WATERLOO REGION
SMALL BUSINESS CENTRE

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 paying the expenses will be paid out.

Why Do A Cash Flow Forecast?

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

- A format for planning the most effective use of your cash (cash management).
- A schedule of anticipated cash receipts - follow through to see that you achieve it!
- A schedule for priorities for the payment of accounts - stick to it!
- Keeps business decision-making on track and your inventory purchasing in control
- A measure of the significance of unexpected changes in circumstances, i.e. reduction of sales, strikes, tight money situations, etc.
- A list, on paper, of all your bill paying details and commitments, so that you can plan in advance to make sure you have the money to cover them.
- 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. The cash flow forecast serves as an early warning indicator when your expenditures are running out of line or your sales targets are not being met.

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- An outline to show a potential lender that you will have the money necessary to make any scheduled loan payments if you are planning to borrow money on a term basis.

Cash flow planning should be a continuous activity, although it must be completely redone at least once a year for you to have a clear picture of additional cash requirements as most lines of credit are renewed annually. The cash flow 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.

Cash flow plans are living entities and must constantly be modified as you learn new things about your business and paying customers. Since you will use this cash flow forecast to regularly compare each month's projected figures with each month's actual performance figures, it will be useful to have a second column for the actual performance figures right alongside each of the planned columns in the cash flow worksheet. As the true strengths and weaknesses of your business unfold before your eyes, actual patterns of cash movement emerge. Look for significant discrepancies between the planned" and actual figures.

For example, if the business' actual figures are failing to meet your cash revenue projections for three months running, this is an unmistakable signal that it is time to revise the year's projections. It may be necessary to delay the stock replenishment plan, or apply to the bank to increase the upper limit of your revolving line of credit. Approaching the bank to increase an operating loan should be done well in advance of the date when the additional funds are required.

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?

Estimate Monthly Sales (Be Realistic)

For new operations, the basis can be the average monthly sales of a similar-sized competitor that are operating in a similar market. It is recommended that you make adjustments for this year's predicted trend for the industry. Be sure to reduce your figures by a start-up year factor of about 50% a month for the start-up months. A relatively low or conservative forecast can be used to determine financial results of bad times. An optimistic forecast can be used to show the strain on working capital which may result from better than expected operations. Finally the most probable forecast between these two remains the anchor point about which plans are made.

For existing operations, sales revenues from the same month in the previous year make a good base for forecasting sales for that month in the succeeding year. For example, if the trend readers in the economy and the industry predict a general growth of 4% for the next year, it will be entirely acceptable for you to show each month's projected sales at 4% higher than your actual sales the previous year. Include Notes to the Cash flow to explain any unusual variations from previous years' numbers.

Consider Cash Inflows (Receipts)

If you sell products on credit terms or with installment payments, you must be careful to enter only the part of each sale that is collectible in cash in the specific month you are considering (realized accounts receivable). Any amount collected after 30 days will be termed Collections on Accounts Receivable and will be shown in the month in which it will be collected.

It is critical to the credibility of your plan that any sales made should only be entered once the cash is received in payment. This is the critical test principle of the cash flow and should be applied whenever you are in doubt as to what amount to enter and when.

When preparing a cash flow the purpose is to forecast cash receipts, to schedule payments and to forecast the use of operating funds (lines of credit) when necessary from the bank. The cash flow forecast illustrates the need and timing for money. It also illustrates when cash receipts will reduce or eliminate that need.

Estimate what amount of your sales will be cash and what amount will be credit. If last year's sales were 20% cash and 80% 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. For example, 60% within 30 days, 30% within 60 days, etc.

Consider Cash Outflows (Disbursements)

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 and expenses will be made in February. If you can obtain credit for longer terms, then cash outlays can be further delayed.

An example of a different type of expense is your insurance expenditure. Your commercial insurance premium may be $2400 annually. Normally, this would be treated as a $200 monthly expense. But the cash flow will not see it this way. The cash flow wants to know exactly how it will be paid. If it is to be paid in two installments, $1200 in January and $1200 in July, then that is how it must be entered on the cash flow worksheet. The exact same principle applies to all cash flow expense items.

Reconciliation of Cash Inflows to Cash Outflows

The reconciliation section of the cash flow worksheet begins by showing the balance carried over from the previous months' operations. To this it will add the total of the current month's revenues and subtract the total of the current month's expenditures. This adjusted balance will be carried forward to the first line of the reconciliation portion of the next month to become the base to which the next month's cash flow activity will be added and/or subtracted.

Designing the Cash Flow Worksheet

Now that total cash collections and total cash payments on goods purchased have been estimated, use the cash flow worksheet 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.

Your general format should allow a double width column along the left side of the page for the account headings, then two side by side vertical columns for each month of the year, beginning from the month you plan to open (e.g. the first dual column might be labeled April Planned and April Actual etc.).

From there, the cash flow worksheet breaks into three distinctive sections. The first section (at the top left portion of the worksheet, starting below and to the left of the month names) is headed Cash Receipts (Cash Inflows). The second section, just below it, is headed Cash Disbursements (Cash Outflows). The final section, below that, is headed Reconciliation of Cash Flow.

Refer to the following page for a sample worksheet with typical entries for each respective section. Remember that your business is unique and therefore your worksheet will have unique entries.

Business Name:						**Cash Flow Forecast**								
Month	Start up	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**Total**
Estimated Sales														
Sales receipts/receivables:														
Current deposits from cash sales														
Receivable from sales 30-60 days														
(A) Estimated Cash Inflows														
Owner Cash & Financing:	Start up													
Bank Account / Owner Contributions														
Loans														
Total Cash Received														
Cost of Sales	Start up													
Purchases- inventory, materials														
Subcontracts														
Total Cost of Sales														
Estimated Expenses	Start up													
Advertising & promotions														
Bank charges														

Business Insurance														
Legal & Accounting & Professional fees														
Lease payments equipment														
Loan payments														
Maintenance and repair														
Meals & Entertainment														
Membership fees, licenses, subscriptions														
Miscellaneous														
Office expenses														
Professional Supplies														
Property Taxes														
Rent														
Salaries, Wages and benefits														
Supplies														
Telephone/Internet/Cell														
Travel and Accommodation														
Utilities electric & gas														
Vehicle Expense Gas, repairs, maintenance														
Vehicle Payments Lease														
Owner wage/draw														
Capital purchases- equipment, leasehold, etc														
(B) Total Expenses Cash Outflow														
(A)-(B) Net Cash flow - for each Month														
Cumulative Net Cash														

Alternate formats and accommodations are available upon request.