HOW TO START YOUR CASHFLOW FORECAST

Cash is King!

There are many crucial tasks involved in keeping your business going but one of the most important is making sure all the bills get paid. Without this everything else grinds to a halt.

Whatever plans you have it is vital that you know that you'll have enough cash in the bank; not just next week but in several months time too. This gives you the information you need to make the right decisions and gives you some security about the future which is often difficult to come by.

Where should you start to forecast what might happen in six months time?

A cashflow forecast is a vital tool for managing your business, but it's the decisions that you make as a result of the forecast that's the most valuable part, so there are some tips included along the way to help you make the right decisions to ensure your cashflow is secure.

First things first

1. Often cashflow forecasts are constructed on a spreadsheet. While this is cheap and easy to start and update it also makes them prone to errors; sometimes serious ones.

   It's worth getting help from an expert when you're setting up your forecast to make sure you have information you can rely on.

2. A forecast will only ever be as good as the data that you start with. You need to make sure that your accounts are up to date and correct so that you have information you can rely on.

   There are a range of software options available that connect to your accounts software to make sure the picture is as up to date as possible.

Predicting the future

The first thing to recognise is that we are talking about predicting the future. However much time you spend refining your forecast you are likely to never get it just right.

It's important to remember that the forecast will never finished; it will need to be updated as better information comes along to make sure that it remains reliable.

But we're not looking for accuracy here; it's the general picture that's most important. Do we expect to run into problems paying the bills and when, and what can we do about it?

To get you started here's my list of things to consider, and also some tips on ways to manage your business in order to influence the forecast.

Duration

How far into the future should your forecast run? There is no right answer for this.

The next 12 months is often a good place to start; this gives you a view into the future, but not so far away that you are just guessing at the sales and costs.

It is likely that your information about the very near future will always be more accurate than the picture several months away. Start by using general estimates of sales and costs and then add more detail as it becomes available.

If this forecast is to be a tool to manage your business there is no point in looking at monthly changes: not all payments happen at the end of the month. Instead focus on daily, or at most weekly movements in order to see where danger may be lurking.

Where does the information come from?

Let's start with your everyday trading income and expenses. You can find all of these figures in the Profit & Loss (P&L) report, but the crucial difference about cashflow is **timing**.

Sales

Sales are not usually paid for on the day an invoice is raised. Even retail sales often have a time lag due to credit card/ bank processing times. This needs to be looked at quite carefully as the important thing is to be clear on when the money should arrive in your bank.

For your expected sales; when do you expect the customers to pay? This may be different from the terms on your invoice/ contract, and it may be different for different types of customers/ sales.

Cashflow Management?

Sometimes new customers expect a trade off between price and credit terms: make sure you factor this in when you are considering a deal. An extra month of delayed payment might not be costly, but will not be free.

Alternatively it may be in your interests to offer a discount for early payment, or ask for a payment up front before starting work. The cash is always better in your bank account.

Business Spending

The same principle is true for spending. How long do you take to pay suppliers' bills? Do they invoice every time a purchase is made, or just once at the end of the month? Have you arranged to pay large annual expenses on a monthly basis?

Depending on what you buy in there are a variety of different options; make sure you include each payment at the appropriate time.

Cashflow Management?

This is where the effects of discounts for buying in bulk need to be considered. This could reduce the price per unit and increase profit, but if that paying more up front this may not be such a good deal.

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Staff costs

Remember that the cost of employing staff is split into (at least) three instalments – a payment to the individual, a payment to HMRC for PAYE and NI and then another one for pension contributions.

These all happen at different times of the month and it is important to plan in the payments so that the cash is available when required.

Irregular payments

It is easy to forget to factor in payments that are quarterly, annual or just irregular. This is where adding in a contingency amount for spend that may not have been included elsewhere can come in handy.

> **Cashflow Management?**
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> Stresses on cashflow typically happen when things change: either sales increase or decrease, or profitability reduces. Sometimes these changes are difficult to spot so it is important to keep your forecast updated and refer to it regularly.

Balance sheet items

One of the common reasons why businesses get stuck with cashflow is that they think that making a profit is good enough.

However there are lots of payments that don't appear on the P&L; including these in your forecast makes sure that you have a reliable picture of what's likely to happen.

VAT

VAT can be a big complication in cashflow forecasts because the amounts involved don't appear anywhere on the P&L.

Your customers pay VAT in their sales payments, and then you keep it for 5 weeks after the end of the accounting quarter before paying it over to HMRC. It can be difficult to keep track of and calculate before the VAT return is completed in your accounts, so this is one area where specialist software proves its worth.

However it is still possible to calculate what's going on manually. Just make sure you think it through carefully and remember: not all sales and purchases include VAT.

Loans

Typically loan repayments are predictable, regular and for fixed amounts, so easy to include in a forecast. If you are preparing this forecast as part of a loan application make sure to add in the repayments to show that you can afford to repay the money borrowed.

The same applies to lease payments; make sure they're included too.

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Corporation Tax

Corporation Tax is due on profits before depreciation and certain other charges. This can be difficult to calculate, so I recommend asking your accountant for advice. It is due 9 months and 1 day after the end of your financial year.

Dividends

Dividends appear on the P&L, but usually only after the end of year accounts are completed. Make sure you factor in any payments to Directors and Shareholders that you expect to make to ensure there's sufficient cash available for when it's required.

The bottom line

All of the factors described above detail the changes to the bank balance. Don't forget to include your starting bank balance so you can see how it changes! That's the figure you really need to know.

What next?

Once you have a forecast it gives you a starting point for action. It's not the forecast that's key; it's what you do with it that counts.

This is the time to think about what the forecast is telling you: do you need to make operational changes in order to improve the picture? Should you be looking for finance to support business growth? Or should you be taking the opportunity to invest in new ventures?

Managing business finances and cashflow in particular is key to what Pound Lane Financial Management does.

If you'd like some expert help with your forecast or if you've got other questions then get in touch with Susie:

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