

FARM FINANCIAL TOOL: CASH FLOW BUDGET FACT SHEET

SOUTHERN REGION

HOW DO I KNOW IF MY BUSINESS HAS ADEQUATE FUNDS?

Maintaining strong control of the cash flow means **planning** (estimating) and **monitoring** the cash flow. Many farmers and banks would say cash flow is **KING** and that is why a cash flow budget is so important!

KEY POINTS

- Cash flow is a financial 'tool' that tracks cash availability to the business, known as 'Liquidity'.
- A positive cash flow is where more money comes into the business than goes out.
- Cash flow is a key measure to show banks whether the business can service its debt.

Key Management Concepts

When managing any business, it is good to have both of the following concepts in mind:

- 1. Liquidity** – This refers to cash flow which should be managed to ensure more cash comes into the business than goes out.
- 2. Efficiency** – This addresses the issue of whether the farm business is getting the best return on the capital being managed, and is measured through both a profit and loss and a balance sheet budget.

By managing both of these concepts (see Figure 1), the farm business will have a greater ability to be sustainable.

What is a Cash Flow Budget?

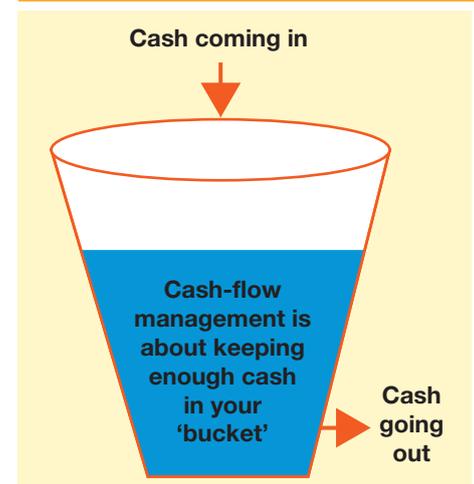
Simply, a cash flow budget measures the amount of money (cash) coming into a business, against what goes out and when. It can be measured as an annual budget, but more commonly it is a one to two-year monthly budget. It is one of the simplest concepts in farm business management, and probably the most used by Australian farmers. Figure 2 provides a simple illustration of how a cash flow works.

Why use a Cash Flow Budget?

Banks value monthly cash flow budgets from farmer clients as they provide two essential pieces of information:

1. Does the client have the ability to make loan repayments as they become due?
2. If the client has an overdraft, when will the peak overdraft requirement be and in what month will it most likely occur, so they can plan ahead for credit requirements.

Figure 2 A Business Cash Flow

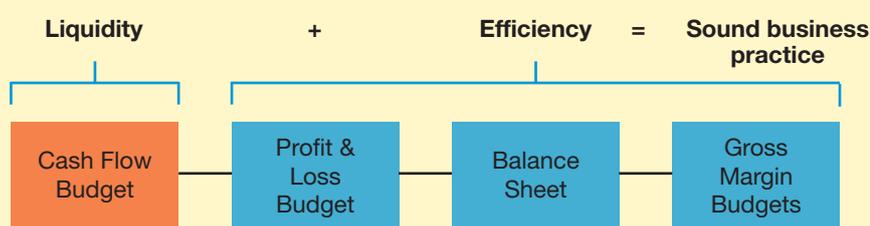


Source: P2PAgri Pty Ltd

As banks value cash flow budgets so highly, farmers have been encouraged to create estimated monthly cash flow budgets. Unfortunately, once farmers have put together this budget and the bank has ticked off all financial questions, it often goes into the farm office top drawer and is not seen again for another year, or until the bank wants another cash flow budget put together for the next season. Quite often this is because the season has turned bad and the bank or the farmer wants to know just how bad, and how much additional overdraft will be needed for the following season.

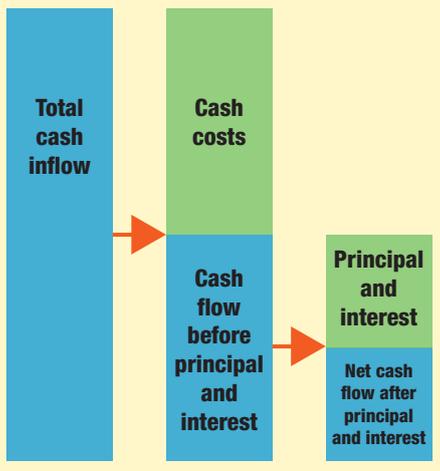
If this is the financial monitoring habit in your farm business, then the bank may be driving your business, rather than you! You may be missing important financial information that can be gained by actually monitoring the cash flow throughout the season and comparing estimated versus actual figures.

Figure 1 Liquidity and efficiency



Source: P2PAgri Pty Ltd

Figure 3 Cash Flow Budget



Source: Assoc. Prof. Bill Malcolm, 'Pursuing Growth without Regret in Risky Crop-Farming'

An estimated monthly cash flow budget provides the following useful information:

- Knowing when income and expenditure are expected to occur.
- Using the cash flow budget to manage payments and income to help minimise the use of an overdraft, and hence decrease overdraft interest costs.
- Providing the farm with an early indicator of how much additional finance might be needed following a bad financial season. The farmer can then be proactive with the bank by looking at additional finance needs early, before other farmers who may be in a similar position.

Figure 3 illustrates a cash flow budget, where the total cash that flows into the farm business is balanced against the cash costs and loan repayment costs (principal and interest). The aim of any business is for the 'Net Cash flow after principal and interest payments' to be positive rather than negative. If the farm business's cash flow is negative for a couple of years, then either business reserves will be needed to maintain business viability, or bank debt will need to grow.

Farm Case Study Estimated Monthly Cash Flow

A cash flow budget will provide the greatest information to a farm business when it involves two steps: a forward estimate of the monthly cash flow, followed by recording monthly actuals against these estimated figures.

Step 1: Estimating Monthly Cash Flow

- The first challenge for farmers is putting an estimate together, as you need to go through each category estimating when

Figure 4 Estimated Monthly Income and Expenses

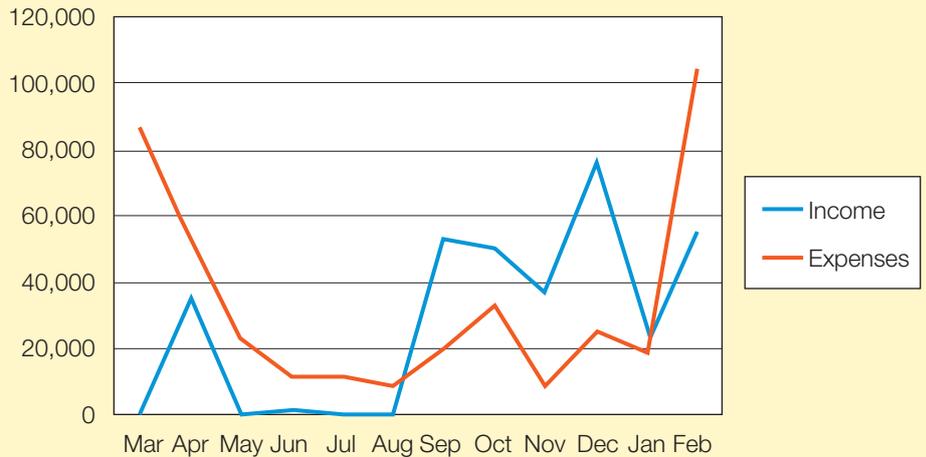
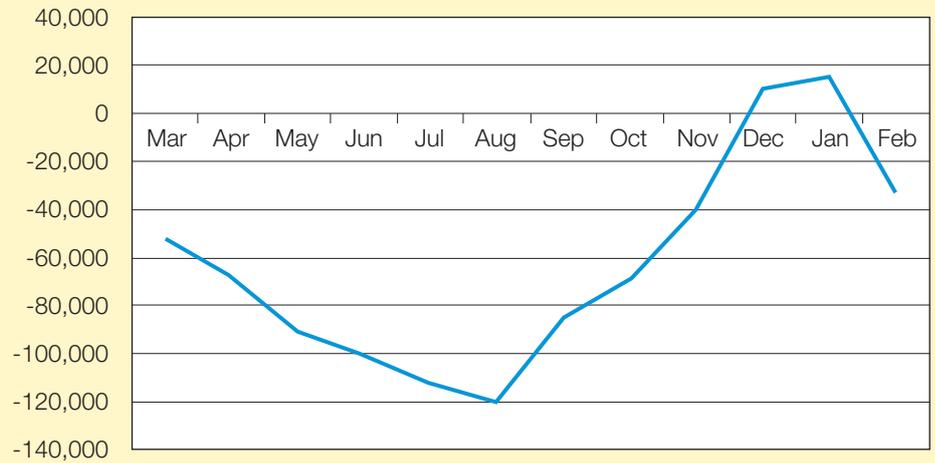


Figure 5 Estimated Monthly Cash Flow



Source: P2PAGri Pty Ltd

income and expenditure will occur. To illustrate this, the cash flow estimate of a farm case study is provided in Table 1.

- The results of this case study's estimated cash flow are summarised in Figures 4 and 5.

Figure 4 shows the 'lumpiness' of the monthly income and the expenses, and that they roughly match-up.

- Figure 5 provides an overview of the estimated monthly cash flow where the interaction of the monthly income is combined with the expenses to show what cash levels are in the business cheque account. If all the income and expenses come out of the one cheque account, then this would show the bank what the overdraft level is expected to be in each month. This provides the bank with a simple tool to monitor the business as the season unfolds.

Note: In Figure 5, the maximum overdraft is \$120,000 and it is expected to occur in August.

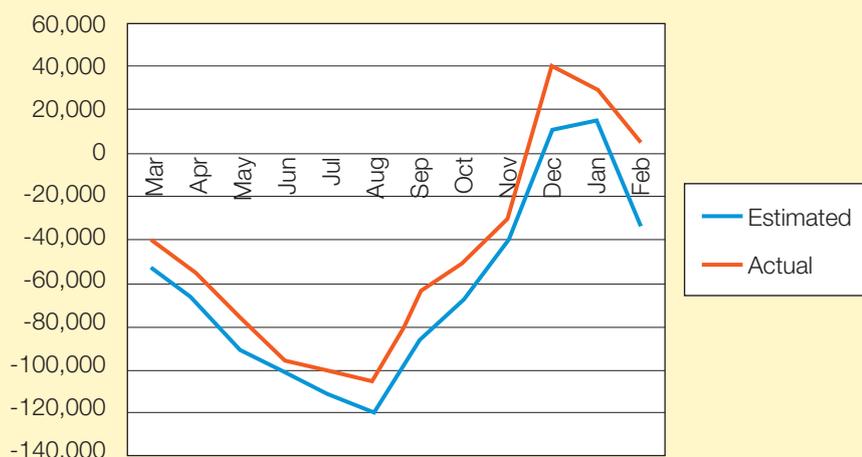
Step 2: Monitoring Actual Cash Flow

- The next challenge for farmers is to actually monitor the monthly cash flow as the season unfolds. Figure 6 shows an expected versus actual monthly cash flow and indicates the season delivered a better outcome than was expected. Monitoring throughout the season is ideally done monthly as the cheque account statement becomes available, or can be done quarterly in line with completing and submitting the Business Activity Statement (BAS) to the Australian Taxation Office (ATO).
- The result in Figure 6 is a typical one. The significant part of the overdraft is used from July to September and is not used again through the summer months, as the grain income begins to enter the cheque account during this period. With this income, the overdraft returns to a \$0 balance, something the bank would like to happen at least once a year. However, in reality, in poor times the \$0 balance

Table 1 Farm Case Study Estimated Cash Flow

		Planned Monthly Cash Flows											
		Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb
Income													
Hard wheat	90,600		35,600								35,000		20,000
Malt barley	50,000										30,000		20,000
Oats	18,000											18,000	
Canola	8,400												8,400
Beans	1,100												1,100
Lupins	800												800
Self replacing merino	134,300							50,000	50,000	34,300			
Prime lambs	20,000										10,000	5,000	5,000
Off-farm	1,000						500				500		
Other farm income	4,000							2,000		2,000			
Interest Earned													
Farm Mangement Deposits (FMD)	3,848	962			962			962			962		
Total Gross Income	332,048	962	35,600	0	962	0	500	52,962	50,000	36,300	76,462	23,000	55,300
Crop Costs													
Seed	6,000	6,000											
Fertiliser	52,000	25,000	27,000										
Chemicals	30,000	10,000	10,000								10,000		
Insurance	215										215		
Fuel & oil	19,000	10,000							9,000				
R&M	10,560	880	880	880	880	880	880	880	880	880	880	880	880
Other	1,560	130	130	130	130	130	130	130	130	130	130	130	130
Livestock Costs													
Purchases	9,800								9,800				
Wool packs	500							500					
Wool freight	400								400				
Shearing	6,000							6,000					
Flock costs	6,000			2,000		2,000	1,000	1,000					
Supplementary feeding	5,500	5,500											
Pasture improvement	17,200	17,200											
Overhead Costs (General)													
General fuel	6,200	1,550			1,550			1,550			1,550		
Accommodation	70				70								
Council rates	768	64	64	64	64	64	64	64	64	64	64	64	64
Council rates parents house	4,360	1,090			1,090			1,090			1,090		
Donations	1,740	435			435			435			435		
Education	55		55										
Electricity Property 1	454			454									
Electricity Property 2	3,336		834			834			834			834	
Private electricity	1,772		443			443			443			443	
Freight	188				188								
Donations	3,915				435	435	435	435	435	435	435	435	435
Farm and personal insurance	25	25											
Levys wool	14,000			10,000							4,000		
Office expenses	57					57							
Postage	90			90									
Stationary	100			20			20		20	20			20
Other office expenses	10	10											
Professional fees - accounting	600	200			200			200					
Property improvements	1,800		1,800										
Property repairs and maintenance	2,800			2,000					800				
Registration	150	150											
R & M farm and house	2,400	200	200	200	200	200	200	200	200	200	200	200	200
Water	1,000				500					500			
Selling expenses	680	170			170			170			170		
Stock fee	420	35	35	35	35	35	35	35	35	35	35	35	35
Subscriptions	1,300								1,300				
Telephone	1,200		200		200		200		200		200		200
tools and equipment purchase	3,120	260	260	260	260	260	260	260	260	260	260	260	260
Vehicle repairs	5,000		2,500						2,500				
Building	4,200	700		700		700		700		700		700	
Clay spreading	1,000		1,000										
Workshop expenses	2,000	2,000											
Workcover	880		440						440				
Family cash drawings	60,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000
Loan Repayments (Interest + Principal) & Lease Costs													
Existing Farm Loans													
Bank 1	30,000												30,000
Airseeder bar and boomspray	31,949												31,949
Tractor 9050	22,495												22,495
New Farm Loans													
	0												
Existing Off-Farm Loans													
Real estate	0												
New Off-Farm Loans													
Real estate	0												
Land Lease + Interest (Other)													
Leased land	0												
Overdraft & stock mortgage	1,860	155	155	155	155	155	155	155	155	155	155	155	155
Bank fees	0												
Total Gross Costs	398,284	86,754	50,996	21,988	11,562	11,193	8,379	18,804	33,051	8,379	24,819	18,536	103,823
Net Inc (dec) in cash held	-66,236	-85,792	-15,396	-21,988	-10,600	-11,193	-7,879	34,158	16,949	27,921	51,643	4,464	-48,523
Cash held at beginning of period	55,000												
Overdraft at beginning of period	21,949												
Total Cash at beginning of period	33,051	33,051	-52,741	-68,137	-90,125	-100,725	-111,918	-119,797	-85,639	-68,690	-40,769	10,874	15,338
Total Cash at end of period	-33,185	-52,741	-68,137	-90,125	-100,725	-111,918	-119,797	-85,639	-68,690	-40,769	10,874	15,338	-33,185

Figure 6 Expected versus actual cash flow



Source: P2PAgri Pty Ltd

in the overdraft may not occur. This is when communication with the bank is essential to revise expectations.

Additional accounting thinking

When undertaking a Cash Flow budget, a number of accounting processes need to be kept in mind:

- **How to handle Goods and Services Tax (GST)** – Technically, the impact of GST should flow through the business. However, as income and expenses usually do not line up in a farming business, there will be times when GST will need to be paid to the ATO, and other times when the ATO refunds the GST. This does have an impact on the cash flow and should be accounted for in cash flow estimates. However, farmers often complete the estimated cash flows without assessing the impact of the GST. So, either:

- (1) include the GST estimate, which means you will be using GST inclusive numbers in the budget, or
- (2) do not allow for GST and use GST exclusive numbers. If using this method, keep in mind that you will need to pay GST with some BAS statements.

Just make it clear which method you have used.

- **Keep farming years in mind** – While the ATO requires farmers to report their tax returns annually over a financial year (July – June), the monthly cash flow can be reported with a different starting month. Usually, it is normal to have the

income and costs of the same season in the one year, so dryland farmers start their monthly cash flow estimates from March each year.

FAQs

Will my bank require a monthly cash flow estimate at the start of each season?

Check with your bank, as not all banks require monthly cash flow estimates. It largely depends on the historic financial performance of the business. However, it is sound business practice to complete an estimated monthly cash flow at the commencement of each season.

Should the cash flow be the only budget I keep on the business?

The monthly cash flow budget is the most common budget kept by farmers in Australia, because banks encourage them to be done. Also, when there are various government schemes assisting during times of hardship, farmers sometimes need to have cash flow estimates to demonstrate eligibility. If a farm's objective is to maintain a livelihood, then a cash flow budget is probably the only budget that is needed. However, if the goal is business sustainability and efficiency, then other budgets such as profit and loss and balance sheets are also needed.

Is there an easier way of calculating the business monthly cash flow budget?

Monthly cash flow budgets are best completed using a computer program.

However, you can use a pencil, rubber, calculator and cash flow templates which are normally available from your bank. There are a number of software packages available to help create a cash flow, ranging from spreadsheets to accounting packages like Phoenix and Agrimaster, or even planning programs like P2PAgri.

What if my monthly cash flow doesn't look good?

Just doing a monthly cash flow is a good discipline. Looking at a poor cash flow can be disheartening but even if it doesn't look positive, at least it is a start to thinking about how can you improve the cash flow. It helps you to objectively focus on strategies to improve the business' financial position.

USEFUL RESOURCES

Related GRDC Fact Sheets

Other fact sheets in this Farm Business Management series provide further detail on farm financial tools: Farm Business Overview (Order Code: GRDC909), Profit and Loss Budget (Order Code: GRDC916), Balance Sheet (Order Code: GRDC917), Crop Gross Margin Budget (Order Code: GRDC914) and Livestock Gross Margin Budget (Order Code: GRDC915).

Copies of all the above fact sheets are FREE plus P&H and available from:

Ground Cover Direct Freephone:

1800 11 00 44 or email:

ground-cover-direct@canprint.com.au

These can also be downloaded from www.GRDC.com.au/fbm

Plan to Profit (P2P), a whole-farm financial management program that can help calculate a farm's financial budgets: www.P2PAgri.com.au

MORE INFORMATION

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