The Cash Flow Statement

This statement is also known as the Statement of Changes in Financial Position

Statement of Changes in Financial Position

A statement of changes in financial position reports the sources and uses of cash in a business. The statement of changes in financial position (SCFP) is needed to show the effect of operating, financing, investing, and personal activities on cash over the fiscal period. For example, the sale of a tractor is not shown on an income statement but has an effect on the cash flow of the business (although gains or losses on sales of such assets would be shown on the income statement). It is important to note that the SCFP is not a projected cash flow statement; the SCFP is an historic account of the cash flows through the business, while cash flow projection is an estimate of the changes in financial position for a projected fiscal period.

The four main sections of the SCFP are:

1. Cash flows from operating activities
2. Cash flows from investing activities
3. Cash flows from financing activities
4. Cash flows from personal activities

Cash Flows from Operations

Cash flows from operations are the revenues generated and expenses incurred from the normal day-to-day operation of the farm business, as reported on a cash, not an accrual, basis. Remember, the SCFP is designed to provide information about the cash requirements of the business and to help manage cash resources in the business. Hence accrued income and expenses must be converted back to cash income and expenses before these values can be recorded in the SCFP. As well, non-cash values such as depreciation or amortization on machinery need to be added back into net income. The income statement and beginning-of-period and ending-of-period balance sheets provide these values. The beginning and ending balance sheets are also required in constructing cash flows from investing and financing activities.

A process for calculating net cash flows from operating activities starting with an accrued income and expense statement is shown here:

Accrued Net Income **+** Amortization (Depreciation) expenses - Increase in current assets **+** Decrease in current assets **+** Increase in current liabilities - Decrease in current liabilities
= Net cash flow from operating activities

Or you may simply use the cash income from the farming operations income tax statement, and subtract the cash expenses from the farm's income tax statement. Remember to remove the Mandatory and Optional Inventory Adjustments, and the Capital Cost Allowance amounts from the cash expense amount on the income tax statement. This cash income minus these cash expenses, are the farm's cash from operations for the year.

The statement of changes in financial position, and/or the cash flow statement can report actual results for an historical fiscal period, or projected results for a future projected fiscal period.

Figure A1-3 illustrates a projected Cash Flow Statement. The information carries through from the example we have been working with, and ties in with the net worth statement above and the income and expense statement above. You will note that the opening cash amount is a negative - $ 90,000 whereas the opening cash on the net worth statement was + $ 10,000. The reason for this discrepancy is that we must take into consideration the opening operating loan as well. The farming operation has cash in its operating account; however this cash is there by choice and should really be applied towards the operating loan outstanding to save interest costs. The starting cash position is the opening cash amount minus the opening operating loan amount. In this case that works out to $ 10,000 - $100,000 = - $90,000.

The projected cash flow statement is then broken into the four main cash flow categories that generate or use cash, of operating activities, investment activities, financing activities, and personal activities with the farming business.

Cash Flow Statement	
January 1, 2012 to December 31, 2012	
Cash on hand January 1, 2004:	-90,000
Cash From Operating Activities	
+ Cash Revenue	250,000
- Cash Expenses	-230,000
Cash From Operating Activities:	20,000
Cash From Investment Activities	
+ Capital (Investment) Items Sold / Traded	150,000
- Capital (Investment) Items Purchased	-300,000
Cash From Investing Activities:	-150,000
Cash From Financing Activities	
+ New Term Loan Principal Borrowed	150,000
- Term Loan Principal Repaid	-60,000
Cash From Financing Activities:	90,000
Cash From Personal Activities	
+ Contributions	40,000
- Withdrawals	-30,000
Cash From Personal Activities:	10,000
- Tax Paid	-10,000
+ or - Accounts Payable Differential	-15,000
+ or - Accounts Receivable Differential	-10,000
Closing Cash December 31, 2004:	-155,000

Figure A1-3 The Cash Flow Statement

In figure A1-3 you will note that the cash income reported on the income and expense statement above is shown as the cash income from operations amount in the cash from operating activities below which is $250,000. The cash expenses from operating activities from the aforementioned income and expense statement above is $230,000. It is shown as a negative number as this amount was a use of cash. Cash income minus cash expenses for the period being reported resulted in a cash from operations amount of $20,000 for the fiscal period.

Cash Flows from Investing Activities

Cash flows from investing activities include the purchase or sale of machinery, equipment, and long-term investments such as land, buildings or other long-term financial assets. For example, buying land or machinery represents a use of funds; selling land or machinery represents a source of funds. Other sources of cash include cashing in term investments to use for cash flow purposes. Other uses of cash include payments to purchase shares in other companies, or payments in the form of loans made to others, for example, loaning an employee $30,000 to purchase a vehicle.

In our example in Figure A1-3 above we have the farmer trading in an old combine and purchasing a new combine. They receive $150,000 in trade-in value on the old combine, which is a source of funds to purchase the new combine. They are then purchasing the new combine for $300,000, which is shown as a negative number as it is a use of funds. This transaction has generated a negative cash amount from investing activities figure of - $ 150,000 because the new combine cost this much more than was received as a trade-in value on the old combine.

Cash Flows from Financing Activities

Cash flows from financing activities arise from transactions between the business and its owner(s) or creditors. Financing activities include borrowing and repaying the principal amount on outstanding loans, on both short and long-term debt. Cash inflows include new loans or proceeds from issuing shares, and cash outflows result from repayments of loans or other credit arrangements, and dividend payments to shareholders.

In our Figure A1-3 example above, we had a farmer purchasing a new combine and trading in his old combine. This left them with a shortfall in cash to complete the transaction of $ 150,000. Under the financing activities section of the cash flow statement we have provided for that shortfall. The farmer took out new term loan proceeds of $ 150,000 as a source of funds to pay for the deficit generated under the investing activities. In the use of funds section of the financing activities we have the principal payments that are to be made during the projection period of
$ 30,000 as the current portion of the old debt plus a $ 30,000 principal payment on the new combine loan for the projected year. Total principal payments for the upcoming year are
$ 60,000. This amount is subtracted from the source of funds to generate a surplus of funds under financing activities for the period of $ 90,000.

Cash Flows from Personal Activities

Every farmer has personal activities with their farm business. In fact they should be maintaining separate Financial Institution accounts for business and personal activities to enable simpler accounting of business and personal transactions undertaken during a fiscal period. Any personal activities done with the farm business that use or provide cash are accounted for on the cash flow statement under personal activities. Sources of funds under this section are called “Contributions” and uses of funds under this section are called “Withdrawals”.

In the example shown in Figure A1-3, we see contributions being made of $ 40,000 and withdrawals being made of $ 30,000. The contribution in this case is from off farm income. The farmer is depositing all net proceeds from their off farm job into the business account as a contribution. The withdrawals shown are for the farm families’ everyday living costs over and above any cash wages that may have been paid to the family members under operating activities. The net benefit of personal activities on this farm for the projected period is $ 10,000. This contribution of cash is used in the farming operations for the year.

Other Activities that Generate or Use Cash

In Figure A1-3 you will note a section where other activities that affect cash are reported. In other cash flow or SCFP statements the cash from operations amounts could be after tax. They may have already had the cash implications for accounts receivable and accounts payable accounted for. In this cash flow statement we have shown these adjustments in a separate section to illustrate their cash flow implications.

Cash income tax paid is of course a use of cash. In the example above $ 10,000 was paid by the farm in income tax, and is shown as a negative number as it was a use of funds.

Accounts receivable can also be a use of cash, or a source of cash. The accounts receivable adjustment made for each fiscal period is plus the beginning and minus the ending. Usually beginning receivables are received as cash during the fiscal period. The ending receivables in a projected statement have been reported as cash income and thus must be subtracted in the accounts receivable adjustment, as the cash had not been received. Normally on a SCFP statement you will see an adjustment for an increase in receivables as a negative adjustment to cash, and a decrease in receivables as a positive adjustment to cash, for the fiscal period being reported.

In the Figure A1-2 example above opening receivables were $ 25,000 and closing receivables were $ 35,000. The cash flow adjustment for accounts receivable is plus the opening and minus the ending. There was an increase of $ 10,000 in receivables for the period and this shows up in the Figure A1-3 cash flow statement as a negative - $ 10,000, or in other words as a $ 10,000 use of funds for the period being reported.

Accounts payable is usually a source of cash to obtain goods and services from a supplier. In the cash flow statement the adjustment may be a use of funds or a source of funds for the period being reported depending on what happened. Beginning payables are usually paid for during the course of a fiscal period and ending payables are a source of funds for the fiscal period being reported. Thus the cash flow adjustment shown on a SCFP for accounts payable is minus the beginning amounts as these used cash during the period, and plus the closing amounts as these were a source of cash for the fiscal period being reported. You will see an adjustment for an increase in payables as a positive adjustment to cash, and a decrease in payables as a negative adjustment to cash, for the fiscal period being reported.

In the Figure A1-2 example above opening payables were $30,000 and closing payables were $15,000. The cash flow adjustment for accounts payable is minus the opening and plus the ending. In this example therefore there was a decrease of $ 15,000 in payables for the period. This shows up in the Figure A1-3 cash flow statement as a negative - $ 15,000, or in other words as a $15,000 use of funds for the period being reported.

Reporting of a Businesses Cash Flow Results or Cash Flow Projections

Cash flow statements may be reported in one-page summaries, or in a multi-page detailed analysis. Cash flow for a fiscal period in the SCFP is usually a summary on one page in the set of financial statements being reviewed. Projected cash flows may also be reported in a one page annual summary. To be more accurate however one should do a monthly cash flow analysis. One of the main functions required in reviewing financial statements for management purposes, is calculating what the operating loan requirements will be for the farming operation in the upcoming year.

Farm businesses usually require large amounts of cash in the spring for crop planting purposes, and have large sources of funds in the fall from cash crop sales. Feedlot operations usually require large sums of cash to purchase feeder cattle in the fall and receive large amounts of cash in the spring when the feeder cattle are sold. Both of these examples illustrate that farming operations traditionally need operating funds at some points during their business cycle. By doing a monthly assessment of their cash flow requirements you will note the month with the largest shortfall amount and the months with the largest surplus amounts.

Knowing this information will allow you to get pre-approved and provide your farm with the operating funds they will require for the upcoming projection year. You will also note the months that there will be surplus funds in which to schedule their loan payments. The ABA (Agricultural Business Analyzer) program will do a projection and credit proposal for your farming operation. As part of the ABA program entries you should be completing a monthly cash flow statement. You can download ABA at the following website:

http://www1.agric.gov.ab.ca/$Department/softdown.nsf/main?openform&type=ABA&page=information

Interconnectivity of the Financial Statements – Cash Flow Statement

The statement of changes in financial position, or SCFP, in an historical basis provides a report of the cash transactions for the fiscal year that was recently completed. In this scenario the information on the opening net worth, closing net worth, and income and expense statement is known. In this case the SCFP statement receives its opening cash flow balance from the opening net worth statement. The cash income and expenses from operations for operating activities are collected from the income and expense statement.

Investment activities for the year will show up on the closing net worth statement, and information details on these activities will have to be gathered from the borrower to complete the investing activities section of the SCFP. As well you will have to get the details on any financing that was received to help out with the investing activities undertaken. These new loans will show up on the closing balance sheet. Once the details are known on the financing activities this section of the SCFP can be completed.

Tax paid during the year for last years tax owing will be known and accounted for on the SCFP. The cash implications of opening and closing accounts receivable and payable will be accounted for under the operating activities of the SCFP statement. Once all of these activities have been accounted for on the SCFP the closing cash balance calculated should match the balance in the FI operating account minus the operating loan balance as of the farms' fiscal year end date. These balances will be reported on the closing balance sheet.

When one is completing a projection for the upcoming year the cash flow statement is very important. For the projection period we will have the closing net worth statement for the previous year. This becomes the opening net worth statement for the projection year. Operating activities are estimated in the production plans and summarized in the projected income and expense statement. The cash implications of these activities are reported in that section of the projected cash flow statement. Projected capital purchases and sales are reported in the investing activities section and financing activities, new loans being advanced and loans being repaid are reported on those pages. There should be sections in the cash flow statement to show monthly withdrawals for family living costs and contributions to the farm. The cash flow allocation for income tax is applied to the proper month, and an annual adjustment is made for closing accounts payable and receivable.

Once all of the entries mentioned in the paragraph above have been made, the pro-forma, or closing, net worth statement for the projection period can be calculated by the financial analysis software you are using. In this example we mentioned using the ABA (Agricultural Business Analyzer) template to create a projected production and expansion plan for the farm. This software financial projection program can be downloaded from the Ropin' the Web Alberta Agriculture website. However, it is important to note that the opening net worth statement information, the projected income and expense statement information, and an accurate and detailed monthly cash flow statement is required for the ABA program to be able to do all of the calculations necessary to produce a closing net worth statement for the projection period.

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