

Sample 1. Cash flow budget (by quarter of the year).

Cash inflow	First Q	Second Q	Third Q	Fourth Q
Beginning cash balance	\$5,000			
Sale of crop products		\$50,000		
Sale of livestock products	25,000			
Government payments				\$10,000
Total inflow	\$30,000	\$50,000		\$10,000
Cash expenditures				
Seed	\$10,000			
Fertilizer		\$20,000		
Feed	10,000			
Processing			\$10,000	
Marketing				\$5,000
Capital purchases		10,000		
Interest			5,000	
Debt payments			10,000	
Total expenditures	\$20,000	\$30,000	\$25,000	\$5,000
Quarterly net cash flow	\$10,000	\$20,000	-\$25,000	\$5,000
Cummulative net cash flow	\$10,000	\$30,000	\$5,000	\$10,000

Reasons for Creating a Cash Flow Budget

Think of cash as the ingredient that makes the business operate smoothly just as grease is the ingredient that makes a machine function smoothly. Without adequate cash a business cannot function because many of the transactions require cash to complete them.

By creating a cash flow budget you can project your sources and applications of funds for the upcoming time periods. You will identify any cash deficit periods in advance so you can take corrective actions now to alleviate the deficit. This may involve shifting the timing of certain transactions. It may also determine when money will be borrowed. If borrowing is involved, it will also determine the amount of cash that needs to be borrowed.

Periods of excess cash can also be identified. This information can be used to direct excess cash into interest bearing assets where additional revenue can be generated or to scheduled loan payments.

Cash Flow is Not Profitability

People often mistakenly believe that a cash flow statement will show the profitability of a business or project. Although closely related, cash flow and

profitability are different. A cash flow statement lists cash inflows and cash outflows while the income statement lists income and expenses. A cash flow statement shows *liquidity* while an income statement shows *profitability*.

Many income items are also cash inflows. The sales of crops and livestock are usually both income and cash inflows. The timing is also usually the same as long as a check is received and deposited in your account at the time of the sale. Many expense items are also cash outflow items. The purchase of livestock feed (cash method of accounting) is both an expense and a cash outflow item. The timing is also the same if a check is written at the time of purchase.

However, there are many cash items that are not income and expense items, and vice versa. For example, the purchase of a tractor is a cash outflow if you pay cash at the time of purchase as shown in the example in Table 1. If money is borrowed for the purchase using a term loan, the down payment is a cash outflow at the time of purchase and the annual principal and interest payments are cash outflows each year as shown in Table 2.

The tractor is a capital asset and has a life of more than one year. It is included as an expense item in

an income statement by the amount it declines in value due to wear and obsolescence. This is called depreciation. The cost of depreciation is listed every year. In the tables below a \$70,000 tractor is depreciated over seven years at the rate of \$10,000 per year.

Depreciation calculated for income tax purposes can be used. However, to more accurately calculate net income, a realistic depreciation amount should be

used to approximate the actual decline in the value of the machine during the year.

In Table 2, where the purchase is financed, the amount of interest paid on the loan is included as an expense, along with depreciation, because interest is the cost of borrowing money. However, principal payments are not an expense but merely a cash transfer between you and your lender.

Table 1. Tractor purchase - no borrowing.

Purchase of a \$70,000 tractor, no money borrowed, depreciated over seven years.

	<u>Cash Outflow</u>	<u>Expense</u>
Current Period	\$70,000	
Year 1		\$10,000
Year 2		10,000
Year 3		10,000
Year 4		10,000
Year 5		10,000
Year 6		10,000
Year 7		10,000
Total	\$70,000	\$70,000

Table 2. Tractor purchase - borrowing.

Purchase of a \$70,000 tractor, \$45,000 down payment, \$25,000 paid over five year, seven percent interest, depreciated over seven years.

	<u>Cash Outflow</u>	<u>Expense</u>
Current Period	\$45,000	\$0
Year 1	\$5,000 principal \$1,750 interest	\$10,000 depreciation \$1,750 interest
Year 2	\$5,000 principal \$1,400 interest	\$10,000 depreciation \$1,400 interest
Year 3	\$5,000 principal \$1,050 interest	\$10,000 depreciation \$1,050 interest
Year 4	\$5,000 principal \$700 interest	\$10,000 depreciation \$700 interest
Year 5	\$5,000 principal \$350 interest	\$10,000 depreciation \$350 interest
Year 6	\$0	\$10,000 depreciation
Year 7	\$0	\$10,000 depreciation
Total	\$75,250	\$75,250

Other Financial Statements

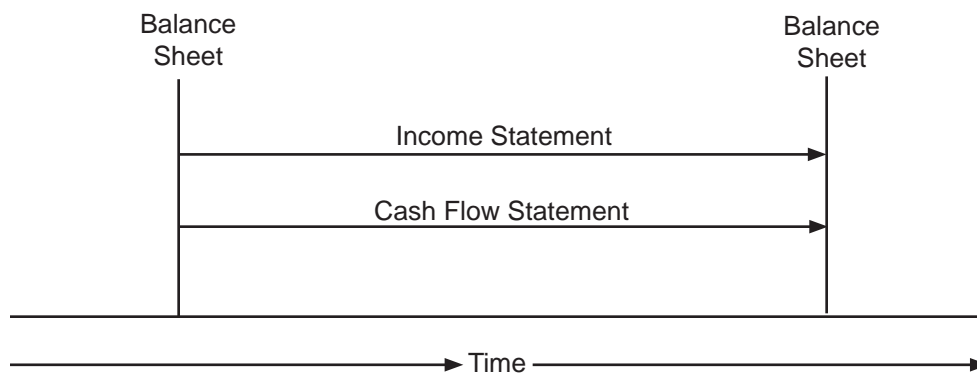
A cash flow statement is only one of several financial statements that can be used to measure the financial strength of a business. Other common statements include the balance sheet or **Net Worth Statement** and the **Income Statement**, although there are several other statements that may be included.

These statements fit together to form a comprehensive financial picture of the business. The balance sheet or net worth statement shows the solvency of the business at a specific point in time. Statements are often prepared at the beginning and ending of the accounting period (i.e. January 1). The statement records the assets of the business and their value and the liabilities or financial

claims against the business, i.e. debts. The amount by which assets exceed liabilities is the net worth of the business. The net worth reflects the current value of investment in the business by the owners.

The income statement is a dynamic statement that records income and expenses over the accounting period. The net income (loss) for the period increases (decreases) the net worth of the business (as shown in the ending balance sheet versus the beginning balance sheet).

Figure 1. Integrated financial statements.



A complete set of **Financial Statements** (*Decision Tool*), including the beginning and ending net worth statements, the income statement, the cash flow statement, the statement of owner equity and the financial performance measures is available to do a comprehensive financial analysis of your business.

To help you assess the financial health of your business, **Financial Performance Measures** allows you to give your business a check-up. **Interpreting Financial Performance Measures** helps you to understand what these performance measures mean for your business.

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