (wheat, canola, hay), livestock sales (calves weaned, hogs, broilers, goats or other livestock), government payments (LFP, ARC, PLC, conservation) are summed along with other farm income, such as custom work.

Capital sales include the sales of culled breeding livestock, vehicles, machinery and equipment, land or buildings. Any asset that is expected to be used in the operation for multiple years is considered a capital asset. Any income that results from the sale of this type of item is a capital sale. So a bull that has tested infertile and is sold at the local livestock auction is a capital sale as is the used farm pickup.

Contributed capital consists of funds that come from outside the farm business to support the farm. It may come from off-farm income, gifts from relatives or lottery winnings. So, if you inherit, \$10,000 from Aunt Mae and choose to deposit it in the farm checking account to be used for farm purposes, it becomes contributed capital.

In the cash outflow section, you also have three general types of items: operating expenses, capital purchases, and family living withdrawals.

Operating expenses include...

Capital purchases are the outflows of cash associated with buying capital assets. The

purchase of a bull to replace the bull that was culled is a capital purchase. The purchase of a sprayer is a capital purchase. And the purchase of land is a capital purchase.

If the farm provides cash for family living expenses, it must also be documented. Any other withdrawals, for instance, to support another business or pay a child's college expenses should also be recorded.

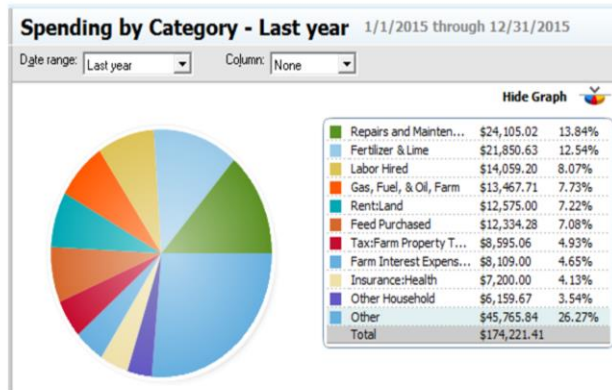
The intent is to fully capture the cash coming into the business and leaving the business.

Cash Flow - 2015		1/1/2015 through 12/31/2015	
Date range:	Yearly	2015	Column: Don't subtotal
Category		1/1/2015-12/31/2015	
INFLOWS			
Uncategorized		0.00	
Capital Sales, Farm		14,075.00	
Government Payments		3,112.00	
Interest Inc		76.73	
Other Inc		527.00	
Raised Sales			
Grain		50,474.56	
Livestock		38,812.88	
Other Products		26,768.50	
TOTAL Raised Sales		116,055.94	
Royalties Received		3,000.00	
Salary Spouse		40,546.86	
TOTAL INFLOWS		177,396.53	
OUTFLOWS			
Auto		262.88	
Gas		56.50	
Registration (Non-taxable)		91.00	
Service		1,903.31	
TOTAL Auto		2,313.69	
Bank Charge		18.80	
Charity		1,525.00	
Chemicals		2,312.20	
Clothing		1,592.87	
Consultants, Farm		250.00	
Custom Hire		1,390.16	
Dining		726.91	
Entertainment		4,852.04	
Farm Interest Expense			
Farm Mortgage		8,109.00	
TOTAL Farm Interest Expense		8,109.00	
Feed Purchased		12,334.28	
Fertilizer & Lime		21,850.63	
Financial			
Financial Advisor		421.00	
TOTAL Financial		421.00	
Food & Dining			
Restaurants		20.00	
TOTAL Food & Dining		20.00	
Freight and Trucking		343.00	
Gas, Fuel, & Oil, Farm		13,467.71	

Here's an example of a cash flow report generated in Quicken. Inflows are summarized using categories established by the user and show the totals for capital sales, government payments, etc. with categories in alphabetic order. Similarly, cash outflows are summarized by category with totals sometimes subdivided using subcategories to capture more detail. Note at the top that you have the option of changing the time period. Because you can easily switch to a monthly view or even shorter time frame, software tools make it easy to quickly gain insights into seasonal patterns of cash surpluses and shortfalls. It also makes it easy to compare years so that you have a record of how high feed expenses were during a drought year or how much repair expenses may be increasing over time.

Quicken Reports and Graphs

- Cash flow
- Tax schedule
- Transactions
- Account balances
- Comparison
- Filtered
- Memorized
- Balance sheet



This list of the kinds of default reports built into Quicken further demonstrates the variety of ways information can be summarized with a couple of clicks of the mouse. I personally like the income and expense bar charts and this pie chart showing the top 10 expense categories for our sample file. Graphs often communicate better than tables of numbers and a good software tool makes it easy to create them.

Seeing that Repairs and Maintenance are the number one expense and the largest portion of the pie may signal that a new investment may be needed in some machinery or equipment or it may mean that better training is needed for hired help.

The numbers and visuals are telling—the manager has to help with the interpretation and understand how the signal can be used in making a decision.

Uses of a Cash Flow Statement

- Establishes target levels for income and expenses which can be used in monitoring progress towards goals
 - Budget
 - Break even analysis
- Points out potential problems in meeting financial obligations
- Indicates when cash is available for new investments
- Risk assessment



The cash flow statement can serve as the basis for a forward looking plan or budget. While history may not repeat itself exactly, it is often a good predictor of the future in many ways. By having a sense of how much is spent on different expense categories, you can focus on managing the important ones. You can also invest relatively more time in looking for outlook information that suggests what to expect for prices in the future for important income or expense items.

A cash flow budget provides a target for the coming year and allows budget to actual comparisons. By monitoring cash flow regularly, you can stay on target for achieving your financial goals or be prepared to take action early in event of an unexpected downturn in the market or unexpected expenses. Looking at cash flow by enterprise (for instance, wheat, stockers, cow-calf, cotton), you can identify break-even prices and yields. This helps inform your marketing plan and insurance decisions and perhaps decisions about what to plant or not plant for the coming year.

Anticipating cash flow and changes in cash flow when circumstances change is important. If market prices change for the worse or yields come up short, it may lead to shortfalls that jeopardize the ability to pay bills or make scheduled loan payments. It is always better to deal with problems early on as more options are available. So early warning signals from your records and cash flow statements and plans are very valuable.

Downturns in the economy often provide opportunities for those who are well positioned.

Measuring Financial Position and Performance

- Liquidity
 - Ability to pay bills as they come due and cover unanticipated events
- Solvency
 - Ability to cover all debts if the business were sold
- Profitability
 - Returns to labor and management generated by the operation
- Financial efficiency
 - Efficiency with which assets generate income
- Repayment capacity
 - Ability to repay term debt in a timely fashion

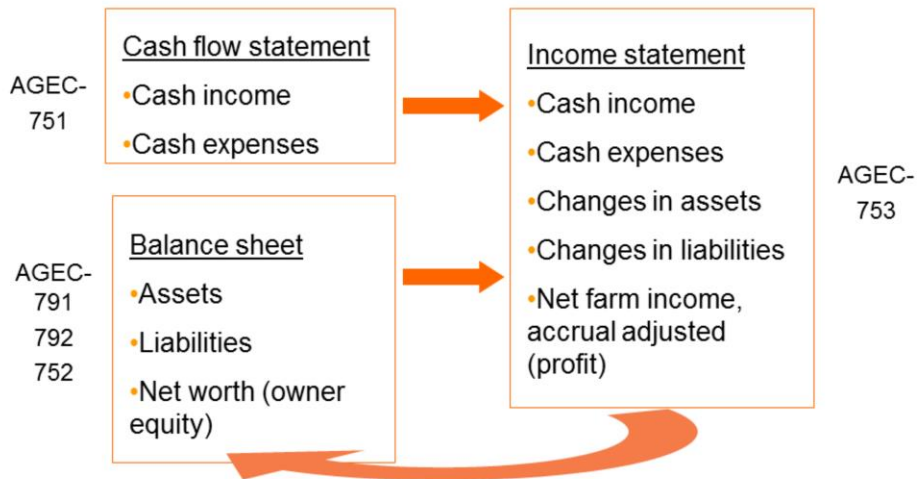


We'll talk more about key farm financial measures in another video, but I want to point out how the cash flow statement contributes valuable information to some of them, particularly liquidity and repayment capacity.

Liquidity is defined as... If your farm truck suddenly develops a problem that requires an engine overhaul and you have to round up and sell a couple of calves to pay for it, your business isn't very liquid. A good understanding of cash flow helps the manager decide what level of cash may be necessary in savings or other liquid assets to provide for ongoing expenses as well as emergency funds.

Repayment capacity is defined as... If money has been borrowed for financing, the lender providing the money expects that both principal and interest will be repaid on schedule. Their business is dependent on borrower's following through on their commitments. A good understanding of cash flow and commitments made will point out potential shortfalls and help inform strategies to best deal with problems.

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A reminder of the cash flow statement's role in an integrated set of farm financial statements.... A good record of cash income and expenses is absolutely necessary in analyzing the profitability of the operation as is done with an income statement. You might think of the cash flow statement as one of the essential building block in developing the income statement. Balance sheets will also be required to identify the necessary accrual adjustments to complete the income statement.

Difference Between Cash Flow and Income Statement

Cash flow statement does not include:

- Depreciation
- Changes in inventory, other accrual adjustments
- Gains/losses on capital asset sales

Income statement does not include:

- Capital sales and contributed capital
- Principal payments
- Family living expenses



This slide highlights some of the key differences in the cash flow statement and serve as a reminder of the distinction between cash flow and profitability. It may be tempting to look at the cash balance in a checking account and think that it is a signal of profitability. But that isn't necessarily so.... Focusing only on cash balances overlooks changes in inventories of feed, hay, supplies, growing crops, etc. and capital assets. It also does not capture gains/losses that may have been associated with sales of assets. In analyzing profitability, we must capture these impacts as well as prorate the expense of owning a capital asset over its expected useful life through depreciation. For example, if we purchase a new farm vehicle for \$30,000, we may expect to use it for 6 years and then sell it for \$3,000. In analyzing our yearly profit, we would prorate the difference between the purchase and sale price of \$27,000 over the useful life of 6 years. That more accurately matches the expense of ownership with its business use.

And as shown here, the cash flow statement may include things that an income statement would not, namely all cash associated with capital sales and contributions, principal payments and family living expenses.

References

- At osufacts.okstate.edu:
 - Developing a Cash Flow Plan, AGEC-751
 - From Cash Records to Cost of Production, AGEC-242
 - Budgets: Their Use in Farm Management, AGEC-139
 - Quicken for Farm and Ranch Financial Records, CR-324
 - Quicken or QuickBooks: What's the Best Choice for Agricultural Producers? AGEC-266
 - Information Systems for Oklahoma Farmers, AGEC-302

■ **FINPACK**, <https://www.cffm.umn.edu/FINPACK/>



We encourage you to learn more about developing a cash flow plan by reading the OSU fact sheet 751. It provides a farm example with detailed explanation as well as a blank form should you want to develop one for your operation. The other publications listed here provide references for related topics. You may also be interested in software tools that assist in financial statement development. FINPACK is one example of that kind of tool.

Please contact your local Extension office or area agricultural economics specialist if you would like more information or are interested in having a program on this topic in your area.