

Planning the Cash Flow

Editorial

Our aim is to provide you with up-to-date news relevant to your working environment and your role in the accounting profession.

In addition to this objective it will also comprise a series of case studies and technical articles to develop your business skills to the benefit of either your employer or your clients.

The case material will provide you with Continuing Professional Development (CPD). This month sees focus on the preparation of a cash flow forecast and the application of the technique to a SME.

Enjoy your reading.

Philip E Dunn

Editor

Head of Education (ICB)

Cash Flow Forecast

The purpose of this short paper and case study is to guide you through the preparation of a cash flow forecast and to aid your continuous professional development (CPD).

The management of cash resources is an integral part of the management of working capital in any organisation.

See **Figure 1**

Working capital comprises short-term net assets: stock, debtors and cash, less creditors. Working capital management then concerns management of all aspects of both current assets and current liabilities, so as to minimise the risk of insolvency while maximising return on assets.

At the centre of this control is the management of cash flow, which also includes provision for capital expenditure, taxation and dividends (these will depend on the type of business entity).

There is a need to forecast and budget the cash flow and monitor, on an ongoing basis, a detailed analysis of budget to actual cash inflows and outflows.

Preparing the Cash Budget

The preparation of a cash budget covers a number of objectives which include:

- providing periodic budgeted cash balances for the budgeted balance sheet
- integrating and profiling the effect of the functional budgets on an organisation's cash resources
- anticipating cash surpluses and or shortages in such a way that time is made available to deal with them
- providing a means of comparison with actual performance so that control can be implemented

It is therefore essential for the control of day to day cash balances to ensure that sufficient cash is available to:

- meet day to day cash flow needs
- pay wages and salaries when they fall due
- pay creditors to ensure continued supply of goods and services
- pay government taxation, VAT and other taxes
- pay providers of capital, dividends and interest and;

- invest in further fixed assets for the longer-term survival of the business

Cash budgets may be prepared for the long-term in line with the longer-term corporate plan of say 3-5 years, or the short-term relating to the current budget cycle and period. It is often the case that a separate cash budget may be formulated for a specific project or contract.

There are a number of factors to take into account when preparing a cash budget. These may include:

- forecast sales volume and level of activity
- forecast the time-lag to convert debtors to cash and link this to the timing of cash inflows
- determine material usages and inventory levels and hence purchases
- forecast time-lag for creditor payments for purchases
- forecast payments for wages and salaries and overheads
- consider other cash payments for: capital expenditure, taxation, dividends and loan repayments
- incorporate any other cash receipts: loans, issue of capital

Format of the Cash Budget

A tabular layout is normally used with rows and columns.

The rows detail the cash inflows and outflows the columns the period base. The format can be readily converted to a computer spreadsheet see **Figure 2**:

Case Study – P B RoseCash Flow Forecast to 31 December 2005

Situation

Philip Rose is the tenant of "The White Rose Inn" in a Lincolnshire village. Over the past three years he has built up a profitable venture.

Prior to year ended 31 December 2004, Philip Rose met with his accountant to plan the business cash flow for the following year.

Philip has a plan to create a childrens' adventure play area at the side of the pub and has secured planning permission for this project. His initial plan is to fund this himself.

After much discussion the planned revenues and expenditure levels as shown in**Figure 3** were agreed, these are estimated and based on an assumed level of business activity.

- Motor vehicle running costs £110 per month
- Heat, light and power – direct debit £750 per month
- Insurances – direct debit £110 per month
- Rent – direct debit £2,500 per month
- Business rates £675 per month
- Cleaning, maintenance and decoration:

£100 per month

other than February redecorating throughout lounge and bar area £1,750

- Consumables £125 per month

- Capital expenditure – childrens’ play area, new equipment £27,000 (May) (inc VAT)
- Personal drawings, £4,300 per month
- Personal income tax – January £5,300 and July £5,300
- Bank charges – £200 per quarter, March, June, September and December
- It is anticipated that his balance at the bank on 31 December 2004 was £30,472

Task

- Prepare a month by month cash flow forecast for the period January – December 2005
- Once you have prepared this state whether you consider Philip should finance this himself or look to the bank for funding of a bank loan

NB: Take into account any significant outflows the business may incur in the early months of 2006

See **Figure 4**

Notes to the cash flow forecast:

January inflows £21,000

January outflows (total of cash outflows) £36,773

Net (outflow) £(15,773) for month

ie: outflows greater than inflows

Balance at Bank 1 January £30,472 (see note in case study detail)

Carried forward £14,699 (ie: £30,472 - £(15,773))

This is then rolled forward to February:

Then:

£20,500 (inflows)

£22,640 (outflows)

Net outflow (2140) C/fwd

B/fwd 14,699 £12,559

This procedure is then continued to end of the planned period

Conclusion

The comment on whether Philip should finance this himself from cash resources or seek funding from the Bank will be discussed next month.

If however members have comments to make please do so to philip@book-keepers.org and the editor will award a book token for £20 for the first reasoned response received.

Next month’s newsletter will focus on an Excel Spreadsheet for producing this standard cash flow proforma

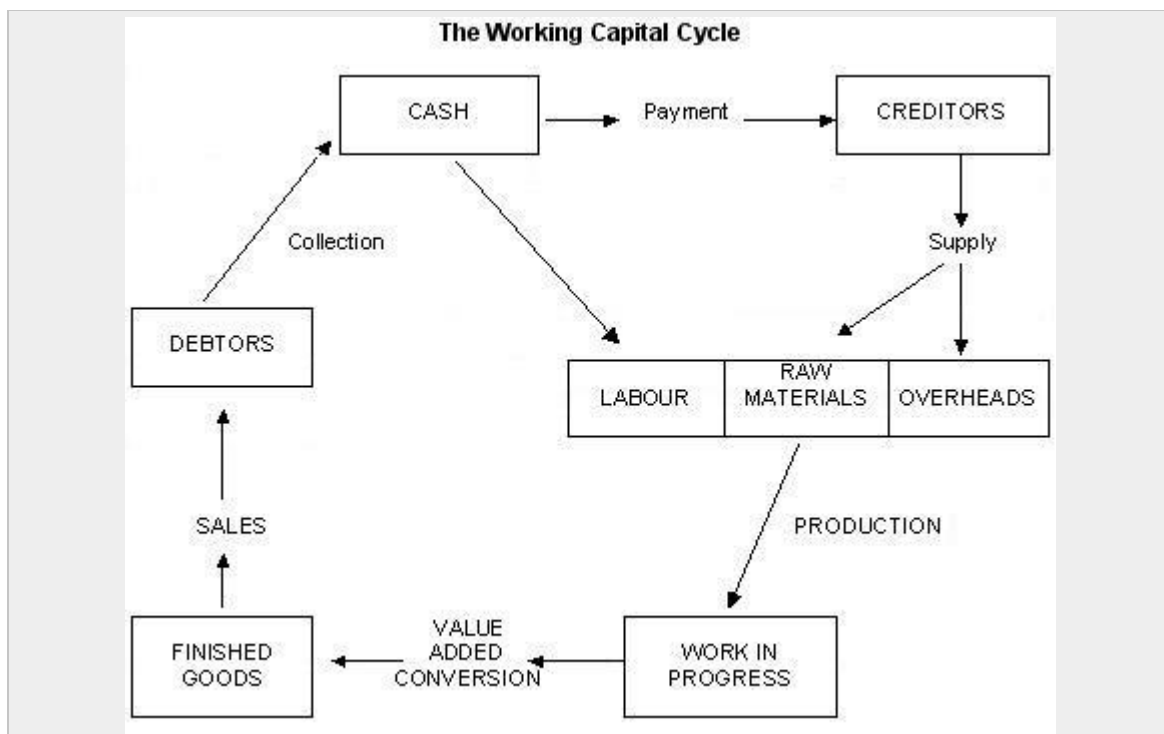


Figure 1: Working Capital Cycle

	January	February	March
Cash inflows			
*	-	-	-
*	-	-	-
*	-	-	-
(1)	-	-	-
Cash outflows			
*	-	-	-
*	-	-	-
*	-	-	-
(2)	-	-	-
Net cash inflow or (outflow) for month	(1-2) -		
Balance in hand/ (overdrawn) b/f	(3) -		
Balance in hand/ (overdrawn) c/f	(4) -		

NB: (4) = (1-2) + (3)

Figure 2: Cash Budget

- Sales including VAT £375,000 and analysis of sales per month:

	£		£
January	21,000	July	48,000
February	20,500	August	49,500
March	21,500	September	24,900
April	31,000	October	20,500
May	40,500	November	20,600
June	46,500	December	30,500

- Purchases and payments for stock (inc VAT):

	£		£
January	15,580	July	29,380
February	10,920	August	24,960
March	10,660	September	25,740
April	11,200	October	12,950
May	16,120	November	10,660
June	21,060	December	10,712

- VAT (Creditor) payments:

	£
January	5,923
April	3,840
July	3,614
October	8,495

- Wages £32,000, analysed as per month:

	£		£
January	1,300	July	4,100
February	1,300	August	4,100
March	1,300	September	2,700
April	4,000	October	1,300
May	4,000	November	1,300
June	4,100	December	2,500

Figure 3: Revenue and Expenditure Levels

The Cash Flow Forecast for the Period January – December would show:

**P B Rose – Cash Flow Forecast
January to June 2005**

	January	February	March	April	May	June
	£	£	£	£	£	£
Inflows:						
Sales	21,000	20,500	21,500	31,000	40,500	46,500
	21,000	20,500	21,500	31,000	40,500	46,500
Outflows:						
Purchases (Creditors)	15,580	10,920	10,660	11,200	16,120	21,060
VAT Payment	5,923			3,840		
Wages	1,300	1,300	1,300	4,000	4,000	4,100
MVRC	110	110	110	110	110	110
HL Power	750	750	750	750	750	750
Insurances	110	110	110	110	110	110
Rent	2,500	2,500	2,500	2,500	2,500	2,500
Business Rates	675	675	675	675	675	675
Maintenance	100	1,850	100	100	100	100
Consumables	125	125	125	125	125	125
Capital Expenditure					27,000	
Bank Charges			200			200
Drawings (Personal)	9,600	4,300	4,300	4,300	4,300	4,300
	36,773	22,640	20,830	27,710	55,790	34,030
Net inflow/(out) for month	(15,773)	(2,140)	670	3,290	(15,290)	12,470
BFWD in hand (O/D)	30,472	14,699	12,559	13,229	16,519	1,229
CFWD in hand (O/D)	14,699	12,559	13,229	16,519	1,229	13,699

(O/D) = overdrawn

**P B Rose – Cash Flow Forecast
July to December 2005**

	July	August	September	October	November	December
	£	£	£	£	£	£
Inflows:						
Sales	48,000	49,500	24,900	20,500	20,600	30,500
	48,000	49,500	24,900	20,500	20,600	30,500
Outflows:						
Purchases (Creditors)	29,380	24,960	25,740	12,950	10,660	10,712
VAT Payment	3,614			8,495		
Wages	4,100	4,100	2,700	1,300	1,300	2,500
MVRC	110	110	110	110	110	110
HL Power	750	750	750	750	750	750
Insurances	110	110	110	110	110	110
Rent	2,500	2,500	2,500	2,500	2,500	2,500
Business Rates	675	675	675	675	675	675
Maintenance	100	100	100	100	100	100
Consumables	125	125	125	125	125	125
Capital Expenditure						
Bank Charges			200			200
Drawings (Personal)	9,600	4,300	4,300	4,300	4,300	4,300
	51,064	37,730	37,310	31,415	20,630	22,082
Net inflow/(out) for month	(3,064)	11,770	(12,410)	(10,915)	(30)	8,418
BFWD in hand (O/D)	13,699	10,635	22,405	9,995	(920)	(950)
CFWD in hand (O/D)	10,635	22,405	9,995	(920)	(950)	7,468

