

## Are you planning for profit or hoping for profit??

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Some people throw budgeting, dieting and visiting the dentist into the same category – they know its good for them but they would rather not bother, thanks all the same! However like most jobs that we think of as troublesome it can often be only the first step that's the most difficult. The budget is really a plan or map, using euros, of how the business will operate during the year ahead. Every business, farming or otherwise, operates to some class of a plan. For most it is a simple matter of a certain number of cows, litres, acres, cattle, ewes, tonnes for the farm for the year. A cash flow budget is simply looking at these plans in the form of money in and money out using euros as the common measure.

### **How will a plan help?**

Having done a cash flow plan you will be more in tune with what happens to farm cash. You will know when & how much cash comes in and leaves at different times of the year. You will be able to plan ahead for times when you think cash may be tight and also be able to plan for when extra money is available. Going through the job of putting a budget together alerts you to what you need to watch for during the year.

### **People use budgets in different ways.**

People who use cash budgets always say that they never had a good grip of their business finances until they started to use a cash budget.

Some people use cash budgets as a monitoring tool – *'I expect it to be like this. Is it as I expected and if not why not?'*

Some people want to see when they might have a shortage or even spare cash at various times during the year. They can then manage this in the best way possible.

Some use the budget to set financial targets or goals – ‘*I plan to spend €8000 on purchased feed this year – this will reduce my spending on feed by €1,000*’. What can this €1,000 be used for?’

### **Not an exact science**

Preparing a cash flow budget is not or never will be an exact science. Farm product & input prices are always on the move and there are always unexpected jumps & falls in both, which can throw the best thought out plans off the rails. The important thing is not to get bogged down in the detail but to map out the main money movements and take it from there. What we look to do in a plan is to make our best attempt to weigh up what might happen with money flow and then use this to compare against what actually happens during the year.

### **A suggested way of doing it**

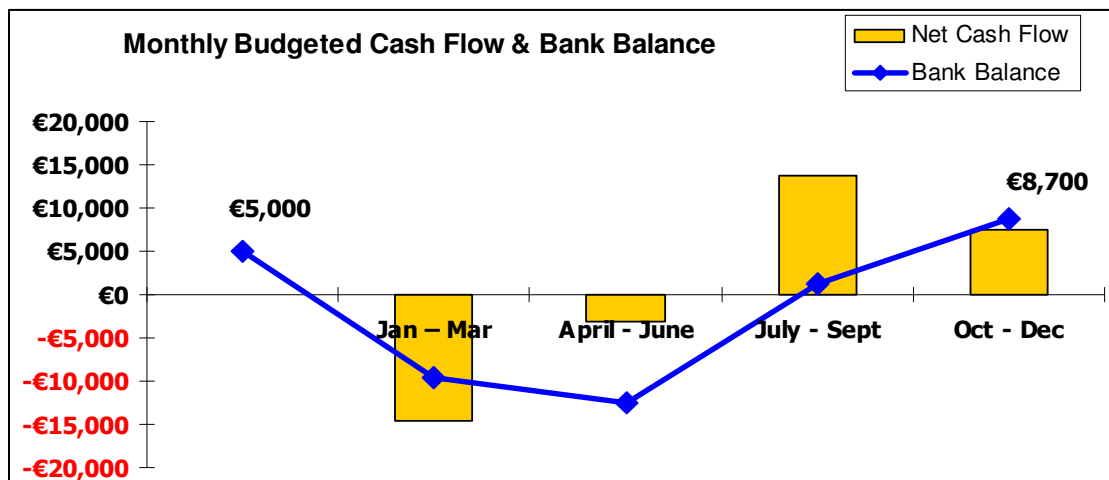
*The time:* set aside time during the day for this job – don’t leave it until the late evening. These types of jobs always look better in daylight. Set aside an hour or 1 ½ hours to start with. If you get a head of steam built up and feel its coming together very easily then keep going. If you’ve had enough after the 1 ½ hour stint, then put the budget to one side but make the promise to come back to it as soon as possible.

*The place:* set yourself up to do this beside where you have the farm records kept i.e. close to the filing cabinet. You will need to be able to easily put your hands on bank statements, sales dockets or statements, cheque books & invoices.

*The tools needed:* You have options here – you can stick to the pencil, paper & calculator which will do the job for most. For the layout and some of the headings see example below.

## Example of a Quarterly Cash Flow Budget

	Year	April -	July -		
	Total	Jan – Mar	June	Sept	Oct - Dec
<b><u>RECEIPTS</u></b>					
Farm Sales	€57,000	€7,000	€15,000	€25,000	€10,000
SFP/ REPS/					
Other Premia	€18,500			€3,500	€15,000
<b>Total Receipts</b>	<b>€75,500</b>	<b>€7,000</b>	<b>€15,000</b>	<b>€28,500</b>	<b>€25,000</b>
<b><u>PAYMENTS</u></b>					
Purchased Feed	€11,500	€3,500	€3,000	€2,000	€3,000
Fertiliser	€3,400	€1,200	€2,200		
Veterinary expenses	€1,100	€400	€500	€100	€100
Land lease/ rental	€1,200				€1,200
Loan Repayments	€9,600	€2,400	€2,400	€2,400	€2,400
Living Expenses & Tax	€45,000	€14,000	€10,000	€10,250	€10,750
<b>Total Payments</b>	<b>€71,800</b>	<b>€21,500</b>	<b>€18,100</b>	<b>€14,750</b>	<b>€17,450</b>
<b>Net Cash Flow</b>	<b>€3,700</b>	<b>- €14,500</b>	<b>- €3,100</b>	<b>€13,750</b>	<b>€7,550</b>
<b>Bank Balance</b>	<b>Beginning</b>				<b>Final</b>
	<b>Balance</b>				<b>Balance</b>
	<b>€5,000</b>	<b>-€9,500</b>	<b>-€12,600</b>	<b>€1,150</b>	<b>€8,700</b>



If you have a computer and even if the “L plates” are still displayed on it then you can still use very simple computer-based guides to help you put together your budget. There are a few computer programmes available to do this and Teagasc has its own – the **Cost Control Planner**. See details at the end of this article about how to get a copy of the Cost Control Planner.

### **Setting out the budget**

For a cash flow budget to become a useful reference for you during the year then you need to break it down month by month or at the very least by quarter (3 month period). This may seem like a lot of work but, even though it will take time to break the figures down by month or quarter, when you are finished you will have a constant point of reference to check on at the end of every month. Remember the purpose of the plan is to give you control of your cash and to do that you need to check on your progress on a regular basis – at least once a month is ideal.

### **Starting the process**

The biggest obstacle to preparing a budget is often the start. Looking at a blank sheet of paper or a blank computer screen and trying to work up the courage or enthusiasm to put a few figures down can be the biggest stumbling block. A good start is half the battle so the thing is to make a start and build from there. My advice is to start with the things you know.

What are the money-in and money-out items that you know are going to happen at certain times of the year? – some examples I can think of here are

- Single farm payment/ REPS/ Compensatory allowance payment  
/ Suckler Welfare payments
- Electricity/ Phone payment
- Contractor
- Insurance for farm & vehicles
- Accountancy & advisory fees
- Land lease or rental payments
- Labour costs

- Loan repayments and machinery lease or hire purchase payments
- Family drawings including mortgage payments, health insurance & pensions

Plug these into the budget in the month you think each receipt or payment will take place. Use your knowledge of what happened in the year just gone by as a guide. Don't worry about trying to predict what the figures will be with 100% accuracy. Just get a figure down for each item and move on to the next one. Some of these transactions will be more or less the same as last year in both their timing and the amount. **As you go you can and should discuss the assumptions you are making with your adviser or others by the phone and run any difficulties you have with them.**

The family drawings figure could be one that could cause you to throw your hands in the air in frustration as you may have no idea how to put a figure on this for the year ahead. But keep the faith – again start with what you know. How much does it cost for groceries for the house for the week? When do you normally get a fill of heating oil or gas? If you have a mortgage then what is the monthly payment here? Do you have health insurance- when is it paid?

If you specifically want to look at household spending and analyse it in greater detail then Teagasc have a **Household Budget Planner** which will help you to do this.

After pulling together figures for each of the headings above then you should be able to see the budget taking shape. The next job is to build into the budget all the other money in and money out items.

### **Building up the budget**

Including a figure for farm sales is going to have the biggest impact on most budgets. The cash figure you put in for sales in each month is going to be determined by the amount sold and the price received. There will be estimation required for both of these but you should be able to make what is called an educated guess. For the volume you can base your prediction on the number of litres, animals, tonnes sold last year and change it up or down based on what you plan to sell for the year ahead. As regards the price this is going to be another guess – try to base it on what is realistically likely to the farm gate price. When deciding how to split the euro sales

figure across the months then again use your knowledge of the way sales went in previous years to guide you.

The following is one method of budgeting milk sales for the year ahead

**Step 1 – *How much milk will be sold this year and at what average price?***

300,000 litres of milk sold at an average price of 24 cent per litre  
= 300,000 X €0.24 = €72,000 of milk sales for the year

**Step 2 – *When do we expect our peak milk month to be?***

A herd where 40% of cows calve down in February could expect to supply 14% of its milk in May so take 14% of the total milk sales and allocate it to June (when the cheque will arrive)

An important point to remember here is that you record the transaction in the month when the money is actually paid or received.

**Step 3 – *allocate out the rest of the total milk sales to the months on either side of the peak milk cheque month***

An alternative way of doing this is to look at your milk supply for last year, work out the % of total milk supplied in each month and apply that to your projected milk sales for the year ahead.

The process of thinking through how to allocate these sales will have helped you clarify the way the farm generates money through its sales. When you start recording what actually happened as the year progresses you will be able to check back to see how accurate you were in your budget.

For the drystock & tillage farms where sales are more seasonal you will again have to estimate numbers and price and plug the figures into the budget in the expected month that you will receive the money for these sales. You can also take the same approach with livestock purchases by estimating numbers and price paid.

### **Plugging in the expenses**

Moving onto the main expenses such as purchased feed, fertiliser, veterinary, seed & sprays and other sundry costs then once again you use your know-how about how these were paid in previous years to come up with a figure and a month when these will feature in your budget. For a lot of these expenses there may be a carry over of outstanding bills to be paid from this year into next year. A recommended approach here is to deal with the expenses for the budget year first i.e. assume a clean slate for all expenses and budget for paying for all expenses incurred from 1<sup>st</sup> January. When you have that done then revisit the budget after 2009 has ended and look at the outstanding bills remaining and work in the repayment of these into the early months of 2010 if it is possible to manage it.

This might seem like a lot of work but keep in mind the end result which will be a clear plan for how you expect money to move through the business for the year. If you find yourself getting bogged down by the numbers & prices then put in a quick estimated figure and move on. Most farmers I have talked to about budgeting agree that it is better to have an almost complete monthly budget done for the year within an hour of starting, using a lot of estimation, than spending an hour getting a couple of income or expense items correct down to the last euro. The main thing to remember about any budget or plan is that you will always have the option of refining it or improving it at any stage.

**You should also make use of the expertise of your adviser when you are budgeting. Use your adviser to trouble shoot your budget - he or she will quickly spot potential problems and areas in the budget where you might be wide of the mark in your predictions. Your adviser will help you to decide what is achievable and how you go about putting your budget to work.**

### **What you should have when you are done**

When you are finished working through the various receipts & expenses month by month you should be able to work out (or have already calculated if using the Teagasc Cost control Planner) the Net Cash Flow (NCF) figure for each month. Net

cash Flow is calculated by deducting monthly expenses from monthly receipts. There will be months when the NCF will be positive (meaning a surplus of cash) but there will no doubt be months when it will be negative (a shortage of cash). If you start off with your bank account balance on 1<sup>st</sup> January and adjust it based on the monthly change in NCF then you can identify which months are going to push your overdraft close to, or above its limit. There are a few options here if this is the case but we'll leave that to the next article.

The purpose of the budget is not to try and predict with 100% accuracy what money is going to come in and out of the business bank account for the coming year. Its purpose is to get you, the business owner, to think through your plans and projections for the year using money as the main measure.

The next instalment in this series of articles on managing cash flow will deal with

- Using the cash flow budget to help make decisions
- How to manage cash flow deficits shown in the budget
- Recording actual cash flow for comparison against the budget

#### **Golden Rules of Cash Flow Budgeting**

- ✓ Have a go – you have to try it before you can understand the benefits
- ✓ Don't get bogged down in the detail of numbers and prices
- ✓ Produce a 1<sup>st</sup> draft of the budget as quickly as possible and discuss it with your adviser.
- ✓ Revisit this budget and refine it over a number of drafts

The Teagasc Cost Control Planner and Teagasc Household Budget Planner are available from your local Teagasc office. Talk to your adviser about how to get set up with these two useful planning tools.