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Cash is King! How to Prepare a Basic Cash Flow Forecast

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What is a Cash Flow Forecast?

Simply put, it provides you with a snapshot of your future bank account balance at a given point in time. A forecasted cash flow provides a snapshot over a period of time of all a company's cash inflows and outflows from ongoing operations.

As income statements are prepared on an accrual basis, they are not representative of the actual flow of cash in a business. Considering COVID-19, historical financial performance may not be useful to plan for what lies ahead. However, a cash flow forecast is a great tool that can be used to analyse the future cash flow position of the company and can better help prepare for potential slowdowns.

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There are two ways in which cash flow statements are prepared: direct and indirect method. This article will focus on the direct method as it is the most intuitive way for entrepreneurs to prepare a cash flow statement forecast.

Why is it prepared?

Cash flow statement forecasts are prepared to provide business owners, lenders, investors or regulators a view on the future cash flow situation of the company. It can tell you where the money is going to come from and where it will go. This can be prepared on a weekly, monthly or yearly basis.

How is it prepared?

Let us assume we are preparing a projected monthly cash flow statement. It starts by adding the current cash of the business. If you have a line of credit, this would be shown as a negative number instead.

As the next step, list out all the expected cash inflows for the current month. What is important to note is that one must only include cash that is expected to be collected. Cash inflow would include payments received from customers, bank loans, shareholder loans, tax refunds investments, etc.

Next, list all expected cash outflows for the current month. Cash outflows would include payment to suppliers, rent, utility, payroll, CRA payments, equipment or other capital expenditures, loan payments, etc.

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The cash balance calculated at the beginning, plus the total cash inflows, minus the total cash outflows for the current month will give you the expected closing cash balance at the end of the month. This closing cash balance is then carried forward as the opening balance for the next month and can be used to prepare the cash flow projection for the next month.

One can use a similar technique to prepare a weekly, monthly or yearly cash flow forecast as well.

Below is an example of a monthly cash flow statement forecast.

	Month 1	**Month 2**	**Month 3**
Opening cash balance	$100	$102	$92
Add:			
Collection of Accounts Receivable (“AR”)	20	25	30
Total cash inflow	**20**	**25**	**30**
Less:			
Payment to suppliers	-10	-20	-5
Payment of rent, utilities	-2	-5	-5
Payment of payroll	-3	-5	-5
CRA payments	-3	-5	0
Total cash outflow	**-18**	**-35**	**-15**
Net cash flow	**2**	**-10**	**15**
Closing cash balance	**$102**	**$92**	**$107**

From the above example, the projection started with $100 on day 1. There are several transactions each month and the below closing cash balance shows what the cash balance would be at the end of each month. For instance, it shows that at the end of month 2, the business expects to start with $102 in the bank, anticipates collecting $25 from customers, paying out $35 in costs such as rent, wages etc., and should therefore have approximately $92 of cash on hand at the end of month 2.

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Key considerations while preparing a cash flow forecast:

1. The expected timing of actual collection of customer invoices is what should be considered and not the actual invoice date. For example, if you ship and invoice goods worth $100 today and the customer has 30 days to pay, then you should reflect the collection of the AR in the next month (i.e. when payment is expected).
2. One should be mindful that the longer out one projects, the more uncertainty and unknowns come into play. Typically, the shorter the projection period, the more accurate it tends to be.
3. It is important to revise and revisit forecasts based on current events on a regular basis to ensure accuracy of the projections.

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Conclusion

Like someone once said, "Revenue is vanity, profit is sanity, but cash is king". Revenues are great to flaunt but it does not mean much if you have not collected this cash. Similarly, having a profit offers peace of mind, but it is not an indication of whether your cash flow situation is sound.

As a result, it is prudent that every business closely monitors its future cash flow position on a regular basis to be better prepared for future uncertainties. COVID-19 is one such uncertainty and business owners should use this tool to navigate through this period.

At Isaacs Advisory, we have extensive experience in advising, structuring, and sourcing a wide range of traditional and non-traditional financing solutions for small & medium sized businesses.

For more information on raising financing solutions for a start-up, early stage, growth, or in-transition business, or a business in distress, please contact Dheeraj Nair at 647-673-4969 or dnair@isaacsadvisory.ca.