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Alaska RightRisk News

Cash Flow Budgets and Year-end Planning

This is the time of year when farmers are reviewing their finances from last year and preparing to deliver information to their tax preparers. They are also updating their balance sheets (a financial statement showing net worth) and computing true profits earned last year (the income statement). Successful farmers should also be developing plans for the coming year. A financial plan for a farm business is called a cash flow budget. Yes, all this paperwork may mean more computer time than desired!

Road map to financial success
A cash flow budget may be thought of as a "road map" for the coming year. It summarizes projected cash inflows and outflows from the farm business over a specific time period, usually each month for one year. It allows the farm manager or lender to estimate the amount and when cash will be available; determine the time and amount of any borrowed funds that might be needed; and estimate the debt repayment capacity of the business.

Each agricultural enterprise has its own special financial needs. Livestock, hay, dairy, flowers, and vegetables have different and unique cash flows throughout the year. This, of course, is due to the timing and nature of costs incurred between starting an enterprise and the sale of the goods produced. A farmer selling vegetables in mid and late summer may have receipts in multiple months. A cow-calf producer may have income only once in the fall when the calves are sold. A peony grower will likely realize no income in the first few years, while the root is growing but not producing a harvestable crop. This is followed by multiple years of production and sales to offset the negative cash flow during the establishment period.

How to Create a Cash Flow Budget

Record cash inflow like the:
- Deposits in a check book
- Deposits on a bank statement
- Payments on a credit card statement

Record cash outflows like the:
- Record of checks in a check book
- Withdraws on a bank statement
- Charges on a credit card statement

One way to think of a cash flow budget is like a checkbook. Your checkbook accounts for all your cash inflows (deposits) into the checking account and all your cash outflows (checks and withdrawals) out of the account. At the end of each month a remaining cash balance is shown. A cash flow budget is very similar except it systematically organizes the data into a form with the upper half containing the cash inflows (receipts and sales) and the lower half the cash outflows (costs and expenses).

Where to begin?
A person who has never prepared a cash flow budget is well advised to first prepare one based on historical information, using past bank statements (canceled checks and deposits) as the source of data provides a good starting point. It is important not to overlook family living expenses and owner withdrawals in a sole proprietorship or partnership because the business and personal/family living expenses and income both affect cash flow.

One way to prepare a cash flow budget is to use the previous year's cash flow and adjust inflows and outflows for coming year based on current and projected information. For example, if livestock prices are projected to increase 10 percent this year, livestock income from the previous year could be increased by 10 percent. Of course, this assumes production levels this year will be the same as last year's. If price and output uncertainty is low, this method would be quite adequate. However, price, cost, and output variance in the agriculture sector may make this method too imprecise for planning and budgeting needs.

Estimate Projected Cash Inflows

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	TOTAL
Cash Inflows													
Flower Sales													
Livestock Sales													
Livestock Product Sales													
Other													
Total Cash Inflows													

Using enterprise budgets to get started
A second method to develop a cash flow budget is to project the timing and flow of income and expenses for the enterprises of the farm with detailed enterprise budgets. This entails developing a cropping plan – including acres, expected yields, expected inputs, and total production. The preparer must estimate the timing and associated costs for seed, fertilizer, chemical, labor, and other input requirements.

A livestock plan is prepared much in the same manner as the crop plan. Knowing feed requirements will assist in determining quantities of grain and hay fed to livestock, that which can be grown versus that

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which must be purchased. Planning crop usage as feed involves estimation of supply (inventory plus production) and calculation of projected feed use for livestock throughout the year. It will assist in identifying feed or grain shortages which require purchase of supplies to meet feeding requirements.

The anticipated capital purchases and repairs for the upcoming production year should also be accounted for in the cash flow budget. It is important for producers to have a capital replacement and repair plan. There may be production years when replacement is not feasible due to low income, but it is important to plan regular replacement of capital assets over the long term. If one anticipates buying capital assets in the upcoming year and financing the purchases, then the loan repayments (principal and interest) should be included in the cash flow budget along with other expected loan payments.

Lastly, farm cashflow budgets should include family living costs, whether the family takes a money draw from the farm account to pay living expenses, or individuals are paid wages or salary directly by the farm account. It is very important not to overlook this aspect of the cash flow preparation process. As much attention should be directed at this aspect as one would spend in determining a budget for the other components.

Estimate Projected Cash Outflows

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	TOTAL
Cash Outflows													
Seed & Plants													
Fuel & Lube													
Insurance													
Supplies													
Utilities													
Labor													
Storage													
Miscellaneous													
Subtotal													
Total Loan Payments													
Total Cash Outflows													

Uses for the cash flow budget

A cash flow budget has a number of uses.

1. *Planning* – it provides an estimate of how the farm or ranch business will be operated for the next production period/year. It also establishes definite expectations that can be utilized as the framework for measuring or monitoring performance over the time period for which the cash flow budget was prepared.
2. *Monitoring* – periodic monitoring helps identify potential cash flow problems. For example, if a rancher observes that his veterinary expenses are exceeding what were anticipated, he can adjust cash outflow in other areas to keep within his budget.
3. *Evaluation* – the evaluation of borrowed capital and the estimation of ability to repay. A projected statement of cash flows identifies the level of capital necessary to operate the business, the requirement for borrowed capital, and the best timing to repay the loan.
4. *Impact* - a cash flow budget helps analyze the potential impact of adding, adjusting, or eliminating an enterprise. Projection of cash flows with changes in the farm business greatly facilitates management of operations.
5. *Cash Management* – the farmer may consider investing these temporary funds in money market instruments (bonds, commercial paper, etc.). Interest earnings on such funds will add to the overall financial position of the business.

Once farmers become familiar with developing a cash flow budget, monitoring it, and analyzing the information, they will find it is a valuable reference and planning tool. Some computer accounting systems have the ability to prepare a cash flow analysis, or the use of an electronic spreadsheet can accomplish the same objective. Many universities have fact sheets and spreadsheet templates for completing farm financial statements and analyzing the information from the statements.

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USDA United States Department of Agriculture
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The RightRisk course entitled *Getting on Track: Better Management through Basic Financial Statements* can help in devloping financial statements to make decisions.

To access the course see: **RightRisk.org** > Courses.

RightRisk News is brought to you by the RightRisk Team

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