

Preparing a Cash Flow

CONTENTS

Introduction	page 1
Steps to Follow	page 2
Cash Flow Worksheet	page 4



PREPARING A CASH FLOW

A cash flow is a forecast of when you expect to receive cash from your sales and when you expect to pay your bills. It is not, and should not be confused with, a pro-forma income statement. A cash flow is not an estimate of your sales and expenses; rather it is an estimate of when the money associated with sales (etc.) will be received and when the money involved in paying for expenses will be paid.

WHY DO A CASH FLOW?

Too often business owners do a cash flow in their head. Putting the cash on paper will give you the following:

1. A format for planning the most effective use of your cash (cash management).
2. A schedule of anticipated cash receipts-follow through to see that you achieve it!
3. A schedule of priorities for the payment of accounts-stick to it!
4. A measure of the significance of unexpected changes in circumstances, i.e. reduction of sales, strikes, tight money situations, etc.
5. A list, on paper; of all the bill paying details which have been running around in your head, keeping you awake nights. A cash flow is not an instant cure for sleeplessness, but it certainly helps. It also clears your mind for more productive thinking.
6. An estimate of the amount of money you need to borrow in order to finance your day-to-day operations. This is perhaps the most important aspect of a completed cash flow projection.
7. An outline to show you and the lender that you have sufficient cash to make loan payments if you are planning to borrow money on a term basis.

HOW OFTEN

Cash flow planning should be a continuous activity, although it must be completely redone at least once a year for you have a clear picture of additional cash requirements. Most lines of credit are renewed annually. The cash flow projection will assist you in making an effective presentation to your lender.

Don't put the cash flow away and forget it. For example, if you don't meet your sales objective or you have a sudden unexpected payment to make, take the cash flow out and work through it again. You will be able to see the effect of the change on your cash position and can logically illustrate any revised loan requirements to your lender.

Effective cash management is essential to survival and increased profits. Don't leave cash inflow and outflow to luck and pressure. You will lose.

WHERE TO START

The first step in preparing a cash flow is to estimate sales on a monthly basis. Sales from previous years can be used to forecast sales for the coming year. There are many yardsticks by which a business can estimate its sales. A relatively conservative or low forecast can be used to determine the financial results of bad times. An optimistic forecast will show the strain on working capital which may result from better than expected operations. Finally, the most probable sales forecast at the centre remains the anchor point about which plans are made.

NOTE: When preparing a cash flow the purpose is to forecast cash receipts and to schedule payments, and to forecast the use of operating funds (line of credit) when necessary from the bank. This line of credit is arranged with the bank in advance (usually annually). The cash flow forecast illustrates the need and timing for money. It also illustrates when cash receipts will reduce or eliminate the need.

Estimate what amount of your sales will be cash and what amount will be credit. If last year's sales were 10% cash and 90% credit and you do not plan to change your credit policies, chances are that the same proportions will occur again this year. If you sell on credit, take into account when you can expect to collect the accounts receivable.

The next step is to plan for accounts payable on a monthly basis according to your sales projections. For example, if you pay your invoices on a 30-day basis, then the cash expenditures for January's purchases will be made in February. If you can obtain trade credit for longer terms, then cash outlays can be further delayed.

CASH FLOW WORK SHEET

Now that total cash collections and total cash payments on goods purchased have been estimated, use the cash flow work sheet to list all cash transactions for the month. Remember-only list the actual cash you are expecting to receive or spend in the appropriate monthly column.