Cash Flow Budget: What Will It Tell Me?*

How much financing will your farm business require this year? When will money be needed, and from where will it come? A little advance planning can help you avoid short-term shortages of cash. One useful tool for planning the use of money in your farm business is a cash flow budget.

Cash Flow Budget

A cash flow budget is an estimate of all cash receipts and all cash expenditures during a certain time period. Estimates are made monthly, bimonthly, or quarterly. Estimates can include non-farm income and expenditures as well as farm items. Cash flow budgeting looks only at money movement, not at profitability. Table 5 (pp. 22-23) provides an example format for a bimonthly cash flow budget.

A cash flow budget is a useful management tool because it:

- Forces you to think through your production and marketing plans for the year.

- Tests your farming plans: will you produce enough income to meet all your cash needs?

- Projects your need for operating credit and your ability to repay borrowed funds.

- Projects when you must borrow money and when you can repay it

- Helps you control your finances. By comparing your budget to actual cash flow, you can spot developing problems because of an unexpected drop in income or unplanned expenses, and spot opportunities to save or invest funds if net cash flow is higher than expected.

- Helps you communicate your farming plans and credit needs to your lender.

Developing a cash flow budget for the first time is never easy. The account totals from last year's records or tax return provide a good beginning point. Notice that Table 5 provides a column just for those totals. Those numbers provide the best evidence you may have of a reasonable estimate for next year for some of the revenue and expense categories. On the other hand, you should estimate many of the values for revenues and expenses based on your plans for the new year. You can find additional information about the development of a cash flow budget in Purdue Extension publication EC-616, "The Projected Cash Flow Statement."

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* Adapted from Edwards, William, "Developing a Cash Flow Budget," *Ag Decision Maker*, C13-15, July 1995, and Edwards, William, "Analyzing a Cash Flow Statement," *Ag Decision Maker*, C3-16, May 1995.

Table 5. Cash Flow Budget

Cash flow budget for ___ _____ Name _____ Date Prepared

	Last Year[1]	Jan.-Feb.	March-April	May-June	July-August	Sept.-Oct.	Nov.-Dec.	Total Projected
INCOME (all sources)								
Livestock sales	$	$	$	$	$	$	$	$
Livestock product sales								
Crop sales								
Government payments								
Custom work income								
Other income								
Capital sales								
New term debt								
TOTAL INFLOW	$	$	$	$	$	$	$	$
EXPENDITURES								
Feed - commercial	$	$	$	$	$	$	$	$
Feed - grain								
Livestock purchases								
Labor	$	$	$	$	$	$	$	$
Mach. & equip. repair								
Gas, fuel, oil								
Machine hire								
Auto, operating								
Utilities								
Fertilizer and lime								
Other crop expense								
Livestock expense								
Building repairs								
Taxes — R.E. & P.P.								
Insurance								
Rent								
Other farm expense								
Life insurance								
Living expenses								
Capital purchases								
Term debt payment due								
Term interest due								
Income tax State								
Federal and								
TOTAL OUTFLOW	$	$	$	$	$	$	$	$
NET CASH FLOW (+ or -)	$	$	$	$	$	$	$	$

[1] Use the first column for last year's totals as a guideline.

Table 5. (Continued)

	Jan.-Feb.	March-April	May-June	July-August	Sept.-Oct.	Nov.-Dec.	Total Projected
CASH TRANSACTIONS							
a) Beginning cash balance							
b) Net cash flow (+ or -)							
c) New operating borrowing							
d) Operating loan repayment — principal							
e) — interest							
Cash balance, end of period (a + b + c - d - e)	$	$	$	$	$	$	$
ACCUMULATED OPERATING BORROWING							
a) Balance, beginning of period							
b) Operating borrowing							
c) Operating principal repayment							
Balance, end of period (a + b - c)	$	$	$	$	$	$	$
ACCUMULATED TERM BORROWING							
a) Balance, beginning of period							
b) Term borrowing							
c) Term principal repayment							
Balance, end of period (a + b - c)	$	$	$	$	$	$	$

Analyzing a Cash Flow Budget Statement

If your total projected net cash flow for the year is negative, there are a number of annual adjustments you can make.

- Sell more current assets (crops and livestock). Be careful here, though. Reducing inventories may solve the cash flow squeeze this year, but result in even more severe problems next year.

- Finance capital expenditures with credit, or postpone them until another year.

- Try to reduce the size of intermediate and long-term debt payments by lengthening the repayment period or adding a balloon payment at the end.

- Convert carry-over short-term debt to intermediate or long-term debt by refinancing.

- Reduce non-farm expenditures, or increase non-farm income.

- Sell intermediate or long-term assets.

Even when your yearly net cash flow is positive, sizable deficits can occur in certain periods. This is due to the seasonal nature of expenses in farming and the tendency to sell large quantities of a product at once. Some types of enterprises, such as dairy, produce a more constant cash flow than other types.

Seasonal adjustments that you can make when projected net cash flow is positive for the whole year but negative for some periods include:

- shifting the timing of some sales,

- shifting the timing of some expenditures,

- increasing short-term borrowing in periods of negative cash flow with repayment projected in periods of positive cash flow (Don't forget to add interest charges to payments.), and

- delaying the due date of fixed debt payments to periods with positive net cash flows.

Some farm business managers operate with a line of credit from their lender, with a maximum borrowing limit, instead of borrowing funds in fixed amounts. You can also use the cash flow budget to test if the need for operating capital will exceed this limit, as shown in the lower part of Table 5.

Review your cash flow budget from time to time during the year. Prices and costs may have been different from your estimates, or your production plans may have changed. Monthly bank statements and canceled checks are a good source of cash flow information against which you can compare your budget. This will help you anticipate changes in your needs for cash and credit later. By planning where you

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are going financially, you can increase your chances of arriving there safely. Cash flow budgeting is an essential part of sound financial management.

A cash flow budget can also be very helpful in evaluating major capital investments or changes in your farm business. Examples are purchasing land, building new hog facilities, or expanding a beef cow herd. Often it will be necessary to develop multi-year budgets: one for a typical business year after the investment or change in the business is complete and one for each intermediate or transition year. Often there is a lag of several months to several years between when you make the initial expenditures associated with capital investment and when you realize the full income potential of the new asset.

Because of the large amount of detailed information in a monthly or multi-year cash flow, you should consider a computerized cash flow generator as an alternative to making all the calculations by hand. A computer program can provide a framework for making the necessary computations. A computer can also ease the number-crunching chores. In particular, it is much easier to make needed adjustments to the cash flow with a computer.

Computerized cash flow generators generally have sub-routines for estimating loan payments and scheduling loans. The best programs of this type include tools for budgeting expenses that typically change from year to year and estimating changes in balance sheet accounts, such as inventories. They also provide monitoring worksheets to facilitate the comparison of the projected cash flows with actual cash flows. The FINFLO program in FINPACK* is a prime example of a computer software program designed for developing monthly budgets for a single year, or multi-year cash flow budgets.

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* See the footnote on page 14 for more information.