Getting full value from a cash flow budget

Kevin Connolly,

Teagasc Financial Management Specialist

kevin.connolly@teagasc.ie

In a previous article I set out the reasons why completing a cash flow budget is important and I also went through the steps involved in putting a budget together.

In this article I will explain how to:-

- Use the budget to create a **cash management plan** for the year ahead to help you manage your cash better
- Use the budget as a target plan against which you can **measure your progress** as the year progresses
- Use cash flow records as an accurate source of information to **complete a Teagasc eProfit Monitor** for the farm

Tweaking the budget

Your completed cash flow budget should be a plan of how you predict money is going to flow in and out of the business (through your bank account, merchant account or pocket) during the year. There will be months where Net Cash Flow (NCF) will be positive (always a good thing) and no doubt other months where NCF is negative (not so good but not unexpected in certain months). These ups-and downs in NCF will feed through to the monthly Current Account balance which is a measure of your available funds to run the farm from month to month. Showing a red (negative) current account balance in certain months is not unusual for most businesses.

However if your budget shows up months where there is clearly a lot more going out in payments than is coming in via receipts then you should take a closer look to see if you can better manage the money flow to try and reduce the monthly cash shortage.

Some options to look at here include..

- Rearranging loan repayments so that they are made in months where there is more cash coming in – the months of October to December normally show a lift in money-in due to the single farm payment so some of the major repayments could be left to that period of the year
- For large merchant account balances, make a staged payment over a number of months rather than a full payment. This is provided your supplier is in agreement and won't change any interest for late payment
- Arranging that any saved funds siphoned off during the year can be fed back in to boost cash flow in months where actual cash flow is tight.

Remember it is better for you to identify when is the best time to make major cash payments and then come to an arrangement with your suppliers or lender. In some cases it may be better to pay for goods on the day, provided you have the cash, as this may allow you to negotiate good cash discounts and may help you to keep tighter control on overall farm spending.

Identifying short term credit needs

Even after tweaking the budget and optimising the best time to make payments there will still be months where cash flow is tight. Most businesses arrange a source of short term credit to cope with these periods. Short term credit comes in the form of a bank overdraft or stocking loan. The secret to using these forms of credit is to always ensure you have enough in reserve but to only use as much as you need at any given time.

You should be able to easily identify what your overdraft or stocking loan requirements will be from the budgeted monthly account balance. By making sure you have arrangements in place to cover the maximum negative current account balance you will avoid excessive bank charges which chip away at your available cash. If there are particular months where you have very high individual payments to deal with then consider arranging a stocking loan instead of an overdraft to cover this. Stocking loans have the advantage of lower interest charges but are less flexible and usually must be repaid in full after a given length of time.

Records for you to use

The cash flow budget is a plan and like any plan for it to be effective you need to refer to it on a regular basis. You also need to measure your progress against it and that is where cash flow recording comes in. A lot of records that are kept by farmers are there for others to inspect. Your cash flow budget and cash flow record is one set of records that you will be inspecting yourself.

Recording your cash flow on a regular basis

- should be done by YOU,
- for YOU and
- YOU should use it to help set your farm on the right track for a successful year.

Keeping a cash flow record involves simply recording the movement of money in and out of the business on a regular basis.

Golden rules of cash flow recording

- Keep all the farm paperwork in the one place
- Identify a recording system, either computer based or paper based and become comfortable using it
- Set aside time every month for the recording job
- Regularly compare your actual against the budget and understand the reasons why they might be different

Cash flow recording made easy

The first requirement for keeping usable cash flow records is to put in place a simple but effective way of gathering together all the paper (i.e. delivery dockets, invoices' statements, bills) associated with the business. The simplest way of doing this is to have a dedicated drawer, tray or other container in the house or office as a collection/storage point. All farm related invoices, receipts, delivery dockets and statements should be removed from the yard, from trouser/ boiler suit pockets or from the jeep/ tractor and put in the dedicated container. Also it's a good idea to keep the farm cheque book in this same box or drawer when you're not using it. Deal with all letters on the day they arrive and keep a stapler (and a bin!) handy. When you get a statement from a supplier, head to your farm records box, dig out all the invoices listed on the statement and staple them to the statement. That way you'll know you'll be easily able to link the figures on the statement with what was purchased. If you are regularly writing cheques then you should be getting a bank statement at least once a month – to fit in with your monthly cash recording ideally you should get this at the beginning of each month. You may be able to get the statement via email or you can use online banking to view it. Whatever way the statement and yourself cross paths you should study all the bank money-ins and outs carefully.

The second obvious requirement is a way of pulling these records together so that you can make sense of what the figures are telling you. As I mentioned in the last article you can use the Teagasc Cost Control Planner for both preparing the budget and the job of regular recording. This Planner has easy to use reports which will allow you to compare the budget against the actual. Contact your Teagasc adviser for more information on the Cost Control Planner. There are also other options including the farm software from Agrinet/ IFC and Kingswood and IFAC accountants also provide a cash flow analysis service. If none of those are suitable then there is always the pen & paper.

Keeping on top to keep in tune

The key thing with cash flow records is a regular routine for doing the recording. This little & often approach is important for two reasons

1. Regular recording means that there will never be a build-up of transactions to record
2. It will also mean that you will be looking at your overall cash flow regularly which will allow you to react quickly where you see yourself running into a cash shortage

Ideally you will be updating your cash flow on a monthly basis. Set aside time on a fixed day every month for the job. A good day to set aside for this is the day after the monthly bank statement arrives. With the statement and the contents of your records store to hand you should then have all the information you need to be able to update the records for the last month.

Think cash at all times

Remember you are tracking the movement of cash so only record a transaction whenever you receive or part with money either by cheque, cash or electronically. For example if you order a load of feed in February and you pay for it in March you record the payment in March. Don't forget to check your bank statement for the direct debits, standing orders and bank charges as these also need to be noted. Another big benefit of regular recording of money-in & money-out for the year is that come the year end you will have all the information you need for a detailed financial analysis of the business using the Teagasc eProfit Monitor. Even those watching cash flow carefully during the year find that the eProfit Monitor analysis gives them a good indication of what area they need to target to improve in the year ahead. See panel on eProfit Monitor on this page for details.

Comparing against the budget.

The cash flow budget you put together was your plan of what you thought would or what you wanted to happen during the year ahead. As you complete your actual cash records each month you will easily see whether you are on track versus your budget or not. Unless you had a crystal ball when you were putting together your budget (and an accurate one at that) there will be differences between the budget and the actual. Carry out the comparison each month after you complete your monthly cash recording, note the difference between the budget and the actual and most importantly trace the reasons for the differences

Ask yourself the following…

- Is the difference due to a "wide of the mark" budget?
- Is the difference due to something beyond my control – an unexpected price change or emergency spending need?
- Is there some thing which was or was not done which caused the actual not to match what was budgeted?
- Do I need to recheck the overdraft or stocking loan requirements as a result of the difference to ensure they will cover any increased shortfall of cash?
- Can I make any changes for the next few months which will bring the actual back in line with the budget?

By challenging yourself to come up with answers to these questions you will be well on the road towards managing your farm business for maximum profit. This will ultimately ensure that your business will remain viable by generating enough cash to meet your daily requirements for cash for both the business and the farm family. It might also help you create a cash reserve to help fund future business development.

Summary

I often look at cash flow as being the only true measure of whether what you are doing day-to-day is a success. Running a farm involves carrying out daily jobs – some big some small, some easily measured some not. But everything you do will eventually filter down to one common measure – cash.

By using cash flow budgets and cash flow recording in tandem you will be clearly focused on the overall direction of the farm business and be in a better position to steer it on the most profitable course.