What is a short-term cash flow forecast and why is it important?

A short-term cash flow forecast is a forecast of the cash you have, the cash you expect to receive and the cash you expect to pay out of your business over a certain period, typically 13 weeks. Fundamentally, it’s about having good enough information to give you time and money to make the right business decisions.

Forecasts are important because:

- They provide visibility of your future cash position and highlight if and when your cash position is going to be tight. This enables you to take action in time to get through a liquidity crunch.
- The information is often required by shareholders or banks to assess whether any requested financial support is sufficient or excessive (they will also want to see your budget or business plan for the next 12 months or more).

Preparing a short-term cash flow forecast

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The COVID-19 crisis has brought the importance of cash flow forecasting and management into sharp focus for businesses.

This document explores the importance of forecasting, explains how it differs from a budget or business plan and offers practical tips for preparing a short-term cash flow forecast.

You can also access this information in podcast form here.

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How does a short-term cash flow forecast differ from a budget or business plan?

The income statement or profit and loss account in a budget or business plan includes non-cash accounting items such as depreciation and accruals for various expenses. The forecast cash flow statement contained in these plans is derived from the forecast income statement and balance sheet on an indirect basis and shows the broad categories of where cash is generated and where cash is spent. They are produced on a monthly or quarterly basis.

In contrast, a short-term cash flow forecast:

- Looks at cash coming into and cash going out of the bank accounts and can be directly compared to the transactions on your bank statement.
- Provides a clearer picture of how much money you’ll have in a given week and therefore how much you can afford to pay creditors.
- Helps you to determine whether you need to collect in specific debts owed by customers or delay payments for a week, for example, to be able to make payroll.
- Gives you a much more detailed view of how much money you have and how much time you have to fix any liquidity problems that may arise.
How do you prepare a short-term cash flow forecast?

There are five key steps:

1. Start with what you know – unwind your opening balance sheet

   - Start with the cash balance in your accounting system and reconcile it to your bank statements.
   - Use the information you have on customers that owe you money (typically aged trade debtors list) and estimate when they will pay you. You can estimate this based on average payment terms, or by looking at historic trends for your largest customers, or any other method that makes sense. If you think that customers will delay paying you, defer the cash receipt to a week when they are more likely to pay.
   - Use your aged trade creditors list and estimate when you will pay them based on normal credit terms. If you don’t think you will pay all your trade creditors on normal credit terms, adjust the payments to the weeks when you think you will pay them, taking into account when you intend to make payment runs (weekly, bi-weekly or monthly).

2. Include other receipts or payments you know will happen in the coming weeks

   These may include:
   - VAT refunds where you have already submitted the return
   - Cash from the sale of assets
   - Payroll runs and PAYE/NIC
   - VAT payments
   - Rent payments
   - Interest on loans or principal repayments

3. Estimate receipts and payments for future sales and purchases

   - **Cash receipts for future sales** – obtain the best information you can on the sales forecast and apply your standard payment terms to estimate when you will receive the cash. If you expect that customers won’t pay on time, you may need to defer cash receipts to later weeks. If you have a few large customers that have non-standard trade terms, it may be worthwhile forecasting their cash receipts individually.
   - **Cash payments for future purchases** – obtain the best information you can from purchasing and then apply your typical payment terms to determine when you will pay them. Again, if you won’t pay according to terms, put the payments in the weeks you are most likely to pay.
   - **Check that you haven’t left anything out of the forecast** – these might include proceeds from asset sales, VAT refunds, and any payments that don’t go through your purchase ledger.

4. Check if you have left anything out

   - Consider unusual receipts and payments to make sure that they have been included in the forecast in the week that makes sense.
   - Check receipts and payments off against your bank statements or the cash account in your systems so that you don’t forget VAT refunds, standing orders, direct debits or other payments.

5. Sense check the output

   - Does the weekly trend for the next 13 weeks make sense?
   - Did you expect to have more or less cash than the forecast indicates? If so, go back and check your assumptions.
Short-term cash flow forecasting: five top tips

1. Always reconcile your opening cash balance to the bank statement

Forecasts sometimes may show a misleading healthy cash position due to an error in the opening cash balance, that would have been picked up if the reconciliation had been checked.

2. Check whether all the cash in the bank account is accessible

You may have cash in the bank that you can't access to pay creditors, e.g., cash in tills in stores, cash that you've posted as collateral for imports, minimum cash balances. It's helpful to show these kinds of balances separately and call them “trapped cash”. Remember, there is always a level of safety cash needed to run the business: check whether the weekly balance left after deducting “trapped cash” is sufficient for normal operation.

3. Involve the business outside of finance

Finance teams forecasting in isolation from operations can often lead to flawed assumptions that can have serious consequences. Develop an understanding of inflows and outflows by having discussions outside of finance, for example with the sales team who have direct contact with a customer whose cash receipt is forecast, or with purchasing who will forecast when goods or services will be received.

4. Variance analysis is key

Understanding your variances and whether they are permanent differences (like lower overtime costs because of lower production) or just timing differences (you delayed paying certain suppliers for a week) will help you to forecast more accurately. Compare your actual cash receipts and payments each week to last week's forecast as this will help you to adjust your new forecast for differences and new information.

5. Prioritise your payments – don’t just listen to the “squeaky wheel”

Liquidity is tight for many companies at the moment, so prioritise the suppliers that you need to pay based on the specific needs of your business. Remember to make sure to include those that you don’t pay on normal terms later in your forecast.

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