

8.2 A cash flow budget

PRODUCT
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Budgeting

A business plan looks nothing like a tax return and tax returns are not a good guide for planning a business venture since they are always a picture of past events.

What you need is the best guess prediction of future trends and economic conditions. For this you will need a business plan which is a comprehensive written account of what you want to achieve and how you will achieve it.

Your business plan will include a budget which will help you manage your finances, including seasonal fluctuations, tax planning and money for expansion, replacement of plant and fixtures and contingencies.

Your accountant will help you set out the initial plan which you will need if you are to obtain finance, and can also show you a record-keeping system to keep the plan up to date. That way you will always know your cash position.

Preparing a budget

There are three steps in preparing a simple but adequate budget:

1. Prepare an expense budget
2. Prepare a sales budget
3. Prepare a cash flow budget

Microsoft Excel or another spreadsheeting program is perfect for this work.

1. Preparing an expense budget

First you will need to know how much your business will cost to run. Your expenses will fall into three major groups:

1. Start up expenses—such as incorporation, registrations and licences, fit out, signage and painting, equipment purchases, initial purchases of marketing materials
2. Recurring overheads—those expenses which must be incurred simply to keep the business running, and do not go directly into products that you can sell—examples include rent, telecommunications, management wages, advertising, stationery, other marketing expenses, finances charges such as interest and bank fees, and maintenance costs, GST and other tax payments
3. Direct expenses—such as production wages, materials, power and fuel, equipment lease charges, packaging

Estimate what these amounts will be, and enter them into a spreadsheet in the months you expect to pay them. If expenses

are unpredictable, divide them by 12 and allocate 1/12th against each month.

This will give you an idea of the cash you need to cover your expenses month by month through the year.

2. Preparing a sales budget

Now you know what it will cost to run your business, you can calculate what sales you need to make to cover your expenses and provide for a profit.

Start by estimating total sales for the year, but then think about whether there are seasonal peaks and troughs. Allocate your estimated annual sales according to the pattern you predict.

3. Preparing a cash flow budget

You should now be in a position to calculate the budgeted cash flow for each month. Sometimes it will be negative; hopefully it will be positive more often. Knowing, as you do, your starting cash position, you can now estimate how your cash balance will fluctuate during the year. If it ever goes into the red, you will need to arrange finance well in advance to cover the temporary deficit. An overdraft or revolving credit is a typical financing arrangement to cover temporary deficits of this kind.

An example cash flow budget is included in the next few pages.



Keeping track

Once the cash flow budget has been worked out, it is obviously necessary to replace the estimated figures with real figures as they become available during the course of the year. Keep your records up-to-date and review them regularly to ensure that the business is performing to expectations. If you don't keep control of the paperwork you may soon lose control of your business.

A careful record of the real figures will make it that much easier to prepare next year's cash flow budget.

Early warning, early action

If you spot any sign that all is not going to plan you should talk at once to your accountant. She or he may be able to advise you on how to reduce costs, more efficient ways of managing your money or where to obtain better and cheaper finance. This may save your original investment.

Become financially literate!

You may seek much more than money from your business, but the facts are that the language of business is money. If you cannot talk this language you are financially illiterate. Even if maths is not your strong suit, it is most definitely in your interests to learn how to cost your product, calculate profit margins, prepare budgets, and analyse and interpret financial statements—profit and loss statements, balance sheets, and tax returns. The effort will pay off in a much deeper understanding of the dynamics of your own business, and you will be in a strong position to manage your finances day to day and plan for growth.

Books

David Hey-Cunningham, *Financial Statements Demystified* (3rd ed, Allen & Unwin, 2002)

Example cash flow budget

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	Total
INFLOWS													
Savings	25,000												25,000
Loan from bank	90,000												90,000
Loan from parents	25,000												25,000
Sales	5,000	6,000	7,000	8,000	12,000	6,000	6,000	12,000	17,000	20,000	30,000	25,000	154,000
GST collected	500	600	700	800	1,200	600	600	1,200	1,700	2,000	3,000	2,500	15,400
Total inflows	145,500	6,600	7,700	8,800	13,200	6,600	6,600	13,200	18,700	22,000	33,000	27,500	309,400
OUTFLOWS													
Materials	4,200	4,200	4,200	4,200	4,200	4,200	4,200	4,200	4,200	4,200	4,200	4,200	50,400
Rent	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200	14,400
Wages	3,250	3,250	3,250	3,250	3,250	3,250	3,250	3,250	3,250	3,250	3,250	3,250	39,000
Electricity	150	150	150	150	150	150	150	150	150	150	150	150	1,800
Motor vehicle	800	800	800	800	800	800	800	800	800	800	800	800	9,600
Advertising	850	850	850	850	850	850	850	850	850	850	850	850	10,200
Miscellaneous costs	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	24,000
GST paid				-9,345			91			991			-8,264
Owner's drawings	3,500	3,500	3,500	3,500	3,500	3,500	3,500	3,500	3,500	3,500	3,500	3,500	42,000
Fit out, signage	35,000												35,000
Equipment	55,000												55,000
Stationery	5,000												5,000
Total outflows	110,950	15,950	15,950	6,605	15,950	15,950	16,041	15,950	15,950	16,941	15,950	15,950	278,136
Excess of inflows over outflows	34,550	-9,350	-8,250	2,195	-2,750	-9,350	-9,441	-2,750	2,750	5,059	17,050	11,550	31,264
Balance at the beginning	0	34,550	25,200	16,950	19,145	16,395	7,045	-2,395	-5,145	-2,395	2,664	19,714	
Balance at the end	34,550	25,200	16,950	19,145	16,395	7,045	-2,395	-5,145	-2,395	2,664	19,714	31,264	